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International Investment Management Services

Purpose

This Excise Tax Advisory (ETA) explains the application of the preferential B&O tax rate authorized by RCW 82.04.290(1) to qualifying international investment management services (“IIMS”). The qualifications for the IIMS B&O tax rate changed effective July 1, 2019. This ETA does not contain guidance on the qualifications for the IIMS B&O tax rate for business activities occurring prior to July 1, 2019.

Overview of qualifications for the IIMS B&O tax rate

This section addresses the basic qualification requirements for the IIMS B&O tax rate.

A person is engaged in providing qualifying international investment management services if it meets all of the following conditions:

1. The person is engaged primarily in the business of providing investment management services (*see Section A*).
2. At least 10% of the person’s gross income is derived from providing investment management services to a qualifying collective investment fund (“CIF”); i.e., a CIF meeting one of the following descriptions (*see Section B*):
 - a. CIFs commercially domiciled outside the United States.
 - b. CIFs with at least ten percent of their investments located outside the United States.
3. More than 25% of the person’s employees are located in Washington (*see Section C*).
4. The person is a member of an affiliated group that collectively has:
 - a. At least ten offices located in at least eight foreign countries;

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- b. At least 500 full-time employees worldwide (*see Section D*);
- c. More than four hundred million dollars of worldwide gross revenue during the entire current or immediately preceding calendar year; and
- d. More than two hundred billion dollars in average assets under management during the entire current or immediately preceding calendar year.

An affiliate of a qualifying person is deemed to also be engaged in the business of providing qualifying investment management services if the affiliate is primarily engaged in a qualifying activity and meets the Washington employment requirement (*see Section E*).

Section A – Primarily in the business of providing investment management services

RCW 82.04.293(3)(d) defines “investment management services” as managing the collective assets of a CIF by engaging, either directly or indirectly through a person’s affiliated group, in all of the following activities:

- (i) Portfolio management;
- (ii) Fund administration;
- (iii) Fund distribution; and
- (iv) Transfer agent services.

In order to qualify for the preferential B&O tax rate imposed by RCW 82.04.290(1), every person engaging within this state in the business of providing qualifying international investment management services must be primarily engaged in the business thereof. A person is primarily engaged in the business of providing investment management services if (1) more than 50% of its gross income is from providing investment management services or (2) more than 50% of its total expenditures are incurred from providing investment management services.

Thus, a person is primarily in the business of providing investment management services if the person, either directly or indirectly, performs each of the four activities enumerated above in managing the assets of a CIF and those services constitute more than 50% of the person’s gross income or more than 50% of the person’s total expenditures.

Section B – 10% of income derived from qualifying CIFs

A “collective investment fund” includes only the following:

1. A mutual fund or other regulated investment company;
2. An “investment company”;
3. A qualified “employee benefit plan”;
4. A fund maintained by a “tax-exempt organization” for operating, quasi-endowment, or endowment purposes;

5. Funds established for the benefit of such “tax-exempt organizations,” such as charitable remainder trusts, charitable lead trusts, charitable annuity trusts, or other similar trusts; or,
6. CIFs similar to those described in 1-5 of this list, created under the laws of a foreign jurisdiction.¹

A person is engaged in the business of providing qualifying international investment management services only if 10% or more of its gross income is derived from (1) CIFs commercially domiciled outside of the United States or (2) CIFs that have at least 10% of their investments located outside of the United States.

A CIF is commercially domiciled outside of the United States if the principal place from which the CIF is directed or managed is located outside of the United States.² A CIF’s investment is located outside of the United States if the underlying securities (i.e., stocks, bonds, etc.), in which the CIF’s investment constitutes a beneficial interest, are issued outside of the United States.³

- In determining whether a person satisfies the 10% threshold, combine the person’s gross income from (1) CIFs commercially domiciled outside of the United States and (2) CIFs with at least 10% of their investments located outside of the United States. For example, a person who derives 5% of their gross income from CIFs described in (1) and 5% from CIFs described in (2) has satisfied the required condition.

Section C – More than 25% of the person’s employees are located in Washington

An employee is located in Washington if the employer is required to report the employee to the Washington State Employment Security Department (ESD) for Washington unemployment insurance tax purposes. See RCW 50.04.110 and 50.04.120. All employees are included in determining whether this requirement is satisfied, regardless of the employee’s status as a full-time, part-time, seasonal, or temporary employee.

A. Washington Employment Calculation

The Department evaluates satisfaction of this requirement based on quarterly unemployment compensation tax reports filed with the ESD under RCW 50.12.070. Taxpayers are not expected to demonstrate this requirement is satisfied each quarter. Instead, the Department will consider a taxpayer’s employment figures reported to ESD for the 4th quarter of each calendar year.

