

Taxation Law

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President's Message

by Robert L. Mahon

The Washington Legislature wrapped up its 2009 regular session on April 26 with a Spartan budget that contains significant spending cuts and very few tax increases or revenue enhancements. Although the Tax Section does not generally support tax positions on substantive legislation, the Tax Section worked with WSBA leadership and its lobbyists to monitor and prevent any effort to single out legal or professional services for a sales tax or business and occupation (B&O) tax increase. Thankfully, there were no serious efforts to do so this session.

The Tax Section also supported the Business Section's successful effort to oppose legislation that would have imposed significant personal liability on officers, managers, members, partners, and trustees for the unpaid state tax liabilities of corporations, LLCs, and other limited liability entities. The legislation, SB 6169, would have substantially undermined the limited liability protections that form the basis of our corporate structure and would have produced a number of unintended negative consequences. Thanks to the efforts of the WSBA Business Section and others, the offensive personal liability provisions were removed from the bill that was ultimately enacted by the legislature, ESSB 6169. This issue of the Tax Section Newsletter contains a Washington state tax update, which includes a summary of the tax legislation enacted during the legislative session.

On the federal legislative front, the Tax Section is delighted to be hosting Mark Prater, deputy staff director and chief tax counsel on the minority staff of the U.S. Senate Finance Committee, as the keynote speaker at our annual luncheon on May 28,

2009. Mr. Prater is a Northwest native and WSBA member who has been at the center of federal tax policy during more than 18 years with the Senate Finance Committee. Mr. Prater will speak on *Federal Fiscal Challenges: Impact on Tax Policy in the Short, Mid, and Long-Term Horizons*.

In addition to Mr. Prater's address, the Tax Section will elect its officers and recognize several individuals and organizations at our annual meeting. First, the Tax Section's nominating committee is recommending the following slate of officers for members' consideration at the annual meeting:

President Robert Boeshaar – Internal Revenue Service
Vice President/President Elect Benjamin Porter – Porter, Kohli & LeMaster
Secretary Paige Davis – Lane Powell
Treasurer Derek Jarski – LeSourd & Patten

The Tax Section will also award its annual scholarship to a graduate of a Washington law school who is pursuing an LL.M. in taxation; present grants to support the important work of the low-income taxpayer clinics at Gonzaga University and

the University of Washington Schools of Law; and present the Tax Section's Stouder Award to Mike Young of Perkins Coie in recognition of his dedication to the community, his exceptional skills in the field of taxation, and his extraordinary professionalism.

I'm also pleased to announce that the Tax Council has created a new Young/New Lawyer Committee to spearhead efforts to involve new tax lawyers in the section. Kevin Sullivan of Carney Badley Spellman has agreed to serve as the chair of the new committee. Kevin will also serve as the Tax Section's liaison with the WSBA Washington Young Lawyers Division. If you are interested in becoming involved with the Tax Section's Young/New Lawyer Committee, please contact Kevin at sullivan@carneylaw.com or (206) 622-8020.

This is my last report as President of the Tax Section. I have thoroughly enjoyed the privilege of serving the section and its members. Please contact me if you have any questions or suggestions about the Tax Section. I can be reached at (206) 359-6360 or rmahon@perkinscoie.com. You can also contact your incoming president, Bob Boeshaar, at (206) 220-5951 or robert.v.boeshaar@irs counsel.treas.gov.

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Letter from the Editor

by Jennifer A. Gellner

From time to time, members of the tax community ask me: "What is the Tax Council and how can I get involved?"

The Tax Council is the governing body of the WSBA Tax Section, and it is comprised of the four officers, several committee chairs, a few at large members, and appointed representatives, e.g., we currently have a representative from the Washington State Department of Revenue on the Tax Council. The officers are elected every year at our annual luncheon, and according to our By-Laws, the President position is filled by the person in the President-Elect position. We also typically require an officer to serve for four years: one year in each position beginning with Treasurer, then Secretary, then President-Elect, then President. The previous year's President is officially recognized as Past-President for one year and is involved in the nomination of officers. The Committee Chairs are appointed annually by the incoming President, and may serve up to three years as chair (longer with Tax Council approval). The Treasurer position is usually filled with a person who has served as a Committee Chair for three years.

