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In this installment of From the Inside, the authors offer their thoughts about the differences and similarities between the Oregon and Washington gross receipts taxes. They note situations that could create the risk of multiple taxation for service providers doing business in both states and how application of the Washington tax and an Ohio gross receipts tax could inform application of Oregon's newer statute.

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## Garry G. Fujita

Reviewing a new tax that has been added to the existing state and local interstate mix of taxes can create interesting issues. I think Oregon's new commercial activities tax (CAT) and Washington's decades-old gross receipts tax, the business and occupation tax (B&O tax), is an interesting comparison. Both are styled as excise taxes that apply to the privilege of engaging in a business activity.

One difference is that Oregon imposes a minimum tax of $250 plus tax on commercial activity of 0.57 percent on all commercial activity over $1 million.[1] Washington imposes a variety of rates on different activities on gross income of the business or gross proceeds of sale.[2]

Another difference is how the two taxing schemes were drafted. Washington imposes the B&O on a business activity measured by gross receipts.[3] Oregon is a bit fuzzy on this point. It defines the activity as an amount of money: Commercial activity means "the total amount realized by a person, arising from transactions and activity in the regular course of the person's

[1]Or. Rev. Stat. section 317A.125(1).

[2]Wash. Rev. Code sections 82.04.220-.240, .250-.257, .260-.290, .29002-.2909, .294, and .298. These rates range from a low of 0.13 percent (parimutuel wagering) to a high of 3.3 percent (radioactive waste disposal). When I worked for the Washington Department of Revenue in the 1980s, I was told that the many B&O rates were due in part to the Legislature's sensitivity to an industry's typical net profit. The "service and other" tax rate was relatively high compared with other rates because the net margins were typically large. The retailing and wholesaling tax rates were relatively low because the net margins were typically small. So, in rough justice, the Legislature had tried to impose a rate that would be about the same proportionate share of B&O tax when expressed through the prism of the net margin. I have never found any legal support for these explanations, and over the years I have grown doubtful that the Legislature has acted with that sensitivity in mind when adjusting rates.

[3]Wash. Rev. Code section 82.04.220(1).



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trade or business, without deduction for expenses incurred by the trade or business."[4] It would have been more clear if the statute had used gross receipts as the tax measure rather than the routing it through commercial activity and then arriving at the amount realized. Conceptually, I did not equate activity with receipts until reading the definition of commercial activity.

A third difference is that the CAT allows a substantial deduction (the statute refers to subtractions that are 35 percent of the greater of input or payroll costs. This 35 percent deduction is reduction of the commercial activity (the tax measure)).[5] The B&O tax, on the other hand, permits deductions. But Washington's deductions are not generally trade or business costs; instead, they are generally gross receipts[6] that a business might receive (including receipts from membership fees, types of interest, and tuition fees) that can be deducted from gross receipts.

A fourth difference is that the CAT imposes a $250 tax plus tax on commercial activity that exceeds $1 million per year.[7] Washington reaches a similar result by granting a credit against taxes of $35 per month.[8] The Legislature established the credit because of the various tax rates. A retailer for example with a 0.471 percent tax rate would receive a credit that would offset tax on $7,431 of receipts ($35/0.471 percent). A service business with a service B&O tax rate of 1.75 percent would receive a credit that would offset tax on $1,944 of receipts ($35/1.75 percent). Annualizing those amounts for retailers and service businesses, the credit would offset taxes on gross receipts of $89,172 and $23,328, respectively. These amounts are substantially less than the $1 million used in the Oregon CAT.

A fifth difference, regarding services, is that the CAT sources commercial activity to the location where the service is delivered[9] (but the state's rule creates other rules that are not as direct as the statute suggests), and the Washington B&O sources the income to where the taxpayer benefits from the service. These sourcing rules may not interface nicely in every case, because the triggers to source the income are not the same. For example, the delivery location may have nothing to do with the location where the benefit is enjoyed.

The Oregon commercial activity sourcing statute says "For purposes of ORS 317A.100 to 317A.158, commercial activity shall be sourced to this state as follows . . . (d) In the case of the sale of a service, if and to the extent the service is delivered to a location in this state."[10]

The Oregon DOR confirms the statute, stating:

> (a) *General Rule*. The receipts from a sale of a service are in Oregon if and to the extent that the service is delivered to a location in Oregon. In general, the term "delivered to a location" refers to the location of the taxpayer's market for the service, which may not be the location of the taxpayer's employees or property. The rules to determine the location of the delivery of a service in the context of several specific types of service transactions are set forth at sections (4)(b)-(d) of this rule.[11]

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[4] Or. Rev. Stat. section 317A.100(1)(a)(A).