¹ See RCW 82.04.293(3)(c) for more information on the meaning of “regulated investment company,” “investment company,” “employee benefit plan,” and “tax-exempt organization.”

² See RCW 82.04.293(2)(a)(i); RCW 82.56.010.

³ See RCW 82.04.293(4).

To determine whether the 25%-Washington-employment requirement is satisfied for the entire calendar year, taxpayers must divide their Washington employment figures for the 4th quarter by their worldwide employment figures for the same period. A taxpayer must include an employee in its worldwide employment figures if the taxpayer would have been required to report the employee in its reports to the ESD had the employee been located in Washington. In general, the Department will accept worldwide employment figures as reported to the federal government for purposes of the federal unemployment compensation tax (FUTA) on the federal *Form 941* for the 4th quarter of the year.

Note: If a taxpayer is required to report less than 100% of its employees on *Form 941*, the taxpayer must include any unreported employees in calculating whether the 25% Washington employment requirement is met.

Note: If a taxpayer's quarterly Washington employment figures are affected by circumstances beyond its control, such as a temporary closure of a Washington business location, the taxpayer may request that the Department consider the taxpayer's employment figures for a different quarterly period within the same calendar year, depending on the circumstances.

B. Functional Employment Relationship

In cases where a taxpayer uses an affiliated business to provide paymaster services and serve as the "qualified employer of record" for Washington employees that have a "functional employment relationship" with the taxpayer, the employees will be considered as the taxpayer's employees for purposes of the requirement in this Section C, so long as the taxpayer provides records maintained in the ordinary course of business that substantiate a "functional employment relationship" between the taxpayer and the employee.⁴

C. Clawback

If a person engaged in the business of providing qualifying international investment management services no longer meets the 25%-Washington-employment requirement, the entire economic benefit resulting from the lower B&O tax rate accruing to the person in the current and immediately preceding nine consecutive calendar years, or during the consecutive years since July 1, 2019, whichever is less, becomes immediately due and payable. The amount due includes interest at the rate imposed for delinquent taxes under RCW 82.32.050.

Section D – 500 Full-time employees in affiliated group

A qualifying person must be a member of an affiliated group that employs at least 500 full-time employees worldwide. The terms "affiliate" and "affiliated" mean a person that directly or indirectly (through one or more intermediaries) controls, is

⁴ For purposes of this provision, the definitions in RCW 82.04.43393 apply.

controlled by, or is under common control with another person. An “affiliated group” simply means any group of two or more persons that are affiliated with each other. See RCW 82.04.293(3). For this purpose, “control” means the possession (directly or indirectly) of more than 50% of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting shares, by contract, or otherwise. RCW 82.04.293(3)(a)(ii).

An employee must work at least 390 hours each quarter to be considered a full-time employee for purposes of this requirement. Satisfaction of this requirement is based on annual employment information reported for federal tax purposes. Taxpayers must retain, and make available for disclosure to the Department, federal tax records which substantiate the taxpayer (and its affiliates) had 500 or more full time employees during each calendar year for which the B&O tax preference is claimed. Suitable records include copies of federal Form 1095-C filings.

Note: A taxpayer may not combine multiple part-time employees as an equivalent to a full-time employee. (*Example:* two part-time employees each work 250 hours during Quarter 4, 2021. For purposes of RCW 82.04.293(1)(d), neither employee, nor the combination of both, equate to one or more full-time employees.)

Note: If a taxpayer is required to report less than 100% of its full-time employees to the IRS for federal tax purposes, the taxpayer must work with the Department to substantiate any claims of unreported full-time employees.

Section E – Qualification of affiliates

An affiliate of a person providing qualifying international investment management services is deemed to also be providing qualifying international investment management services if the affiliate (1) *primarily* engages in providing one or more investment management services, whether directly or through its affiliated group, to CIFs commercially domiciled outside the United States or CIFs with at least 10% of their investments outside the United States, and (2) employs more than 25% of its total employees in Washington. RCW 82.04.293(2).

A qualifying activity for this purpose means portfolio management, fund administration, fund distribution, or transfer agent services.