The Tax Council typically holds bi-monthly meetings, but the meetings are set by the President and can be held monthly or as needed. A copy of the By-Laws is posted on the Tax Section web site, and meeting minutes are also posted.

The best way to get involved is to join and participate in one or more of the Tax Section committees. When the President and outgoing Committee Chair are looking for a replacement, the most active committee members are usually approached to become a committee chair. Likewise, the officer ranks are filled by committee chairs who have successfully lead their committees and actively attended Tax Council meetings.

I strongly encourage every member of the Tax Section to get involved.

CLE Committee Report

by Amber Quintal

Mark your calendars and make sure not to miss these informative and timely CLEs throughout 2009! We have two half-day and two lunchtime brownbag CLEs coming up.

Join the Estate and Gift Committee for a half day CLE on August 27 at the WSBA offices in downtown Seattle, starting at noon. Our distinguished presenters will provide you with timely updates on federal and state tax legislation, tips on marital deduction planning and trust funding, tax issues facing domestic partners, and post-mortem tax planning opportunities.

The CLE Committee will be putting on two Brown Bag CLEs. While the dates have not been set, the subjects will be low-income taxpayer clinics and estate planning. Feel free to bring a lunch and join us for an hour of CLE credit. Remember that these brownbag CLEs are free to Tax Section members.

Back by popular demand! On December 11 we will be presenting a Tax Toolbox CLE: Tax for Business Attorneys. Our last Tax Toolbox CLE in 2007 sold out and was met with rave reviews, so watch for announcements and register early for our 2009 program!

If you have ideas for CLE topics, are interested in being a speaker at one of our programs or are interested in joining the CLE Committee, please contact Amber Quintal at aquintal@omwlaw.com, John Lynch at jaclynch@comcast.net or Chris Brown at chrisb@summitlaw.com.

Estate & Gift Tax Committee Report

by Alan Macpherson

The Estate and Gift Tax Committee met on April 24th and discussed the following:

1. Principal and Income Act changes. The legislature passed a bill on the determination of income from IRA distributions to QTIP trusts. During the coming year the Committee will work on another bill on income tax allocation to trusts holding interests in pass-through entities.

2. RCW 6.15 changes. We will be proposing legislation to facilitate non-pro-rata distributions of estates including the non-participant's interest in non-ERISA 403(b) plans, and to give asset protection to education accounts established under IRC sections 529 and 530.

3. QTIP controversies. There are some lawsuits pending over the State estate tax treatment of QTIPs established before our stand-alone State estate tax was enacted.

4. State estate tax apportionment changes. We are likely to offer legislation for next year, exempting a certain amount of tangible personal property and cash from estate tax apportionment.

5. We are speculating on likely Federal estate tax legislation, but no one knows.

6. State estate tax legislation. SB 5688 has been passed and forwarded to the Governor. It gives the marital deduction to domestic partners, starting in 2014.

7. Treatment of LLCs for State estate tax purposes. The Department of Revenue is considering whether to disregard certain LLCs in determining estate tax situs. An LLC interest is personal property that resides with the owner of the interest. This issue is important in taxation of those in Washington owning property out of State, and those out of State owning property in Washington.

8. Estate tax allocation and retirement plans. This study group is just getting started.

9. There is a half-day estate tax seminar planned for August 27th.

Our next meeting is Friday, June 5th. Please contact me at amacpherson@gth-law.com if you'd like to join.