[5] Or. Rev. Stat. section 317A.119(1).

[6] There are some exceptions, like bad debt deductions (Wash. Rev. Code section 82.04.4284) or direct mail delivery charges (Wash. Rev. Code section 82.04.4272), that are costs of doing business as opposed to types of receipts that can be deducted.

[7] Or. Rev. Stat. section 317A.125(2). The statute does not say that tax begins at $1 million; rather, it says that "a tax is not owed . . . if . . . taxable commercial activity does not exceed $1 million." I am not sure whether to interpret that as an exemption (in Washington, exemptions are construed in favor of the tax) or an exclusion (in Washington, exclusions are construed against the tax).

[8] Wash. Rev. Code section 82.04.4451(1). The credit is not exactly straightforward as $35 per month: It is $35 per month for the reporting period, or potentially $420 per year. So, if a taxpayer was on a monthly reporting period and fully used the $35 credit for January, used only $25 for February, and $35 for March, then that taxpayer would lose $10 of credit because there is no carryback or carryforward concept to take advantage of the unused $10. By contrast, if the taxpayer filed on a quarterly reporting period, that taxpayer could spread the $105 ($35 x 3 months) across the quarter. So, if the aggregate tax for the quarter reporting period was as least $105, that taxpayer would get the full benefit of the $35 per month. The monthly reporter would lose $10 in my example because of the reporting period assigned to that taxpayer.

[9] Or. Rev. Stat. section 317A.128(1)(d): "commercial activity shall be sourced to this state [Oregon] as follows: . . . In the case of the sale of a service, if and to the extent the service is delivered to a location in this state."

[10] Or. Rev. Stat. section 317A.128(1)(d).

[11] Or. Admin. R. 150-317-1040(4)(a).



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But the rule goes beyond the precision of the statute and distinguishes between different types of purchasers of a service (e.g., in-person service and professional service). The rule says:

> (A) *In General*. If the service provided by the taxpayer is not an in-person service within the meaning of section (4)(b) of this rule or a professional service within the meaning of section (4)(d) of this rule, and the service is delivered to . . . the customer, or delivered electronically through the customer, the receipts from a sale are in Oregon if and to the extent that the service is delivered in Oregon.[12]

The rule provides more specific guidance when the professional services are provided to business customers. It states:

> (II) *Professional Services Delivered to Business Customers*. Except as otherwise provided in section (4)(d) of this rule, in any instance in which the service provided is a professional service and the taxpayer's customer is a business customer, the state or states in which the service is delivered must be reasonably approximated as set forth in this section. In particular, unless the taxpayer may use the safe harbor set forth at section (4)(d)(C)(i)(III) of this rule, the taxpayer must assign the receipts from the sale as follows: first, by assigning the receipts to the state where the contract of sale is principally managed by the customer; second, if the place of customer management is not reasonably determinable, to the customer's place of order; and third, if the customer place of order is not reasonably determinable, to the customer's billing address; provided, however, in any instance in which the taxpayer derives more than five percent of its receipts from sales of all services from a customer, the taxpayer is required to identify the state in which the contract of sale is principally managed by the customer.

Thus, for professional services, the statute abandons the place of delivery and replaces it with "reasonable approximation" that uses hierarchy rules that apply in sequence. First is where the customer manages the contract; second is where the customer ordered the services if the first rule does not apply; and last is where the customer's billing address is located if the two preceding rules do not apply.

Thus, assume that an Oregon client purchases $1.5 million of legal services from a New York law firm to reorganize a large corporate family that has Washington subsidiaries that need to be dissolved. All the legal work is performed in New York City, and the law firm is never present performing legal services in either state. The Washington-associated legal work is $100,000 to complete the dissolution and distribution of corporate assets. If the Oregon client manages the contract for legal services in Oregon, then the commercial activity is sourced to Oregon. The state would source 100 percent of the legal fees to Oregon, where the client manages the contract for legal services. The New York law firm would owe CAT in Oregon of $250 plus 0.57 percent on $500,000 (the amount over $1,000,000), or $250 plus $2,850, for a total of $3,100.

