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Washington Court of Appeals: Cash management account proceeds constitute gross income

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Authored by: Kathryn Thurber

Funds withdrawn from an affiliated group's cash management concentration account by one member to cover costs it incurred in providing administrative services to other members constitute gross income for Seattle business and occupation (B&O) tax purposes, even though the funds are recorded as an account payable and not gross income, the Washington Court of Appeal, Division One, ruled. [*Getty Images (Seattle) Inc. v. City of Seattle*, Wa. Ct. of App. No. 65113-7-I, September 12, 2011]

Background

Getty Images Seattle, Inc. ("Getty"), a Washington corporation located and registered to do business in Seattle, is the headquarters of Getty Images (Images), the parent of approximately 60 companies doing business around the world. As the headquarters corporation, Getty provides administrative and managerial services to its affiliates, including human resources, technology support, legal services, accounting, budgeting, payroll, and billing.

Prior to 2002, Getty provided services directly to its foreign affiliates without a written contract. However, in response to a foreign tax audit that prohibited the deduction of intercompany service charges absent a written agreement, Images required its affiliates to enter into formal written service agreements with Getty.



As part of the agreement, Getty in late 2001 incorporated a wholly-owned subsidiary, Getty Images (Management Company) LLC ("Management") under the laws of California. Management had no employees and no real property. Getty and Management entered into a "General and Administrative Services Agreement" ("GASA"), effective January 1, 2002, stating that Management "is engaged in the business of providing general and administrative services" to Getty affiliates. The GASA provided that Getty will perform all general and administrative services to Getty affiliates as an independent contractor of Management. In consideration of performing these services, Management paid Getty \$1 million per year. Getty recorded the \$1 million as income and paid B&O tax on that amount each year.

Management entered into agreements with the Getty affiliates to provide general and administrative services. While Getty provided the services agreed to under the contracts, determined the amount to charge for the services, and prepared invoices for the services that included its Seattle address, Management, and not Getty, recorded the payments as income.

To cover the costs of the general and administrative services provided under the agreement, which ranged from \$25 million to \$98 million annually, Getty withdrew funds from a cash management concentration account, established by Images to consolidate the funds of various affiliates. The withdrawals were recorded as an account payable owed to Management by Getty.

The city of Seattle audited tax years 2002 through 2006 and concluded that Getty's gross income included the amounts Management received from the Getty affiliates. An element of the City's assessment on the withdrawn funds was the determination that the annual fee of \$1 million is not an accurate, arms' length transaction between separate entities. Getty paid the assessment and filed an appeal with the City of Seattle Hearing Examiner, asserting that only the consideration of \$1 million per year as agreed to in the GASA was subject to Seattle B&O tax.

A hearing examiner upheld the additional assessment, finding that the amounts transferred to Getty from the cash management concentration account were "compensation for the rendition of services." Accordingly, the amounts constituted "gross income of the business" under Seattle Municipal Code Sec. 5.30.035(D).

The superior court affirmed the decision of the hearing examiner.

Broad definition of gross income

On appeal, Getty asserted that the funds transferred from the cash management account were not gross income of the business subject to the B&O tax. Instead, Getty contended that the funds were an account payable. The court noted that gross income for purposes of B&O tax is broadly defined and includes any consideration a person is entitled to receive or accrue or which is actually received or accrued. The court held that it is not bound by Getty's internal accounting practice of designating the income it received as an account payable on its books. In this case, Getty actually received funds from the cash management account to pay the cost of providing administrative services to its affiliates. Although this transaction was also presented to the court as a loan, no documents or promissory note existed, which obligated Getty Images to repay the funds.

Getty also argued that its consideration for rendering the general and administrative services is limited to the \$1 million fee agreed to in the GASA. Citing a recent decision by the Washington Supreme Court that rejected a similar attempt to rely on the terms of a contract to avoid B&O tax, *Ford Motor Co. v. City of Seattle*, Exec. Servs. Dep't, 160 Wn2d 32 at 43-44 (2007), the court held that regardless of the agreement in the GASA to only pay \$1 million for the rendering of general and administrative services, the funds actually "received to pay for the services is gross income under SMC 5.30.035(D)."

Finally, the court found that the expenses to provide the general and administrative services to Getty affiliates were "paid with the funds transferred from the cash management concentration account" to Getty's bank account. Accordingly, "the hearing examiner did not err in concluding "that the amounts charged to Getty affiliates were compensation for the rendition of services and constituted gross income of the business because the costs that Getty incurred to provide the general and administrative services equalled such amounts.

PwC Observes

"This case provides additional support for Seattle's policy to scrutinize and impute income on intercompany transactions despite the specific business structure, agreements, and fee arrangements legally in place," says Stephanie Anderson, State and Local Tax Director with PwC in Seattle. "In addition, the case highlights the discordant nature of the state and city B&O tax regimes and the resulting frustrations it causes taxpayers. Just as importantly, the case raises several questions as to what will happen at the state level, such as whether the court's interpretation of the meaning of 'gross income of the business' binds the state and the other cities in Washington and whether the other jurisdictions will impute income in similar circumstances."

Given the potential for the states and other cities to follow the court's reasoning, taxpayers are well advised to evaluate their intercompany pricing structures based on Getty, Anderson suggests.

"Getty has until October 22 to submit a petition for review with the Washington Supreme Court," Anderson says. "If the Supreme Court decides to review the case, it will likely hold oral arguments and issue a decision in 2012. We understand from Washington Department of Revenue representatives that the Department is interested in the final outcome of the case and will be monitoring the developments closely."

For more information, please do not hesitate to contact:

Stephanie Anderson (206) 398-3424 stephanie.d.anderson@us.pwc.com

Michael Kelley (206) 398-3503 michael.s.kelley@us.pwc.com

Nicole Bryant (206) 398-3435 nicole.l.bryant@us.pwc.com

Kate Thurber (202) 346-5122 kathryn.thurber@us.pwc.com

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