International Tax Committee Report

by Chris Brown

The International Tax Committee helped to organize the recent “International Tax Conference,” held on May 1st at the Red Lion Hotel in Seattle. This event was sponsored by the Washington Society of Certified Public Accountants, and featured speakers on a number of key international topics. These included a presentation on tax planning for inbound investment in Canada (presented by Kevin Zimka of Blake, Cassels), U.S. tax considerations in setting up a foreign subsidiary (by Max Legg of Moss Adams), and special presentations on PFICs (by Gary Tober of Lane Powell), and the new Section 877A rules for individuals and green card holders who expatriate (by Bill Zaleski of PwC). In addition, the conference featured presentations from David Cordova of Deloitte Tax and Michael Ferguson of Ernst & Young on new legislative developments and Subpart F, including a discussion of possible tax planning responses to expected law changes.

Legislative Committee Report

by David Petteys

The principal objective of the Taxation Section’s Legislative Committee is to provide the Section’s members with a forum for participating in the legislative process. The Committee attempts to fulfill this objective primarily by working with the WSBA’s Legislative Department to facilitate the review of tax-related bills introduced during a legislative session and, when appropriate under the WSBA’s Comment Policy, by publicly expressing the Section’s official position with respect to such legislation. Although the Section generally refrains from commenting on the substantive merits of legislation, the Section may take a position on significant issues affecting the practice of law or the administration of justice.

The 2009 Regular Session of the Washington Legislature adjourned sine die on April 26, 2009. Although the much of the legislature’s attention was consumed with finding solutions to the state’s enormous budget shortfall, the session did produce in the passage of some important tax-related legislation, including House Bill 2075, which makes some fundamental changes to the law pertaining to Washington’s taxation of electronically delivered products. For more details on this and other significant legislation, please turn to the State and Local Tax Update on page __ of this newsletter, which was prepared by the current President of the Taxation Section, Bob Mahon.

The chair of the Legislative Committee would like to encourage Section members who are interested in getting involved in the legislative process to join the Legislative Committee. If you are interested in becoming a member, please contact David Petteys at 206.223.7049 or by email at petteysd@lanepowell.com.

Scholarship Committee Report

by Cori Flanders-Palmer

The Tax Section has received numerous applicants for its scholarship award this year. The scholarship award has subsidized the increasing costs of obtaining a degree of LL.M. in Taxation for eight years. Each year the applicants’ achievements get more impressive and the selection process becomes more difficult. The award recipient will be announced at the 2009 Tax Section annual luncheon.

We are still accepting donations for the scholarship and hope to raise at least \$5,000 this year. Anyone who contributes to the scholarship fund will be acknowledged at the Tax Section’s annual luncheon and on the Tax Section website.

For more information, please visit the scholarship link under our Tax Section website.

IRS Liaison Committee Report

by Derek Jarski

Bob Boeshaar of IRS Counsel and Derek Jarski of LeSourd & Patten, P.S. are currently serving as co-chairs of the IRS Liaison Committee. The committee conducts regular meetings to discuss various topics pertinent to practice before the Internal Revenue Service. The meetings generally take place in the Eagle Room of the Jackson Federal Building in Seattle. Recent presentations include the role of IRS Taxpayer Advocate Service featuring Rod Kobayashi, Area Director, Taxpayer Advocate Service, Seattle and Tom McDonell, Supervisory Associate Area Advocate, Seattle, innocent spouse relief under I.R.C. § 6015 featuring Bob Boeshaar of IRS Counsel, and international collection issues featuring International Collection Manager Scott Forrester.

The Taxation Law Section newsletter invites its readers to submit articles, items of interest, and announcements for publication in upcoming issues. Share your expertise, your knowledge, and your insights for the benefit of your colleagues.

So you have an idea you would like to flesh out, or a finished article ready to go?

Please contact the Newsletter Editor, Jennifer Gellner, by sending an e-mail to jennifer@gellnertaxlaw.com.

We would like to read what you have to say.

