

# Washington State Issues Special Notice Interpreting the Applicable Nexus Standard, Apportionment, and Service B&O Tax on Director Fees

## Overview

The Washington Department of Revenue ("Department") recently published a *Special Notice, Director fees subject to Business and Occupation tax*, ("Special Notice") that reiterates the Department's interpretation of Washington law regarding the applicable nexus standard, apportionment, and types of director fee compensation that are subject to the Business and Occupation ("B&O") tax.<sup>1</sup>

This Tax Alert summarizes the Special Notice and provides some taxpayer considerations.

## Director Fees

Corporate directors who receive compensation (i.e., director fees) for serving as a member on the board of directors are subject to the B&O tax effective July 1, 2010.<sup>2</sup>

As provided in the Special Notice, all compensation received, in any form, for services rendered as a corporate director including, but not limited to, reimbursement of expenses, fees, value of stock options<sup>3</sup> or property received in exchange for services, awards, and bonuses are subject to the B&O tax. In addition, all amounts recovered for expenses incurred in connection with such services including, but not limited to, telephone costs, preparation fees for meetings, and travel expenses are also subject to B&O tax.<sup>4</sup>

In the case where a corporate director also has a role as an employee of the corporation, the compensation is bifurcated for B&O tax purposes. The compensation earned as an employee of the corporation is exempt from B&O tax.<sup>5</sup> Generally, director fees will be reported on IRS Form 1099-MISC, and the Department will accept the income listed on a Form 1099-MISC as the amount subject to tax.<sup>6</sup>

## Nexus

The Special Notice further notes that a corporate director is considered to have substantial nexus, triggering B&O tax reporting requirements, if the director is a resident of Washington, or a nonresident and in any tax year meets one of the following economic nexus thresholds:

- More than \$53,000 of payroll in Washington;
- More than \$53,000 of property in Washington;
- More than \$267,000 of gross receipts from Washington from retail sales, apportionable activities or wholesaling activities; or

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<sup>1</sup> See Washington State Department of Revenue Special Notice, "Director fees subject to Business and Occupation (B&O) tax," May 24, 2017 available [here](#).

<sup>2</sup> Wash. Rev. Code 82.04.290; Wash. Rev. Code 82.04.360.

<sup>3</sup> The Special Notice provides that compensatory stock options are included in taxable director fees to the extent that the amounts are required to be reported on IRS Form MISC, though it does not apply to compensatory stock options granted prior to July 1, 2010. Special Notice (May 24, 2017) at p. 1.

<sup>4</sup> *Id.*

<sup>5</sup> Wash. Rev. Code 82.04.360.

<sup>6</sup> Special Notice, (May 24, 2017) at p. 1.

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- At least 25 percent of total property, payroll, or receipts in/from Washington.<sup>7</sup>

### Apportioning Director Fees

As provided in the Special Notice, a corporate director may be eligible to report their taxable income for B&O tax purposes on an apportioned basis if they meet one of the following requirements:

- He or she is subject to a business activities tax on his or her director fees in another state; or
- Another state has jurisdiction to tax the corporate director's income under the same substantial nexus standards.<sup>8</sup>

Generally, the B&O tax would apply to apportioned director fee income from corporations headquartered in Washington, however, a liability could arise from a corporation headquartered out-of-state if:

- The director performs at least some of the activity of a corporate director for the out-of-state corporation within Washington; and
- Is not taxable on the director fees in the other state.<sup>9</sup>

### Registering and Reporting Tax

The Department does not require registration by corporate directors if all of the following apply:

- Gross income from all activities subject to B&O tax is less than \$12,000 per year;
- The director has no requirement to collect or pay to the department any other tax or fee administered by the department; and
- The director is not otherwise required to obtain a license or registration from another Washington agency.<sup>10</sup>

Amounts received as director fees must be reported on the Combined Excise Tax Returns under the service and other activities B&O tax classification. Taxpayers who are monthly filers may be eligible to claim a small business B&O tax credit of up to \$70 per month (\$840 for annual filers) against the amount of B&O tax due.<sup>11</sup>

Corporations may voluntarily participate and agree to report and pay taxes on behalf of their registered directors. However, the directors still remain responsible for the timely and accurate filing and payments of any tax due.

### Considerations

The Special Notice recently issued by the Washington Department of Revenue did not substantively change the interpretation of the current law regarding director fees. The Department issued a nearly identical notice in 2010.<sup>12</sup> The issuance of this recent notice may be an indication that the Department plans to more closely monitor and enforce compliance in this area.

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<sup>7</sup> Wash. Rev. Code 82.04.067(1)(c); Wash. Admin. Code 458-20-19401(3); see also Excise Tax Advisory 3195.2016. (The economic nexus thresholds are subject to change annually pursuant to the consumer price index).

<sup>8</sup> Wash. Admin. Code 458-20-19402(106)(h)(i).

<sup>9</sup> Special Notice, (May 24, 2017) at p. 2; see also WAC 458-20-19402(301).

<sup>10</sup> See Special Notice, May 24, 2017. Note that taxpayers that have established nexus and are required to register but do not exceed \$46,667 in service and other activity receipts may be eligible for active non-reporting status. Taxpayers that are assigned active non-reporting status will be considered to be actively doing business in Washington, but are not required to file tax returns. Wash. Admin. Code 458-20-101(3)(a).

<sup>11</sup> Wash. Admin. Code 458-20-104.

<sup>12</sup> Washington State Department of Revenue Special Notice, "Director Fees are Subject to the Business and Occupation (B&O) Tax," June 22, 2010 available [here](#).

## Contacts:

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