



This Week in State Tax (TWIST)

April 17, 2023



WASHINGTON



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Washington State: Investment Funds Do Not Qualify for Investment Income Deduction

In a recent published opinion, a Washington State appellate court held that several investment fund LLCs did not qualify for a B&O deduction for investment income. Under RCW 82.04.4281(1)(a), a deduction is allowed in computing B&O liability for “amounts derived from investments.” The LLCs filed B&O refund claims on the basis that all of their income, which was agreed to be income from investments, qualified for the investment income deduction. The refunds were subsequently denied and the LLCs filed suit. After a trial court granted summary judgment in favor of the Department of Revenue, the LLCs appealed, arguing that under the plain language of the law they were entitled to the investment income deduction.

On appeal, the court observed that it was undisputed that 100 percent of the income of the taxpayers, which were investment funds, was investment income and that the plain language of the statute appeared to support their position. However, the Department’s position was that the deduction did not apply when the investment was not incidental to the main purpose of the taxpayer’s business or when the investment income was more than five percent of the taxpayer’s gross income. This position was based on a 1986 Washington State Supreme Court ruling, *O’Leary*, in which the court held that an investment must be incidental to the main purpose of the taxpayer’s business to qualify for the investment income deduction. The appeals court held that because the LLCs’ investments was their only business, they were not entitled to the investment income deduction under *O’Leary*. The court next rejected the taxpayer’s position that amendments to the law superseded the definition of “investment” in *O’Leary*. Notably, the court found that the amendments, in the form of findings of subsequent legislation, were intended to ensure that certain “other financial businesses” were not restricted from claiming the deduction, but they did not change the meaning of the term “investments” as interpreted by the *O’Leary* court in 1986. The LLCs also argued that the Department was bound by published guidance on its website that private investment funds (such as the LLCs) are entitled to the B&O deduction. In the court’s view, the guidance on the Department’s website did not control over the statutory language and a Supreme Court decision interpreting that language. Please contact [Michele Baisler](#) with questions on in *Antio, LLC v. Washington State Dep’t of Revenue*.



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