State and Local Tax Update

by Robert L. Mahon – Perkins Coie LLP

The Washington State Legislature completed a difficult and—from a tax perspective—surprisingly uneventful session on April 26. This update surveys some of the most important tax legislation adopted this session as well as significant judicial and administrative developments in the Washington state and local tax area over the past year.¹

A. Legislative Developments

1. Sales/Use Taxes

Sales tax compliance—seller's permit required to claim sales tax exemption for purchases for resale. The legislature has substantially complicated the ability of taxpayers to claim a sales/use tax exemption for purchases for resale. SB 6173. If signed by the governor, SB 6173 would replace the current resale exemption certificate system with seller's permits. In order to make an exempt purchase, a taxpayer would be required to obtain a seller's permit from the Department of Revenue and provide the permit to its vendor. Taxpayers that are not required to be registered with the Department would be able to provide a uniform exemption certificate developed by the Multistate Tax Commission or the Streamlined Sales and Use Tax Agreement Governing Board in lieu of a permit. The legislation also includes special rules for construction contractors. The legislation is expected to raise revenue by decreasing fraud—particularly in the construction industry. However, the bill applies broadly and will increase compliance costs for both taxpayers and the Department of Revenue.

Taxation of digital goods. In another significant piece of tax legislation, the legislature clarified that digital goods and digital automated services are subject to sales/use tax and B&O tax similarly to their tangible counterparts. ESHB 2075. “Digital goods” are defined as “sounds, images, data, facts, or information, or any combination thereof, transferred electronically” including “Digital automated services” are generally defined as “any service transferred electronically that uses one or more software applications” (e.g., credit reports, online games, and search-

able databases). The legislation also allows taxpayers that use digital goods and pre-written software concurrently within and without Washington to apportion sales/use tax liability based on the number and location of users.

Streamlined sales tax amendments. The legislature passed legislation that would bring Washington law into conformity with the Streamlined Sales and Use Tax Agreement (SSUTA) by sourcing interstate direct mail transactions based on the seller's location and clarifying the sourcing of ancillary telecommunications services based on the customer's primary place of use. SSB 5566.

Tax administration—use of electronic methods. New legislation requires the Department of Revenue to send assessments, notices, and other information to taxpayers electronically. The legislation also requires taxpayers that file monthly combined excise tax returns to file returns and pay taxes electronically. The use of electronic tax reporting is expected to decrease the Department's administrative costs and increase the accuracy of tax returns. Ch. 176, Laws of 2009 (SSB 5571).

Environmental tax incentives. The legislature has adopted legislation containing numerous environmental tax incentives. ESSB 6170. The legislation creates a new sales/use tax exemption for machinery and equipment used to create energy from a variety of renewable sources. (This exemption replaces an exemption that sunsets in June.) Taxpayers would be required to pay sales/use tax on their exempt purchases and claim a sales/use tax refund from the Department. The exemption is reduced to 75% on July 1, 2011 and expires June 30, 2013. The legislation also contains sales/use tax exemptions for hog fuel, gases and chemicals used in the production of solar energy equipment and clarifies the exemption for certain livestock nutrient equipment and facilities. The legislation also provides B&O tax and public utility tax incentives for log hauling, harvesters of forest biomass, manufacturers and sellers of solar systems, and radioactive waste cleanup activities.

2. B&O Taxes

Reduced B&O tax rate for newspaper publishing and printing. The legislature adopted B&O tax relief for newspaper publishers and printers. EHB 2122. Under this legislation, the B&O tax rate for printers and publishers of newspapers would be reduced from 0.484% to 0.2904%. Printers of materials other than newspapers and publishers of other periodicals would continue to be subject to B&O tax under the printing and publishing classification at the 0.484% rate.

B&O tax on manufacturing bunker fuel – retroactive clarification / amendment. The legislature has retroactively clarified that taxpayers that manufacture and sell bunker fuel for consumption by vessels in foreign commerce are subject to manufacturing B&O tax on the gross proceeds of sales. SB 6096. If signed by the governor, this legislation would preempt litigation pending in superior court and, according to the Department of Revenue, prevent more than \$17 million in refunds.

3. Property Tax

Property tax – annual revaluation. The legislature adopted legislation that would require counties to revalue all property on an annual basis. SSB 5368. This legislation would eliminate the multi-year valuation cycles used by 19 counties (17 counties currently revalue every four years; 1 every three years; 1 every two years; and the remaining 20 counties revalue annually).