Washington sources gross receipts to the location where the customer benefits from the service[13] rather than where the services are delivered. However, like Oregon's rule, Washington uses a hierarchical statutory approach to use a known proxy for where a customer enjoyed the benefit of the service. The statute looks at where the customer ordered the services, where bills are sent to the customer, from where the customer sends payments, the customer's location, and the customer's commercial domicile.[14] Washington has said it will generally not look to any allocation to a location other than where the customer benefitted from the service, stating:

> The department expects that most taxpayers will attribute apportionable receipts based on (a)(i) of this subsection

[12] Or. Admin. R. 150-317-1040(4)(d)(A).

[13] Wash. Rev. Code section 82.04.462(3)(b)(i) and (ii).

[14] Wash. Rev. Code section 82.04.462(3)(b)(i)-(vii).



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> because the department believes that either the taxpayer will know where the benefit is actually received or a "reasonable method of proportionally attributing receipts" will generally be available.[15]

In the example above, the New York law firm would attribute $100,000 of the revenue to Washington. That would be the numerator, and $1,500,000 would be the denominator. The apportionment ratio would be 6.7 percent. That ratio would be multiplied by total gross receipts of $1.5 million. Washington's apportioned share would be 6.7 percent times $1,500,000, or $100,500. That share would be taxable at the service rate of 1.8 percent, leaving a tax due of $2,700.

The $150,000 would have been taxed twice because Oregon taxed it at 0.57 percent for a tax of $855. Washington taxed the same activity at 1.8 percent for a tax of $2,700.

One would think that all or a part of the same activity could not be taxed twice by different states. At a minimum, there should be a credit to offset one of the taxes. However, neither state offers a credit. So, in my example, the New York law firm that has no physical presence in either Oregon or Washington will be paying the CAT and B&O to each state on the same activity and gross receipts. But why is there is no credit for taxes paid to another jurisdiction?

Both states use a method to source the income. Oregon's allocates the commercial activity to a place. Washington allocates gross receipts, then then uses that allocation in an apportionment formula. As described above, Oregon allocates the commercial activity to a place, but Washington allocates the sale to a place where the customer benefits from the service provided. Unfortunately, the two methods do not source the income to the same location, causing the methods to risk income being taxed on the same activity by each state.

In the example, the taxpayer sold a service, and the apportionment and allocation theoretically eliminate the risk of multiple taxation. However, for goods, income can also be subject to taxation by both states. The CAT does not provide for any credits; however, the B&O tax on the sale or manufacture of goods can be offset by the multiple activities tax credit (MATC) for taxes that are similar to a gross receipts tax.[16] However, according to the Washington DOR, the MATC does not apply because the CAT is not similar to a gross receipts tax in that it permits the 35 percent deductions of some costs.

The taxes appear to be internally consistent under *Tyler Pipe*,[17] so they likely survive that analysis. Whether they satisfy external consistency under *Container Corp.*[18] is another question. As the Court said, without a central coordinating agency, absolute consistency may be a standard too high. The question would be whether "the factor or factors used in the apportionment formula [] actually reflect[ed] a reasonable sense of how income is generated."[19] That might be an interesting question in the future. The Court has not had the opportunity to determine whether sourcing income based on where the customer manages a contract and where the customer benefits from the service is "a reasonable sense of how income is generated," especially in the example of a New York law firm performing all the legal work in New York and never being present in Oregon or Washington. Whether this issue will be resolved by amending state statutes, congressional intervention, litigation, or is just a fact of life remains to be seen.

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[15] Wash. Admin. Code section 458-20-19402(303).

[16] Wash. Rev. Code section 82.04.440(4).

[17] *Tyler Pipe Industries Inc. v. Washington State Department of Revenue*, 483 U.S. 232 (1987).

[18] *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983).

[19] *Id.* at 169.



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**Michelle DeLappe**

For those not versed in the new Oregon CAT and the Washington B&O tax, the appearance that both are gross receipts taxes can be deceiving. That appearance might lead taxpayers who are familiar with gross receipts taxes to believe that complying with the Oregon CAT will be simple. But as many tax practitioners are realizing, applying the statute (including amendments) and the host of new temporary regulations interpreting it is challenging. And its challenges differ markedly from those posed by Washington's B&O tax.