Example 1: Qualifying Arrangement

General Facts:

XYZ is a financial services provider, primarily offering portfolio management services. XYZ also offers legal and accounting services, which comprise a small segment of XYZ’s revenue streams. XYZ is affiliated with four other entities which comprise an affiliated group: ABC, DEF, GHI, and JKL. Each of the affiliated

businesses offer similar services, with each affiliate servicing CIF customers in different global geographical regions. XYZ exclusively provides its services to North American-based CIFs. The other affiliates provide services in the following regions: Europe (ABC), Asia/Australia (DEF), Africa/Middle East/India (GHI), and South America (JKL). As of January 1, 2020, XYZ is commercially domiciled in Seattle, WA.

With respect to XYZ's portfolio management services, XYZ (and its affiliates) specializes in providing its services to qualified pension plans for corporate employers and non-profit organizations. All of XYZ's customers are CIFs that outsource their financial investment activities to XYZ. With respect to XYZ's accounting and legal services, all of XYZ's services relate to qualified employer pension plans, and non-profit financing and funding issues.

Step 1: *For 2020, is XYZ primarily engaged in providing investment management services?*

Step 1 Facts:

In 2020, XYZ's revenue and expense streams were as follows:

- Portfolio management services provided to CIFs:
 - Gross Income: \$400,000,000
 - Total Expenses: \$180,000,000

- Accounting and legal services provided/related to CIFs:
 - Gross Income: \$100,000,000
 - Total Expenses: \$60,000,000

Step 1 Result:

In 2020, XYZ was primarily engaged in providing investment management services because more than 50% of XYZ's gross income was derived from directly or indirectly providing investment management services. In this case, 80% of XYZ's 2020 gross income was derived from an investment management service, portfolio management.

XYZ was also primarily engaged in providing investment management services because more than 50% of XYZ's total expenses were incurred in providing qualifying investment management services. In this case, 75% of XYZ's 2020 expenses were incurred in providing portfolio management.

Step 2: *Is at least 10% of XYZ's gross investment management service income derived from (1) CIFs commercially domiciled outside of the United States or (2)*

CIFs that have at least 10% of their investments located outside of the United States?

Step 2 Facts:

XYZ's 2020 income from CIFs was as follows:

- Total income from CIFs: \$400,000,000
 - \$50,000,000 in gross income from CIFs that are managed and directed in Canada (i.e., not commercially domiciled in the United States).
 - \$350,000,000 in gross income from Domestic CIFs:
 - \$50,000,000 in gross income from Domestic CIFs, where 10% or more of each CIF's investments were located outside the United States.
 - \$300,000,000 in gross income from Domestic CIFs, where less than 10% of each CIF's investments were located outside the United States.

Step 2 Result:

In 2020, XYZ satisfied the "at least ten percent of gross income" requirement in RCW 82.04.293(1)(b), as 25% of its gross income was derived from investment management services provided to a combination of (a) CIFs that are commercially domiciled outside of the United States and (b) CIFs commercially domiciled in the United States with at least ten percent of their investments held outside the United States (\$100,000,000/\$400,000,000).

Step 3: *Are more than 25% of XYZ's total employees located in Washington?*

Step 3 Facts:

According to XYZ's Quarter 4, 2020 unemployment compensation tax return filed with ESD, XYZ had 100 employees located in Washington. According to XYZ's 2020 federal unemployment compensation tax return filed with the IRS, XYZ had 300 employees worldwide. All of XYZ's employees were reported for federal tax purposes.

Step 3 Result:

In 2020, XYZ satisfied the 25% Washington employment requirement in RCW 82.04.293(1)(c), as 33.33% (100/300) of XYZ's employees were located in Washington.

Step 4: *Is XYZ a member of an affiliated group that satisfies all the requirements in RCW 82.04.293(1)(d)?*

Step 4 Facts:

Collectively, XYZ and its affiliates had the following characteristics in 2020:

- Forty offices, two of which were located in Washington, six located in other U.S. states, and 32 located in 15 foreign countries;
- 1,200 full-time employees worldwide;
- Worldwide gross revenue of \$2,000,000,000; and,
- Average assets under management of \$300,000,000,000 according to 2020 Form ADV filing with the US Securities and Exchange Commission (SEC).

Step 4 Result:

In 2020, XYZ satisfied all the requirements in RCW 82.04.293(1)(d), as it is a member of an affiliated group that has:

- Ten or more offices located in at least eight foreign countries (the XYZ affiliated group has 32 offices located in 15 foreign countries).
- At least 500 full-time employees worldwide (the XYZ affiliated group has 1,200 full-time employees worldwide).
- Worldwide gross revenue greater than \$400,000,000 during the entire current or immediately preceding calendar year (the XYZ affiliated group had 2020 gross revenue of \$2,000,000,000).
- Average assets under management of more than \$200,000,000,000 during the entire current or immediately preceding calendar year (the XYZ affiliated group had \$300,000,000,000 of average assets under management in 2020).