Property tax – administration. The legislature made a number of administrative changes to the property tax system, including authorizing county treasurers to begin collecting taxes and assessments once the treasurer completes the tax rolls and requiring all property tax refund claims to be filed within three years of the due date for payment. E2SHB 1208.

B. Judicial Developments

1. Sales/Use Taxes

Local natural gas use tax – first use – state supreme court accepts review—legislature fails to pass bill to clarify or

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amend. The Washington Court of Appeals held that local natural gas use tax applies only at the place where the taxpayer makes first use of the gas in Washington and not on any subsequent use elsewhere. The court concluded that the taxpayer first used the gas at the location outside the city where it assumed dominion and control of gas and, accordingly, was not subject to use tax when it subsequently transported the gas into the city and consumed it in its manufacturing operation. *G-P Gypsum Corp. v. Department of Revenue*, 144 Wn.App. 664, 183 P.3d 1109 (2008), *petition for rev. granted*, 165 Wn.2d 1023 (2009). During the 2009 session, the legislature considered but did not pass legislation that would have reversed the outcome of the G-P Gypsum case by retroactively amending the definition of “use” to mean the first act within the state by which the taxpayer “consumes the gas by burning the gas or storing the gas in the taxpayer’s own facilities for later consumption by the taxpayer.” See HB 1422 and Amendment 5433-S2 AMHFIN H2984.2 (an unsuccessful striker amendment to 2SSB 5433).

Pay-to-play – state tax refund lawsuits – sales tax on managed modem service. The Washington Court of Appeals held that, where the Department of Revenue has issued an assessment against a taxpayer for a given period, the taxpayer must pay the entire assessment before bringing a tax refund lawsuit with respect to taxes for any portion of the assessment period. The taxpayer in this case was issued a substantial assessment of sales tax on its purchases of managed modem service. While an administrative appeal of the assessment was pending before the Department of Revenue, the taxpayer paid one month of tax and filed a lawsuit in superior court seeking a refund. Although the lawsuit did not challenge the assessment—rather it sought a refund of tax paid for a period included in the assessment period—the court concluded that the taxpayer was improperly attempting to challenge part of an assessment without paying the assessment in full as required by RCW 82.32.150. *AOL, LLC v. Department of Revenue*, 2009 WL 922741 (Wash. Ct. App. 2009). The substantive issues in AOL’s assessment and

dispute with the Department involve the taxation of purchases of managed modem service to provide Internet service. The taxpayer claims that sales tax does not apply to the services because state taxation is preempted by the Internet Tax Freedom Act, the services are not network telephone services, and, if they are network telephone services, are sourced outside Washington. This case is pending in Thurston County Superior Court.

Sales tax – speculative versus contract builder. In an unpublished decision, the court of appeals held that joint venture that built a house on real property, title to which remained in one of the co-venturers instead of the joint venture, was subject to B&O tax and sales tax as a contract builder and not a speculative builder under WAC 458-20-170. *Stowe v. Department of Revenue*, 2008 WL 3319801 (Wash. Ct. App. 2008). *But see Nord Northwest Corp. v. Department of Revenue*, BTA Dkt. No. 08-071 (2009) (holding that a taxpayer was a speculative builder despite not holding legal title to the property where the land owner was an LLC controlled by the taxpayer and the facts demonstrated that the taxpayer was the beneficiary of a resulting trust).

2. B&O Taxes

City B&O and utility taxation of Internet service providers. The Washington Supreme Court held that a city cannot tax an Internet service provider at a tax rate exceeding the city’s general service B&O tax rate. The court rejected the City of Seattle’s argument that the taxpayer’s cable Internet service included a transmission component that could be bifurcated from Internet service and taxed as “network telephone service” under the much higher city utility tax rate. The court concluded that “the transmission component of Internet service cannot be separated from the actual service” and that state law “plainly expresses the legislature’s intent to prohibit the taxation of Internet service providers as network telephone providers.” *Community Teleable of Seattle, Inc. v. City of Seattle*, 164 Wn.2d 35, 186 P.3d 1032 (2008).