### Washington DOR Excludes the Oregon CAT From Its Credit for Gross Receipts Taxes

Confirming the dissimilarity of these two taxes, the Washington DOR recently published guidance on whether the Oregon CAT qualifies for Washington's MATC.[20] Washington's B&O tax is pyramiding: A product manufactured in Washington and sold to a Washington consumer would be subject to manufacturing B&O tax on the value of the product, and then wholesaling or retailing B&O tax on the selling price of the product. For companies that are vertically integrated, the MATC eliminates multiple taxation by providing a credit. That credit applies not only to B&O tax on products extracted or manufactured in Washington, but also to gross receipts taxes paid to another state, foreign country, or territory. But there is a major obstacle when it comes to the Oregon CAT: The MATC does not apply to anything but a *true* gross receipts tax. The Oregon CAT routinely allows the deduction of some costs of doing business, which dooms it as ineligible for the MATC. This deduction that sets the CAT apart is both limited and complex — particularly because it requires apportioning the costs to the state, which is highly unusual in a state tax system.

### Washington B&O and Oregon CAT Treat Affiliate Transactions Differently

These two taxes also differ in their treatment of vertical integration. The B&O tax only respects vertical integration within the same entity (whether a corporation, limited liability company, partnership, or sole proprietorship). Each entity must pay tax on its gross receipts, even if those receipts come from transactions with affiliates, and regardless of whether the income taxed is in money or in the value of the benefit received. In contrast, the Oregon CAT shows its roots in the Ohio CAT with unitary reporting — a concept that does not exist at all in Washington's tax regime. As a result, the benefits of vertically integrated businesses in Oregon extend to affiliates with more than 50 percent direct or indirect common ownership that are engaged in a unitary business (i.e., have centralized management, economies of scale, or functional integration).

### Oregon CAT Provides 47 Exclusions, Including Categories Taxable in Washington

Major exclusions from the Oregon CAT mark another key difference from the Washington B&O tax. For example, unlike the B&O tax, the CAT excludes the wholesale and retail sale of groceries, sales to in-state wholesalers that certify that the goods will be resold outside the state, and the resale or transfer of motor vehicles between dealers. The Oregon DOR recently issued temporary regulations on these exclusions.[21] While providing helpful guidance, they show a whole area of complexity that the B&O tax, by taxing all such sales, lacks. On the other hand, there are good policy reasons for excluding these types of sales from a gross receipts tax — or a nearly gross receipts tax like the CAT. Washington's B&O tax has always posed challenges for low-margin businesses like grocery stores, and applying the B&O tax to groceries goes against the very reasons that Washington exempts such sales from sales tax.

### Oregon's More Practical Approach to Excluding Agent Reimbursements

An exclusion that should be important in both states is that for reimbursements or advances received by an agent. In Washington, this exclusion, commonly referred to as the "Rule 111"[22] exclusion,

[20] Washington State DOR, "Oregon Corporate Activity Tax (CAT) — Is It Eligible for the Multiple Activities Tax Credit?"

[21] Or. Admin. R. 150-317-1140, 150-317-1150, 150-317-1400, and 150-317-1410 (temporary rules in effect as of Feb. 1, 2020).

[22] Wash. Admin. Code section 458-20-111.



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has in practice become as difficult to qualify for as it is for a camel to pass through the eye of a needle. Taxpayers in Washington can only deduct reimbursements or advances from their taxable income if they clearly establish an agency relationship, with the agent acting solely as an agent and having nothing more than agency liability.[23] Thus, unless the other parties are aware that the payments merely pass through the agent and that the agent has "no personal liability therefor, either primarily or secondarily, other than as agent for the customer or client," the agent must pay B&O tax on the full amount as income.[24] Oregon seems to bring a more common-sense approach to the requirements for its similar deduction for "amounts received or acquired by an agent on behalf of another in excess of the agent's commission, fee or other remuneration."[25] The temporary "agent exclusion" rule interprets these terms to include, for example, payroll processing and payments to employees.[26] The Washington Legislature had to pass specific exemptions since Rule 111 was deemed to not cover them.[27]

### Caveats Against Passing the Tax on to Customers

Both the Washington B&O tax and the Oregon CAT are intended to be part of the taxpayer's overhead. They are not intended to act as a sales or use tax that can be passed on to the customer. In Oregon, auto dealers persuaded legislators to provide an exception to this for that industry. But other businesses are generally supposed to treat the tax as part of their overhead. Businesses can raise their prices, but they are not allowed to be transparent about why they are doing so (at least not by adding a line item for the Oregon CAT). Washington takes a similar approach. But the reasoning, based on two contrary decisions that the Washington Supreme Court found a way to reconcile, leaves a narrow exception to the general rule against passing the tax through as a line item: If passing the B&O tax through separately is a negotiated element of the sales price, and if both parties intend the reimbursement of the overhead expense, and if the B&O tax is not presented as a surcharge or in addition to the sales price but rather as a separate line item above the price subtotal, then businesses should be able to transparently pass that item on to the customer.[28] Because there are so many "ifs" involved, most taxpayers simply accept the B&O tax as an unstated part of overhead.

