Cite as Det. No. 13-0255R, 36 WTD 155 (2017)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Reconsideration of Assessment of	)	FINAL DETERMINATION
	)	No. 13-0255R
. . .	)	Registration No. . . .

RCW 82.04.080; RCW 82.04.090: B&O TAX – MEASURE OF TAX – Tax is due on the total consideration Taxpayer received, which includes the amount received by the affiliates plus the value of services provided by the affiliated companies.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

Lewis, A.L.J. – Taxpayer requests reconsideration of Det. No. 13-0255. Taxpayer is a health care insurance company. Taxpayer's affiliated companies provide services to Taxpayer. Similarly, Taxpayer provides services to its affiliates. Taxpayer paid service and other business and occupation ("B&O") tax on the amount it received for services provided to the affiliates, which was offset by the amount Taxpayer owed the affiliates for services they provided to Taxpayer. The Audit Division assessed service and other activities B&O tax on total consideration Taxpayer received, which was the amount received from the affiliates plus the value of the services provided by the affiliates. We sustain Det. No. 13-0255, which sustained the assessment and deny the refund of tax paid.[1]

ISSUE:

Under the provisions of RCW 82.04.220, what is the correct measure of tax when a parent's compensation for service provided includes both a transfer of funds and receipt of services?

FINDINGS OF FACT:

Taxpayer is a Washington non-profit health insurance company, headquartered in Washington, which provides a wide range of medical, dental, and other coverage to individuals and businesses.

Taxpayer is the direct or indirect owner of several subsidiary companies ("affiliates"). The affiliates perform services; such as sales support, customer service, and insurance claim investigation and administration; that benefit Taxpayer. Likewise, Taxpayer provides services that

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

benefit the affiliates, such as human resources, facilities, legal, administrative and data processing services. The amount of the fees charged is determined according to the terms of an intercompany agreement between Taxpayer and each of its affiliates. Periodically, the charges are settled. The settlement amount paid by either Taxpayer to the affiliate or the affiliate to Taxpayer is the difference between the value of the services received and the services rendered.

The Department's Audit Division audited Taxpayer's books and records for the period January 1, 2007, through December 31, 2010. On July 20, 2012, the Department issued a $ . . . assessment. The audit examination disclosed that Taxpayer reported service and other activities B&O tax on $ . . . million in settlement amounts received from its affiliates. The Audit Division assessed service and other activities B&O tax on an additional $ . . . million, which was the value of services provided to Taxpayer by the affiliates. Thus, the Audit Division assessed tax on the gross income from providing the services to affiliates, as recognized in Taxpayer's business records, rather than the net after deducting the value of the services received from the affiliates.

Taxpayer disagreed with the assessment. On August 21, 2012, Taxpayer filed an appeal requesting correction of the assessment and refund of tax paid. Taxpayer's appeal was limited to the issue of whether the value of services provided to Taxpayer by its affiliates should be included in the measure of the B&O tax.

The Appeals Division held an in-person hearing with Taxpayer's representatives on July 31, 2013. On August 15, 2013, the Appeals Division issued Det. No. 13-0255, which sustained the assessment. In sustaining the assessment, the Appeals Division explained that the B&O tax applies to the gross income of the business with no deductions for expenses. Washington law recognizes that separately organized companies are persons within the meaning of the law and that business transactions between different persons are subject to taxation unless there is a specific deduction or exemption. The fact that entities are related does not change the fact that they are separate persons for tax purposes. WAC 458-20-203 ("Rule 203"). *Washington Sav-Mor Oil Co. v. Tax Comm.*, 58 Wn.2d 518 (1961).

Thus, the assessment was sustained with Det. No. 13-0255 concluding:

> The fact that the parent company is related to Taxpayer or that compensation was not received in the form of cash does not alter the fact that an income earning activity occurred between two separate legal entities.

Taxpayer disagreed with the decision. On October 9, 2013, Taxpayer filed a petition for reconsideration. Taxpayer maintained Det. No. 13-0255 should be reversed because of . . . errors of fact and law.

. . .

ANALYSIS:

Taxpayer took issue with the section of the FINDINGS OF FACT that stated:

> In order to meet regulatory requirements imposed by each state's insurance commission, Taxpayer is required to charge a fee that is representative of the value of the services it renders to the affiliates. Similarly, the affiliates charge Taxpayer a fee for the services they provide it. The amount of the fees charged is determined according to the terms of an intercompany agreement between Taxpayer and each of its affiliates.

Taxpayer's reconsideration petition explains:

> The description suggests that [Taxpayer] is required to charge each affiliate for the full (i.e. fair market) value of any services it provides, and the affiliates are required to do the same in return. In reality, state statutes provide only that when a health carrier engages in transactions with other entities within a health carrier holding company system, the charges or fees for services performed must be "fair and reasonable."

Taxpayer does not challenge the fact that Taxpayer and affiliated entities provide services to each other and pay each other for those services. The bottom line is that the fact section stated that "The amount of the fees charged is determined according to the terms of an intercompany agreement between Taxpayer and each of its affiliates." Taxpayer's assignment of error had no effect on the decision.