“Direct seller’s representative”

exemption narrowly construed – state supreme court review pending. The Washington Court of Appeals held that an out-of-state seller did not qualify for the direct seller’s representative exemption from B&O tax because a small portion of its Washington sales consisted of non-consumer products. The court concluded that the exemption was limited to taxpayers that exclusively sell consumer products. While it did not benefit the taxpayer in this case, the Court also held that the exemption was not limited to natural persons. *Dot Foods, Inc. v. Department of Revenue*, 141 Wn.App. 874, 173 P.3d 309 (2007), *petition for rev. granted*, 163 Wn.2d 1052, 187 P.3d 751 (2008). The state supreme court accepted review and heard argument earlier this year.

B&O tax deduction for amounts derived from interest – statutory construction – state supreme court review pending. The state supreme court is currently reviewing whether a bank that originates residential first mortgage loans and sells or securitizes loans on the secondary market on a “servicing retain basis” is entitled to a B&O tax deduction for “amounts derived from interest.” The court of appeals held that the bank was not entitled to the deduction. The supreme court accepted review and heard oral argument on September 16, 2008. *HomeStreet, Inc. v. Department of Revenue*, 139 Wn.App. 827, 162 P.3d 458 (2007), *petition for rev. granted*, 163 Wn.2d 1022, 185 P.3d 1194 (2008).

Pass-through of B&O taxes legal if part of negotiated price. The Washington Court of Appeals held that a car dealer that disclosed a pass-through of its B&O tax during negotiations with its customers on the final purchase price of vehicles did not violate the Consumer Protection Act or RCW 82.04.500. The court distinguished this case from *Nelson v. Appleway Chevrolet, Inc.*, 160 Wn.2d 173, 157 P.3d 847 (2007), because the uncontested evidence presented at summary judgment was that the parties negotiated the B&O tax as part of the purchase price and the B&O tax charge was clearly listed on the writeback document used by the seller’s sales staff to determine the final price. *Johnson v. Camp Automotive, Inc.*, 148 Wn.App. 181, 199

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P.3d 491 (2009).

City B&O taxation of HMOs – state and federal preemption. The court of appeals held that Washington cities are prevented by state law from imposing B&O tax on premium revenue received by health maintenance organizations. The court further held that the Federal Employee Health Benefits Act (FEHBA) also preempted city taxation of premiums paid by the federal government to HMOs. Finally, the court held that Seattle's B&O tax code was not invalid as a result of the city's initial failure to comply with state-mandated uniformity requirements regarding the calculation and payment of interest on B&O tax assessment and refunds. The court concluded that this extreme remedy was not warranted because Seattle promptly amended its interest ordinance to bring it into compliance with state law and refunded the over-assessed interest to Group Health prior to summary judgment. *Group Health Coop. v. City of Seattle*, 146 Wn.App. 80, 189 P.3d 216 (2008).

3. Property Tax

Property tax foreclosure notice – separate notice to each cotenant. The court concluded that a single notice sent together to two owners, who owned the property as tenants in common, did not satisfy state law requirements that notice be given to each owner "in a manner reasonably calculated to inform the owner or owners." Instead, the county should have sent a separate notice to each cotenant. As a result of the inadequate notice, the court invalidated the county's property tax foreclosure. *Homeowners Solutions, LLC v. Nguyen*, 148 Wn.App. 545, 200 P.3d 743 (2009).

4. Other Taxes / Issues

Supermajority requirement to raise state taxes – I-960 – political question. In the middle of the 2009 legislative session, the Washington Supreme Court issued a unanimous opinion addressing the two-thirds supermajority requirement of Initiative Measure No. 960 (I-960). The court declined to issue a writ of mandamus ordering the lieutenant governor to forward a tax bill to the house of representatives

that passed the state senate by a majority but not a two-thirds supermajority vote. The court concluded that the issue was a nonjusticiable political question. The court found that the lieutenant governor properly declined to decide the constitutionality of the supermajority requirement and did not abuse his discretion in applying I-960. The court did not reach the question of whether the supermajority requirement is unconstitutional. *Brown v. Owen*, 2009 WL 564432 (Wash. 2009). (In January 2010, the legislature will have the legal power—although perhaps not the political will—to amend I-960 to eliminate or suspend the supermajority requirement by a simple majority).