### The New, Uncertain Oregon CAT

When Depression-era lawmakers in Washington passed the Revenue Act of 1935 establishing the B&O tax and its original 21 exemptions (including one for boxing and wrestling matches!),[29] tax practitioners were perhaps flustered about how to interpret and comply with the law. Certainly over the years the U.S. Supreme Court has heard a number of challenges to various aspects of the B&O tax while the state worked out constitutional issues with it.[30] On the other hand, what started as a relatively straightforward tax has evolved over the years into a tax with many classifications, rates, and narrow exceptions.

In contrast, the Oregon CAT is starting out as a complex law that has been hastily implemented. Having been adopted only last year, the Oregon DOR has had to scramble to implement it by its January 1, 2020, effective date. To ascertain what regulatory guidance taxpayers need, the DOR held meetings around the state and convened conference calls open to out-of-state participants. And it has moved quickly to issue temporary rules clarifying many aspects of the law. But even with the temporary rules, much uncertainty remains. For the time being, this has turned the Oregon CAT into the SALT Practitioner Full Employment Act.

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[23] *See, e.g.*, *Washington Imaging Services LLC v. Department of Revenue*, 252 P.3d 885 (Wash. 2011).

[24] *Id.* 171 Wash. 2d at 561 (quoting Wash. Admin. Code section 458-20-111).

[25] 2019 Or. Laws Ch. 122, section 58(1)(b)(M).

[26] Or. Admin. R. 150-317-1100 (temporary rule in effect as of Jan. 1, 2020).

[27] *See, e.g.*, Washington DOR Special Notice: Paymaster Deduction (Sept. 27, 2013); and Washington DOR Excise Tax Advisory 3100.2009.

[28] *Peck v. AT&T Mobility*, 275 P.3d 304 (Wash. 2012).

[29] *See* Washington DOR, "History of Washington Taxes."

[30] *See, e.g.*, *Tyler Pipe*, 483 U.S. 232 (holding unlawful discrimination occurred where the B&O tax's multiple activities exemption did not provide a credit for wholesaling taxes paid to other states); and *Gwin, White & Prince v. Henneford*, 305 U.S. 434 (1939) (holding the B&O tax placed an unlawful burden on interstate commerce where it failed to apportion the tax to only activities in the state).



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**Gregg Barton**

Oregon and Washington share a border, but their tax systems have historically been diametrically opposite. Oregon has corporate and personal net income taxes, but no sales tax; Washington has a B&O tax, or gross receipts tax, and a sales tax, but no net income taxes. That changed with Oregon's adoption of its CAT, effective January 1. Now, practitioners and clients alike are comparing the Washington B&O tax and the Oregon CAT, as well as the Ohio CAT, on which the Oregon CAT was modeled.

To start, it may be useful to consider an underlying political observation about Oregon and Washington by Daniel Hauser, an analyst with the Oregon Center for Public Policy. In Hauser's November 2, 2018, commentary, in which he cited a report released by the Institute on Taxation and Economic Policy before Oregon's enactment of the CAT, he described the tax systems in Oregon and Washington as regressive (although it may be worth noting that, according to the same report, Oregon's tax structure was the 10th least regressive in the country). There was pressure to remedy this regressivity leading up to adoption of the Oregon CAT, and similar pressures in Washington. In 2019 there were tax changes directed at big business. For the CAT, there is a $1 million threshold, and for Washington's B&O tax surcharges, thresholds were set at $25 billion of gross, $100 billion of gross, and $2 billion of net income with respect to some classifications.