On reconsideration, Taxpayer also assigned . . . errors of law to the decision. Taxpayer's first assignment of error of law was:

> The Determination misinterprets the Taxpayer's reliance on the *Weyerhauser v. Dept. of Revenue* decision and does not adequately address Taxpayer's central argument that the accounting entries upon which the Audit Division based its assessment did not represent "value proceeding or accruing" by reason of the transaction of the business engaged in.

More specifically, Taxpayer's reconsideration petition stated:

> [Taxpayer] and its affiliates have chosen to provide certain services to each other. To the extent that [Taxpayer] incurs costs to perform services to an affiliate during a given period that are greater than the costs incurred by the affiliate will be charged and will pay an amount to [Taxpayer] equal to such excess. This agreement results in a "fair and reasonable" charge for intercompany services as required by insurance regulations. The Determination's conclusion seems to be that because a charge is imposed for these intercompany services at all, the taxable amount must equal the full cost incurred by [Taxpayer] to provide the services, rather than the amount of compensation actually received. This conclusion is unsupported by Washington law and thus is an error of law that must be corrected.

The original determination stated:

> Taxpayer also argued that under RCW 82.04.080(1), the taxpayer must have either a legally enforceable right to receive the amount or must actually receive it. Taxpayer maintained that its recording of the value of the work done for the affiliates was not taxable under the

> Court's ruling in *Weyerhaeuser v. Dept. of Revenue*, 106 Wn.2d 557, 723 P.2d 1141 (1986) because the mere recording of an entry in a taxpayer's books and records does not itself create an entitlement to receive the amount recorded, absent a legally enforceable right to receive the amount or the actual receipt of it.
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> We disagree with Taxpayer's reading of *Weyerhaeuser*. Taxpayer contends the Audit Division is imputing income and there was no gross income of the business upon which to impose the tax. In *Weyerhaeuser*, the Department's assessment was contrary to the existing installment contracts, which charged no interest. Weyerhaeuser reported the entire contract price as gross proceeds taxable under the wholesaling B&O tax rate, which was lower than the service rate applied to interest income. *Weyerhaeuser* at 564. The Department did not impute receipts; rather it reclassified Weyerhaeuser's receipts from wholesaling to service, thus "imputing interest." That decision concluded that interest income, taxable at a higher rate, could not be imputed from amounts received for the interstate installment sale of its logs.
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> The Court did not find that *Weyerhaeuser* did not receive the money. Rather, the Court found that a wholesale installment sales contract, which did not provide for interest, was not subject to an imputation of interest for Washington business and occupation excise tax purposes even though the wholesaler might have computed an interest component of the sale for its internal bookkeeping purposes. Thus, *Weyerhaeuser* does not preclude the Department from taxing income, as represented by accounting entries. Here, in addition to cash payments Taxpayer also received services from its affiliates in exchange for services rendered by Taxpayer to the affiliates. The value of the services, which Taxpayer received, is part of gross income of the business and subject to B&O tax.

Washington's B&O tax is an activities tax that is imposed on the gross income of the business. RCW 82.04.220 imposes the B&O tax itself, and the measure of the tax is the gross proceeds of sales or the gross income of the business:

> There is levied and shall be collected from every person a tax for the act or privilege of engaging in business activities. Such tax shall be measured by the application of rates against value of products, gross proceeds of sales, or gross income of the business, as the case may be.

RCW 82.04.080 defines the "gross income of the business" as:

> the value proceeding or accruing by reason of the transaction of the business engaged in and includes gross proceeds of sales, compensation for the rendition of services, gains realized from trading in stocks, bonds, or other evidences of indebtedness, interest, discount, rents, royalties, fees, commissions, dividends, and other emoluments however designated, all without any deduction on account of the cost of tangible property sold, the cost of materials used, labor costs, interest, discount, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.

RCW 82.04.090 defines the term "value proceeding or accruing" as:

> [T]he consideration, whether money, credits, rights, or other property expressed in terms of money, actually received or accrued.

From the quoted statutes, the nature and measure of the tax are well fixed in law. As stated above, the B&O tax is applied to the gross income of the business. RCW 82.04.220. Gross income of the business includes compensation for the rendition of services. RCW 82.04.080. Such compensation, "value proceeding or accruing" includes credits . . . expressed in terms of money, actually received or accrued." Taxpayer acknowledges that it and its affiliates provide services to each other. The services provided have value. The value is quantified by the fact that Taxpayer's books and records reflected that $ . . . in services were netted against what Taxpayer provided the affiliates and were not reported for B&O tax purposes. As stated earlier, . . . *Weyerhaeuser* [does not] restrict the Department from taxing services that are paid for by way of a credit netted against the services the other entity provides. Taxpayer assignment of error is not persuasive.

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DECISION AND DISPOSITION:

Taxpayer's petition for adjustment of the assessment and refund of tax is denied.

Dated this 9th day of April 2014.