Cite as Det. No. 20-0268, 41 WTD 218 (2022)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Refund of Assessment of	)	D E T E R M I N A T I O N
	)	No. 20-0268
. . .	)	Registration No. . . .

[1] RCW 82.04.220; RCW 82.04.140: SERVICE B&O TAX – BUSINESS ACTIVITY – GROSS INCOME – DAMAGE FEES. Additional fees a rental RV company charges for damage to vehicles is gross income.

[2] RCW 82.04.290; WAC 458-20-211: B&O TAX – CLASSIFICATION – DAMAGE FEES. Optional charges charged separately from a vehicle rental price are taxable under the service and other business activities B&O tax classification.

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.

NATURE OF THE CASE

Gabriella Herkert, T.R.O. – An out-of-state company that rents recreational vehicles (RVs) protests the inclusion of amounts it receives from customers when they damage vehicles in its gross income subject to the business and occupation (B&O) tax. We deny Taxpayer's petition in part and grant it in part.[1]

ISSUE

1. Are amounts a rental company receives from customers for damage to vehicles during the rental period gross income from the business under RCW 82.04.220 and RCW 82.04.140?

2. What is the classification of gross income from damage proceeds received by a rental RV company under chapter 82.04 RCW and WAC 458-20-211?

FINDINGS OF FACT

. . . (Taxpayer) rents recreational vehicles to drivers . . . in Washington. The rental agreements entered into between Taxpayer and the drivers specifically address the possibility that vehicles will

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

be returned subject to excessive wear and tear or damage. The rental agreements state that Taxpayer reserves the right to require additional payment upon return of the vehicles due to those damages. Taxpayer routinely charges drivers for damage to the rental vehicles.

The Department of Revenue's (Department) Audit Division (Audit) reviewed Taxpayer's books and records for January 1, 2015, through September 30, 2018. During that period, Taxpayer charged . . . separate renters a total of $ . . . for damage to vehicles. Audit determined that Taxpayer did not include amounts received from drivers for damage to vehicles in its measure of gross income. Audit further determined that the classification of income from the same amounts was retailing income. Audit imposed B&O tax on the underreported amount resulting in approximately $ . . .[2] in retailing B&O tax and retail sales tax.[3] Taxpayer paid the entire assessment . . . .

Taxpayer timely requested review. Taxpayer limited its request for review to the taxability of the damage payments.

ANALYSIS

Washington imposes a retail sales tax on each retail sale in this state. RCW 82.08.020. The rental of motor vehicles is considered a retail sale. RCW 82.04.050(4)(a); WAC 458-20-180. An additional retail sales tax is imposed on the rental of cars. RCW 82.08.020(2).

Washington also imposes a B&O tax "for the act or privilege of engaging in business" in this state. RCW 82.04.220. Washington's B&O tax applies to various tax classifications, including making sales at retail pursuant to RCW 82.04.250, making wholesale sales under RCW 82.04.270, and providing services pursuant to RCW 82.04.290. Persons engaged in any business activities that are not specifically included in a tax classification under chapter 82.04 RCW, are taxable under the service and other business activities classification upon gross income from such business. RCW 82.04.290.

According to RCW 82.04.220(1), the B&O tax "is 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."[4] In other words, the two elements for determining the amount of B&O tax due are (1) determining the amount of taxable income, and (2) applying the proper B&O tax rate to that amount. We address both of these elements in turn.

Taxpayer disputes only the taxability of amounts paid by its customers for damage caused to RVs during the rental period. First, we consider whether these proceeds constitute part of Taxpayer's taxable income.

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[2] The assessment . . . was for $ . . . . The assessment included $ . . . in Service and Other B&O tax, $ . . . in Retailing B&O, $ . . . in retail sales tax, $ . . . in local retail sales tax, $ . . . in rental car tax, $ . . . in motor vehicle sales tax, $ . . . in use/deferred sales tax and $ . . . in local use/deferred sales tax.

[3] There were other issues in the assessment that Taxpayer does not dispute here.

[4] The specific term used to describe the amount depends on the specific classification of the business activity at issue. For instance, manufacturing B&O tax is measured by "the value of products," (RCW 82.04.240), retailing and wholesaling B&O tax are measured by "gross proceeds of sales," (RCW 82.04.250; RCW 82.04.270), and service and other activities B&O tax is measured by "gross income of the business," (RCW 82.04.290(2)). For convenience, we use the general term "gross income" to describe Taxpayer's reportable income.