The Oregon CAT and Washington B&O tax have similarities. However, there are a few important differences that taxpayers will want to consider. First, although both taxes are thought of as gross receipts taxes, Oregon's CAT has a substantial deduction for 35 percent of the greater of cost inputs or labor costs. While Washington's B&O tax is peppered with a variety of special interest exemptions and deductions, there is no broadly applicable deduction of such magnitude. Also, Washington's tax is computed on a separate-entity basis, whereas Oregon's tax is computed on a unitary basis — an important difference because, in contrast to Washington's system, Oregon's tax is avoided on intercompany transactions. The Oregon CAT has a single rate of 0.57 percent, which is comparable to Washington's B&O tax rates of 0.471 and 0.484 percent for retailing and wholesaling, respectively. However, Washington's rate for service activities is 1.5 percent and will rise to 1.75 percent effective April 1. Washington has several additional classifications, each with its own rate.

With those basics out of the way, what are some of the pressing issues presented by taxpayers so far? The most common question regarding the Oregon CAT, in our experience, is whether taxpayers can pass the tax on to their customers. As we see with the Washington B&O tax, taxpayers seem much more motivated to pass new and unfamiliar taxes along to their customers. The threat of Oregon CAT being passed through to customers may also have been used to influence an unsuccessful referendum campaign to repeal the CAT. While there was some initial debate about whether the CAT could be passed on, the DOR and the primary legislative sponsor have now said there is no prohibition in the law. Some taxpayers are passing on the tax — or, more specifically, an estimate of the expense. In part because of the significant deduction, it is impossible for any taxpayer to know precisely how much tax is applicable to any one transaction (particularly at the time of sale). Therefore, the advice has been to not call it a tax, but instead call it an estimate of the tax expense. Any additional proceeds received to cover one's tax expense are, of course, income subject to the CAT.

Washington has likewise seen controversy regarding the ability to pass the B&O tax through to customers. There would not appear to be any policy reason why a knowledgeable buyer and seller could not agree on the buyer paying the seller's B&O tax. After all, that is very much the nature of a cost-plus contract. Still, after a series of cases, Washington courts seem to have reached the opposite conclusion. In *Nelson v. Appleway Chevrolet Inc.*,[31] the Washington Supreme Court held that a used car dealer "improperly charged Nelson B&O tax on top of the final price." At the time, most interpreted the decision as involving a situation in which the parties had agreed to a final price, and then the seller added on the B&O tax afterward. *Johnson v. Camp Automotive Inc.*[32] followed closely

[31] 157 P.3d 847 (Wash. 2007).

[32] 199 P.3d 491 (Wash. Ct. App. 2009).



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behind and appeared to confirm that a B&O tax charge disclosed during price negotiations was permitted. However, in *Peck v. AT&T Mobility*,[33] the Washington Supreme Court appeared to resolve any doubt by concluding that "regardless of disclosure, RCW 82.04.500[34] prevents a business from recouping the B&O tax as an added charge to its sales price." To this day, it is unclear why the parties should not be allowed to negotiate for the buyer to pay the seller's B&O tax just as costs are recovered in cost-plus contracts. Oregon has no statute like section 82.04.500. In Washington, some have speculated that the conclusion in *Peck* violates sellers' First Amendment rights under *Expressions Hair Design v. Schneiderman*,[35] (holding that a New York state statute prohibiting merchants from imposing a surcharge on customers who elected to pay with a credit card restricted free speech). Before *Expressions Hair Design*, the Washington Supreme Court held that section 82.04.500 did not impinge on the First Amendment because it was "silent about disclosure, and Appleway is free to disclose and itemize any tax or cost."[36]

Another issue is the treatment of passthrough receipts. For net income taxes, it is usually not particularly important whether those receipts are included in gross income and deducted, or never included in income in the first place. For gross receipts taxes, however, this issue can be material. Imagine a commission agent selling goods for a manufacturer: The commission agent earns a 10 percent fee on each sale of the manufacturer's product. On $1 million of sales, the taxpayer's commission and gross income is $100,000. If, instead, the taxpayer purchased the goods for $900,000 and resold them for $1 million, the taxpayer has the same $100,000 of net income but $1 million of gross proceeds. Determining the proper amount of gross income under the Washington B&O tax is a common problem, and could be so under the Oregon CAT too.

Passthrough issues arise for almost every kind of management company imaginable (including hotel, food service, golf course, and payroll). Other businesses have faced the issue, with a few of those matters leading to litigation. In *Washington Imaging Services*,[37] the Washington Supreme Court held that a radiology clinic could not exclude payments it received from patients that it passed on to radiologists acting as independent contractors with whom the clinic contracted to provide review of X-rays. The court first analyzed simply whether the amounts were "gross income of the business" of the clinic and held that the taxpayer would have to prove that it acted only as a collection agent for the radiologists. Even though the parties had an agreement that the clinic would collect fees for the radiologists, the court observed that the clinic was required to prove that it was collecting money owed to the radiologists. However, the patients had no agreement with the radiologists and owed them no money. Therefore, the money collected was income of the clinic.