Class action lawsuit related to tax surcharges. The Washington Supreme Court held that the dispute resolution provisions of a telecommunication company's consumer services agreement were unconscionable and unenforceable to the extent they purported to waive consumers' right to class actions, require confidentiality, shorten the Consumer Protection Act statute of limitations, and limit the availability of attorney fees. The case arose from a class action lawsuit related to allegedly improper surcharges for city utility taxes and late fees. *McKee v. AT&T Corp.*, 164 Wn.2d 372, 191 P.3d 845 (2008).

Hazardous substance tax — effect of administrative regulations. The state supreme court held that an oil refinery had "possession" and "control" of refinery gas produced as a by-product of the refining process and was, accordingly, subject to hazardous substance tax on the refinery gas. The court concluded that the tax applied even though the gas existed only for a matter of seconds before being consumed in the refining process. A vigorous dissent would have required the Department of Revenue follow its own published administrative rule, which provided a reasonable construction of the term "taxable possession." Chief Justice Alexander filed a concurring opinion that noted "a certain unseemliness about the Department of Revenue disavowing its own regulation," but concluded that the rule was inconsistent with the statute and therefore invalid. *Tesoro Refining and Marketing Co. v. Department of Revenue*,

164 Wn.2d 310, 190 P.3d 28 (2008).

C. Administrative Developments

1. Sales/Use Taxes

New rule on computer hardware, software, and computer and information services. Effective January 16, 2009, the Department of Revenue adopted a new and extremely lengthy regulation addressing the state B&O and sales and use taxation of computer hardware, software, and computer and information services. WAC 458-20-15501. The rule supplements the Department's longstanding rule on information and computer services, WAC 458-20-155, which was last amended in 1985 (when Microsoft was a privately held start-up).

Resale certificate requirements amended. The Department of Revenue amended its resale certificate rule to provide that it will accept a resale certificate as evidence of wholesale sales more than four years after the effective date of the certificate as long as the customer has a "recurring business relationship" with the seller. A "recurring business relationship" is defined as making at least one purchase from the seller within a period of 12 consecutive months. WAC 458-20-102. Rule 102 will have limited applicability as the result of the legislature's adoption of SB 6173, which replaces resale certificates with seller's permits effective January 1, 2010. See discussion of SB 6173 above.

Sales tax on electronically delivered software – delivery outside Washington. The Board of Tax Appeals held that a taxpayer was entitled to a refund of sales tax on prewritten software that was electronically delivered to the taxpayer's servers outside Washington. The fact that the sales documents identified Washington as the ship to address was not controlling where the taxpayer presented evidence that its computer servers were moved from Washington to California prior to the sale and delivery was actually made to the servers in California. *Seattle SMSA LP v. Department of Revenue*, BTA Dkt. No. 66729 (2008).

Sales tax – officer liability. The Department of Revenue held that a corporate sales manager who had check signing au-

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thority was not personally liable for sales tax collected by a corporation but not remitted to the Department where the manager did not have responsibility for filing the tax returns or paying the collected tax. Det. No. 08-203, 28 WTD 29 (2009).

Multiple use software licenses taxed entirely to state of delivery. The Department of Revenue concluded that taxpayers who purchase multiple use licenses for prewritten software and accept delivery of the software in Washington are subject to sales tax on the entire sales price without apportionment or reduction for copies used outside Washington. The Department reasoned that the only delivery of software occurred in Washington and there was no statutory basis to apportion the sales price based on licenses used outside Washington. Det. No. 07-0120, 27 WTD 109 (2008). *But see ESHB 2075* (discussed above) (permitting taxpayers to apportion sales/ use tax on digital goods and prewritten software used concurrently within and without Washington).