The B&O tax is a "gross receipts tax," meaning that it applies to all value proceeding or accruing to the company, and not only to its profit margins. *See Lamtec Corp. v. Dep't of Revenue*, 170 Wn.2d 838, 843, 246 P.3d 788, 791 (2011). RCW 82.04.090 defines "value proceeding or accruing" as "the consideration, whether money, credits, rights, or other property expressed in terms of money, actually received or accrued." As such, generally, all gross receipts "actually received" by a business are subject to B&O tax, without any deductions for costs such as labor, materials, taxes, or any other expense. *See* RCW 82.04.070; RCW 82.04.080. This general rule holds true unless the legislature has carved out a specific exclusion or deduction.

Here, the Audit Division found that, during the audit period, Taxpayer had received approximately $ . . . from customers to pay for the customers' damage to RVs during the rental period. Taxpayer's customers made those payments as required under the rental agreement. Taxpayer did not report this amount as part of its taxable income. The Audit Division, however, concluded that the proceeds were part of Taxpayer's taxable income.

We addressed the taxability of settlement proceeds in Determination No. 13-0269, 33 WTD 144 (2013), which are similar [in some respects] to the proceeds in this case. However, in this case, the proceeds flow from Taxpayer's contract with its renters rather than the settlement of a particular claim against the renter. In [33 WTD 144], we held that settlement proceeds a taxpayer received from its landlord for the landlord breaching the lease terms were not taxable income for the taxpayer. In that decision, we held that "settlements related to a business purpose" are taxable, while "settlements that make an injured party whole," are not taxable. To illustrate the difference, we referred to two earlier determinations. In Determination No. 89-505, 11 WTD 39 (1989), we held that liquidated damages received by a company engaged in the leasing of automobiles paid after early termination of a lease by the lessee were "an integral part of the business of leasing automobiles," and, therefore, were related to that company's business purpose.

By contrast, in Determination No. 98-164, 19 WTD 393 (2000), we held that a public utility's settlement proceeds paid by the state to relocate utility lines for state road construction were "for the purpose of mitigating the damages to the taxpayers' facilities," and, therefore, simply to make the injured taxpayer whole. We concluded in 33 WTD 144 that the settlement proceeds fell in this latter, non-taxable, category since they were not related to Taxpayer's business purpose.

Here, we conclude that the proceeds at issue are taxable. The proceeds were, in essence, compensation to repair . . . rental RVs damaged by drivers that are necessarily related to Taxpayer's business of renting [RVs]. [They are a separate contractual stream of income specified in the rental agreement between Taxpayer and its customers, and the income is not the settlement of a claim outside the contractual business relationship between Taxpayer and its customers.] Thus, the proceeds were clearly and directly related to Taxpayer's ongoing business purpose – to rent recreational vehicles – and were, therefore, taxable income for Taxpayer. We deny Taxpayer's petition [on this issue].

Next, we consider the classification of gross income from damage charges. The charges imposed by the taxpayer for the rental of its cars are properly subject to retailing B&O tax because the renting of tangible personal property is defined as a retail sale. RCW 82.04.050(4). "Renting" is "the act of granting to another the right of possession to and use of tangible personal property for

a consideration." WAC 458-20-211. The . . . damage charges, however, are not for renting tangible personal property. These charges are for . . . [damages beyond the normal wear and tear covered by] the RV rental retail purchase. They are not otherwise classified as "retail sales" under RCW 82.04.050. Where the charges are for optional items and charged separately from the rental price (so that they are not part of a bundled transaction under RCW 82.08.190), the income from those charges is taxable under the service and other business activities B&O tax classification and is not subject to retailing B&O or retail sales tax. *See* Det. No. 10-0340, 32 WTD 30 (2013) (holding that additional damage and roadside assistance charges imposed by a rental car agency is properly classified as [subject to] service and other business activities B&O tax); Det. No. 91-164, 11 WTD 337 (1992) (holding that a taxi cab rental company's income from charges for optional dispatching services is subject to service and other business activities B&O tax because the dispatching charges were not required as part of the taxi cab rental price).

We partially grant Taxpayer's petition. The gross amount of . . . damage payments received by Taxpayer are included in its measure of gross income subject to the service and other business classification. We deny the remainder of Taxpayer's petition.

DECISION AND DISPOSITION

Taxpayer's petition is granted in part . . . [and denied in part] . . . .

Dated this 12th day of October 2020.