Separately, the court analyzed whether the payments could be excluded under Rule 111. Again, however, the court concluded that the clinic must be an agent of the patients, and there was no such arrangement. It did not matter that the clinic had no obligation to pay the radiologist if it was not paid by the patient. One of Rule 111's other requirements is that the taxpayer is not liable for paying the ultimate recipient, except solely as the agent of the client. However, in this case, the clinic's obligation to pay the radiologist was because of its own contractual obligation. Since then, the courts have rendered similar decisions in *St. Joseph General Hospital*[38] (with no independent obligation on patients to pay emergency physicians, hospital did not make payments for the patients); *Everi Payments*[39] (because Everi, and not the tribes, contracted with casino patrons for cash access services,

[33] 275 P.3d 304 (Wash. 2012).

[34] "It is not the intention of this chapter that the taxes herein levied upon persons engaging in business be construed as taxes upon the purchasers or customers, but that such taxes shall be levied upon, and collectible from, the person engaging in the business activities herein designated and that such taxes shall constitute a part of the operating overhead of such persons."

[35] 581 U.S. ___, 137 S. Ct. 1144 (2017).

[36] 160 Wash. 2d, at 184.

[37] *Washington Imaging Services LLC v. Washington State Department of Revenue*, 252 P.3d 885 (Wash. 2011).

[38] *St. Joseph General Hospital v. Department of Revenue*, 267 P.3d 1018 (Wash. 2011).

[39] *Everi Payments Inc. v. Washington State Department of Revenue*, 432 P.3d 411 (Wash. Ct. App. 2018).



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passthrough treatment was not permitted); and *Express Scripts*[40] (because Express Scripts takes on the obligation to pay retail pharmacies as part of its business model, and it negotiates payment and recoupment with the retail pharmacies and clients, it is subject to B&O tax on the money it receives from its clients).

One interesting aspect of *Express Scripts* is that the court of appeals stated, "Generally, the only way funds qualify for 'pass-through' treatment is under WAC 458-22-111," citing *Washington Imaging*. However, it appears that the court in *Washington Imaging* evaluated both whether the amounts were gross income under the statute and whether they were excluded under Rule 111. This may be an important as-yet-unresolved issue, because Rule 111 might not reflect all situations in which something is not income to the recipient. For example, both accounting and federal tax principles differ from Rule 111 in their bases for determining whether something is gross income. For federal tax purposes, reimbursements for expenses incurred by a taxpayer on behalf of another in a nonemployment context is not includible in the taxpayer's gross income.[41] Even though it may not be relevant for net income tax purposes, we regularly advise clients to carefully consider how they record income for financial accounting purposes. If they have the latitude to exclude a payment from book income, this is probably the best first step toward avoiding the payment of gross receipts taxes on that income.

The Oregon CAT specifically excludes "property, money and other amounts received or acquired by an agent on behalf of another in excess of the agent's commission, fee or other remuneration." This exclusion is identical to that of the Ohio CAT. In Ohio, the exclusion has been interpreted very much in line with traditional agency law.[42] This may mean that the exclusion is applied more liberally than by Washington under Rule 111. Oregon has adopted a temporary rule, Or. Admin. R. 150-317-1100, regarding the agency exclusion for the Oregon CAT, but interestingly, it is not modeled after the agency exclusion rule in Ohio. We expect continued controversy regarding passthrough payments in Washington, such as for the credit card processing industry, and probably similar issues in Ohio and Oregon.

The Washington B&O tax and the Oregon CAT have some similarities, but also a great many differences, and there are a few key areas where taxpayers will probably want to make important comparisons. ■

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[40] *Express Scripts Inc. v. Department of Revenue*, 437 P.3d 747 (Wash. Ct. App. 2019).

[41] *See, e.g.*, Rev. Rul. 80-99, 1980-1 C.B. 10; Rev. Rul. 79-142, 1979-1 C.B. 58; Rev. Rul. 77-280, 1977-2 C.B. 14.

[42] *Willoughby Hills Development and Distribution Inc. v. Testa*, 155 Ohio St. 3d 276, 120 N.E.3d 836 (2018).



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