

WSGR ALERT

MAY 2010

WASHINGTON EXTENDS B&O TAX TO DIRECTORS OF WASHINGTON CORPORATIONS

In an effort to correct a prior “widespread misunderstanding” on the part of corporate directors, legislation recently was enacted to extend the Washington business and occupation (B&O) tax to directors of corporations based or headquartered in Washington State. The legislation, Second Engrossed Substitute Senate Bill 6143 (2ESSB 6143), signed by Governor Christine Gregoire into law on April 23, 2010, makes corporate directors subject to the B&O tax on the gross amount of compensation they receive in their capacity as directors effective July 1, 2010. The text of 2ESSB 6143 is available at <http://apps.leg.wa.gov/documents/billdocs/2009-10/Pdf/Bills/Session%20Law%202010/6143-S.SL.pdf>.

B&O Tax Background

With limited exception, the B&O tax applies to all persons engaging in business activities in Washington State. One such exception exists for gross receipts derived by a person in the capacity as an “employee” or “servant” as distinguished from an independent contractor. Many corporate directors have taken the position that the role they played for a corporation was of the nature of an employee or servant of the corporation and, thus, their compensation should be exempt from the B&O tax. The new law under 2ESSB 6143 explicitly corrects that misunderstanding.

Extension of B&O Tax to Corporate Directors

Beginning July 1, 2010, “amounts received by an individual from a corporation as compensation for serving as a member of that

corporation’s board of directors” are treated as amounts received by an independent contractor that is engaged in business in Washington and subject to the B&O tax under the Services and Other Activities B&O tax classification. In addition, 2ESSB 6143 also temporarily increases the B&O tax rate applicable to Services and Other Activities from 1.5 percent to 1.8 percent until June 30, 2013. The Services and Other Activities B&O tax rate will be applied against the gross amount of compensation received by a director from a corporation based or headquartered in Washington. To the extent that a director is also an employee of a Washington corporation, it appears that the B&O tax should apply solely to the compensation (if any) received in a director capacity (i.e., wages received in an employee capacity continue to be exempt from the B&O tax).

The Washington legislature also clarified that the new law does not apply retroactively. Presumably, this means that corporate directors who paid the B&O tax on compensation received in their capacity as directors before July 1, 2010, may not receive a refund of such B&O taxes. There are currently unanswered questions regarding the new law, including its specific application to out-of-state directors and its treatment of compensation received in the form of stock or stock options.

Implications for Nonresident Directors

2ESSB 6143 also clarifies certain nexus standards, which have implications for nonresident directors serving on the board of a corporation based or headquartered in

Washington. Under these standards, a nonresident director may be exempt from the B&O tax unless such director (i) owns more than \$50,000 of property, (ii) has more than \$50,000 of payroll, (iii) has more than \$250,000 of total gross receipts, or (iv) has 25 percent or more of his or her total property, total payroll, or total gross receipts, in each case, located or attributable to Washington.

Strict Liability for Corporate Officers

Also of interest to companies currently operating in Washington State, 2ESSB 6143 makes current or former corporate CEOs and CFOs strictly liable for collected but unpaid retail sales tax. Effective June 1, 2010, if the Washington State Department of Revenue (DOR) issues a warrant for collection of unpaid retail sales tax that has been collected and held in trust by a “limited liability business entity” (any business entity, such as a corporation or limited liability company, that shields its owners from personal liability for the entity’s debts) that is insolvent or terminated, dissolved, or abandoned, the CEO and CFO of such business entity may be personally liable for such taxes (including penalties and interest) regardless of fault or whether the CEO or CFO was or should have been aware of such unpaid tax.

Previously, only a “responsible individual” (generally, an officer, member, manager, or other individual having control or supervision of collection of retail sales tax) for a corporation or limited liability company was personally liable for unpaid retail sales tax and only if such individual “willfully” failed to

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pay or caused not to be paid any retail sales taxes due. Under the new law, responsible individuals who are not the CEO or CFO can be liable for the unpaid tax, and a current or former CEO or CFO is subject to the strict liability standard for unpaid retail sales tax liability (i) during the period that such individual served as CEO or CFO or (ii) during the period that such individual had the responsibility or duty to remit payment of retail sales tax (although not serving as CEO or CFO at such time). For purposes of the new law, a CEO includes the president of a company or, if a business entity does not have a president, the highest ranking executive manager or administrator, and a CFO includes the treasurer of a company or, if a business entity does not have a treasurer, the highest senior manager who is responsible for overseeing the financial activities of the entire company or organization.

The following links may be used to access the current announcements from the DOR regarding the changes to the B&O tax and the new tax legislation in general:

<http://dor.wa.gov/Content/FindALawOrRule/NewLegislation/Default.aspx>

<http://dor.wa.gov/Docs/Pubs/Misc/LegislativeTaxUpdate.pdf>

As of the writing of this update, the DOR has not provided substantive guidance regarding the extension of the B&O tax to Washington corporate directors, but we anticipate that such guidance will be forthcoming.

Please contact Andrew Bryant (abryant@wsgr.com or 206-883-2512) in Wilson Sonsini Goodrich & Rosati's tax practice with any questions. Individual directors are encouraged to consult their personal tax advisors for further guidance regarding the applicability of the B&O tax to them based on their individual circumstances.

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