Cumulative Result:

For 2020, XYZ qualifies for the preferential B&O tax rate described in RCW 82.04.290(1), as all of the requirements in RCW 82.04.293 have been met. XYZ's \$400,000,000 in gross income from investment management services is subject to B&O tax under the preferential IIMS classification. XYZ's \$100,000,000 in gross income from accounting and legal services is subject to B&O tax under the service and other activities classification.

Example 2: Previously Qualified Arrangement that No Longer Qualifies (Washington

Facts:

Assume the facts from Example 1 (except those in step 2). On October 1, 2020, XYZ closes one of its Washington offices and relocates 70 of its Washington employees to California. As a result of the relocation, only 10% of XYZ's

Employment
Requirement)

worldwide employees were located in Washington, as of October 1, 2020 (30 Washington employees, 300 worldwide employees).

Result:

XYZ no longer meets the Washington state employment eligibility requirement under RCW 82.04.293(1)(c). Under RCW 82.04.293(5) (aka “clawback” provision), XYZ is subject to B&O tax in an amount equal to the entire economic benefit it received for the period of July 1, 2019, through September 30, 2020, plus interest on the additional B&O tax due.

Example 3: Previously
Qualified Arrangement
that No Longer
Qualifies (Affiliated
Group Element No
Longer Satisfied)

Facts:

Assume the general facts from Example 1. On January 10, 2021, two of XYZ’s four affiliates are sold to a third-party and no longer affiliated with XYZ. XYZ will continue to be affiliated with GHI (Europe Region) and JKL (Asia Region). The sale of two of XYZ’s affiliates results in the following demographics for the remaining affiliated group, for 2021 and 2022:

- 24 offices located in 10 foreign countries in both 2021 and 2022.
- At least five hundred full-time employees worldwide: 800 full-time employees in both 2021 and 2022.
- 2020 gross revenue of \$2,000,000,000; 2021 gross revenue of \$1,200,000,000; 2022 gross revenue of \$1,000,000,000.
- 2020 average assets under management of \$250,000,000,000; 2021 average assets under management of \$180,000,000,000; 2022 average assets under management of \$175,000,000,000.
- Employees located in Washington: over 25% of XYZ’s total workforce in 2020, 2021, and 2022.

Result:

For 2021, XYZ continues to satisfy the affiliated group requirements in RCW 82.04.293(1)(d). This is because the eligibility factors in RCW 82.04.293(1)(d)(iii) and (iv) may be satisfied using current year or previous year data. For 2021, XYZ satisfied RCW 82.04.293(1)(d)(iii) using current year data and RCW 82.04.293(d)(iv) using prior year data.

For 2022, XYZ no longer satisfies the affiliated group requirements in RCW 82.04.293(1)(d), as the affiliated group did not have average assets under management of more than \$200,000,000,000 either during the 2021 or 2022 calendar years.

Example 4: Non-
qualifying arrangement

General Facts:

(services provided primarily to individuals, not CIFs)

Assume the facts from Example 1, except that XYZ also provides a significant amount of portfolio management services to individual clients who reside in the United States, Canada, and Mexico.

Step 1: *For 2020, is XYZ primarily engaged in providing investment management services?*

Step 1 Facts:

In 2020, XYZ's revenue streams were as follows:

- Portfolio management services provided to CIFs:
 - Gross Income: \$400,000,000
 - Total Expenses: \$180,000,000
- Accounting and legal services provided/related to CIFs:
 - Gross Income: \$100,000,000
 - Total Expenses: \$60,000,000
- Portfolio management services provided to individuals:
 - Gross Income: \$500,000,000
 - Total Expenses: \$300,000,000

Step 1 Result:

In 2020, XYZ was NOT primarily engaged in providing investment management services because less than 50% of XYZ's gross income was derived from directly or indirectly providing qualifying investment management services. In this case, 40% of XYZ's 2020 gross income was derived from qualifying investment management services, portfolio management services provided to CIFs. Sixty percent of XYZ's 2020 gross income was derived from non-qualifying service revenue, accounting and legal services and individual portfolio management services.

Additionally, XYZ's annual expenses for 2020 were not primarily related to its provision of qualifying investment management services because less than 50% of XYZ's total expenditures were incurred in providing these services. In this case, 33.3% of XYZ's 2020 expenditures were incurred in providing qualifying investment management services.

Note: There is no need to consider the other factors for qualification (steps 2 – 4), as XYZ has not satisfied the requirement that it are “primarily” engaged in the business of providing qualifying investment management services.