Sales tax – true versus finance lease. The Department of Revenue held that a taxpayer's lease of telephone equipment was an operating or "true" lease rather than a financing lease. As a result sales tax was due on the lease payments over the course of the lease rather than at the outset of the lease as with an installment sale. The Department examined nine factors and concluded that the weight of the factors supported a true lease conclusion. Det. No. 07-0247, 27 WTD 41 (2008).

2. B&O Taxes

B&O tax on "intelligent database" services – data communications. The Department of Revenue held that a taxpayer's sale of toll-free number services, line number identification services, and other intelligent database services to telecommunications companies was subject to tax under the service and other classification rather than wholesaling B&O tax (as network telephone service). The Department concluded that the customers' true object was to access the taxpayer's databases and not to purchase communications service. Det. No. 08-0003E, 28 WTD 40 (2009). The taxpayer in this case has paid the tax

and filed a refund suit in Thurston County Superior Court. *VeriSign, Inc. v. Department of Revenue*, Thurston County Dkt. No. 08-2-00294-0.

B&O tax – true object test – professional services or rental of equipment. The Department of Revenue held that a taxpayer that provided testing services for structures was subject to B&O tax under the service and other classification rather than the retailing classification. The Department concluded that, although the taxpayer's billings included line items for the use of testing equipment, the true object of the transactions was the taxpayer's knowledge, skills, and expertise. Det. No. 08-0138, 28 WTD 19 (2009).

B&O tax nexus – affiliate did not create nexus. The Department held that an out-of-state corporation that sold goods into Washington exclusively through the Internet and television infomercials did not have taxable nexus in Washington. The company's activities were not tainted by the nexus creating activities of an affiliated entity that made wholesale sales of some of the same products to retailers. The Department noted that "affiliation or common ownership is insufficient to link the activities and tax liabilities of one entity to the other." Since the entity with nexus did not directly represent or support the sales of the out-of-state affiliate, its activities were insufficient to create nexus for the out-of-state affiliate. Det. No. 08-128, 28 WTD 9 (2009).

B&O tax nexus – infrequent sales visits creates nexus. The Department of Revenue held that an out-of-state manufacturer had nexus in Washington by virtue of sending a sales representative into Washington for a single day in 2001 and a single day in 2005. Det. No. 08-117, 27 WTD 239 (2008).

B&O tax – staffing company. The Department of Revenue held that a staffing company was subject to B&O tax on amounts paid by the government to the taxpayer and, in turn, paid to hospital emergency room staff. The Department reasoned that WAC 458-20-111 did not permit the exclusion of the receipts from gross income as a nontaxable advance or reimbursement because the taxpayer did

not have an agency relationship with the government. Det. No. 08-0032, 27 WTD 182 (2008).

3. Other Taxes

Leasehold excise tax – leasehold interest – dominion and control. The Department of Revenue held that ski resort operator was subject to leasehold excise tax on its use of public land pursuant to a special use permit from the U.S. Forest Service. The Department concluded that the permit created a taxable "leasehold interest" even though the taxpayer did not have exclusive dominion and control over the area covered by the permit. The Department reasoned that the statute and its administrative rule require that a taxpayer have "some identifiable" dominion and control over the property and "complete and exclusive dominion and control over the defined area is not necessary." Det. No. 08-0076, 28 WTD 55 (2009).

Real estate excise tax – sale of controlling interest – county property tax value as measure. The Department of Revenue held that the proper measure of the real estate excise tax in a controlling interest transaction was the assessed value of the real property owned by the entity as maintained on the county property tax rolls. The Department concluded that the purchase price for the entity did not reflect the value of the real property because the entity owned assets other than real property and had substantial liabilities. Det. No. 08-0169, 28 WTD 25 (2009).

¹ As we go to press in early May, the governor has not yet taken action on much of the legislation covered in this update. You can find updates on executive action and other legislative materials at apps.leg.wa.gov/billinfo.

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