

# Excise Tax Advisory

Excise Tax Advisories are interpretive statements authorized by RCW 34.05.230.

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## **Real Estate Brokers -- Shared Commissions and Expenses**

This excise tax advisory explains how real estate commissions are taxable when shared between a broker and associates. This advisory also explains circumstances under which payments by an associate to a broker for use of space, telephone, office supplies, multiple listing service, advertising, and similar items are taxable.

Real estate brokerage offices are required to pay business and occupation (B&O) tax on the gross commission earned by the office, including that portion which will be paid to sales staff or associates in the same office. Where the brokerage office has paid the B&O tax on the gross commissions, the sales staff or associate brokers within the same office of the broker are not required to pay a B&O tax on the shared commissions. (See RCW 82.04.255.) The exclusion from the B&O tax for the sales staff or associate broker applies regardless of the accounting method used, method of payment, or percentage of commission received. For example, an associate broker is not subject to B&O tax on the commissions even if the associate broker is entitled to receive one hundred percent of the commission, provided the broker has paid B&O tax on the full commission.

It is not unusual for brokers to make a charge to sales staff or associate brokers for providing space and other facilities such as telephone, advertising, multiple listing service, and office supplies. These charges may be a fixed amount per month or may be computed as a percentage of commissions or a percentage of sales. Generally, brokers are subject to B&O tax on these charges, as well as on the gross commissions. The B&O tax applies to these charges even if the broker is simply attempting to recover the costs, without any markup, which are incurred by having the sales staff or associate broker within the office. The recovery of these costs does not qualify as a nontaxable reimbursement under WAC 458-20-111 because the broker is not acting as the agent of the associates or agents in incurring the costs, but has primary or secondary liability to pay the provider of the supplies or services.

In some cases, brokers may enter into commission sharing agreements with sales staff or associate brokers where it is agreed that the broker will be liable for all expenses. In these situations, the agreement may provide that the expenses will be subtracted from the gross commissions to arrive at the amount of commissions to be shared. These net commissions will then be shared based on predetermined or formula-derived percentages. If commissions are less than expenses, the associate broker or sales staff will not be entitled to any commissions, nor be liable for payment to the broker for any share of the expenses. If the

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agreement is of this type, the broker is not considered to have received income from the associates for payment of the expenses. (See Option 3 in particular.)

The following options show how the B&O tax would be applied in specific circumstances. These options should be used only as a general guide. The tax status of each situation must be determined after a review of all of the facts and circumstances.

Option 1: The Broker and Associate agree that commissions will be split 50/50 for any real estate sold by the Associate. It is also agreed that the Associate will pay the Broker a fixed charge of \$500 per month for use of a desk, office space, advertising, and other services furnished by the Broker. The agreement provides for the Broker to deduct the fixed charge from the commission which will be paid to the Associate each month. The Associate made a sale in the current month for which the brokerage office will receive a commission of \$1,200. The Associate is entitled to receive \$600 as a commission which will be reduced by the \$500 fixed fee for "office expenses." The Broker gives the Associate a check for \$100 and retains \$1,100.

The Broker is taxable on the gross commission of \$1,200 and on the \$500 fixed fee. The total of \$1,700 is taxable under the service B&O tax classification. The Associate is not subject to the B&O tax.

Option 2: The Broker and Associate agree that commissions will be split 50/50 for any real estate sold by the Associate. It is agreed that the Associate will pay the Broker for one half of the Associate's expenses incurred during the month. During the current month the Associate made sales which resulted in the office receiving \$6,000 of commissions. The Associate's actual expenses for the month were \$3,000 which included advertising, multiple listing charges, telephone, etc. The Broker paid the Associate \$3,000 in commissions. The Associate gave the Broker a check for \$1,500 to cover half of the expenses.

The Broker is taxable on the gross commissions of \$6,000 plus the \$1,500 payment from the Associate. The \$7,500 is taxable under the service B&O tax classification. The Associate is not subject to the B&O tax.

Option 3: The Broker and Associate agree that commissions will be split 50/50, but the split is to be made after deducting the Associate's expenses. The agreement also calls for the Associate to pay the broker \$200 per month as a "desk charge." This desk charge will be deducted by the Broker from the commissions to be paid the Associate. The desk charge is intended to pay the broker for providing space to the Associate.

During the current month the Associate generated gross commissions of \$7,000. The Associate's expenses for the month were \$3,000.

The Broker wrote a check to the Associate for \$1,800. This amount was calculated by first deducting the \$3,000 in expenses from the gross commissions to arrive at the commissions subject to the split. The amount subject to the split was \$4,000. The Associate was entitled to \$2,000 before deducting the \$200 desk charge.

The Broker is taxable on \$7,200. This includes the \$7,000 gross commission and \$200 desk charge. The Associate is not subject to B&O tax. Since the commission sharing agreement calls for the Associate to receive a commission after deducting actual expenses, there is no payment by the Associate for these expenses or any services provided by the Broker for which a charge is made, other than the desk charge.

Option 4: The Broker and Associate agree that the Broker alone will be liable for certain expenses involved in conducting the business, including but not limited to telephone, office supplies, multiple listing service, advertising, space and similar items. The Associate has no personal liability for these items. The written contract between the Broker and the Associate has substantially the following language:

Broker and Associate agree that Broker shall be solely responsible for the following expenses associated with doing business as a Real Estate Agency, including expenses for that portion of Broker's business in which Associate is active. Such items include but are not limited to telephone, including long distance utilized by Associate, office supplies, multiple listing service fees incurred by Associate and Broker, advertising costs for real estate sales opportunities in which Associate is active, space, utilities and general overhead (the "Expenses"). Associate shall have no financial responsibility or liability to third parties or to Broker for such Expenses.

The written contract also calls for commissions to be split between the Broker and Associate according to the following formula:

Broker's share:  $B = C(X+E/C)$  OR,  $B = (C \text{ times } X) + E$

Associate's Share:  $A = C-B$

Where: C= Gross Commission  
X= Base % of Commission to Broker  
E= Total Expense of Broker per contract  
B= Commission to be retained by Broker  
A= Commission to be paid to Associate

Example A: The office received gross commission of \$10,500 attributable to activities of the Associate. The expenses accrued at that point attributed to the Associate were \$600. The written contract between the Broker and Associate states that the base commission will be reduced by expenses with the remainder to be split as indicated through the formula above with the Broker retaining 40 percent and the Associate receiving 60 percent. It is agreed that figures will be rounded to the nearest dollar. The Broker will write a check to the Associate for \$5,700. This amount is calculated by determining the expenses expressed as a percentage of the total commissions or 5.7 percent in this case. That percentage is then added to the base percentage of the commission to be retained by the Broker, for a total of 45.7 percent in this example. The 45.7 percent is then multiplied by the gross commission of \$10,500 to reach \$4,800 to be retained by the Broker. This amount is then deducted from the gross commission which results in \$5,700 as the amount paid to the Associate.

The Broker is taxable on \$10,500, which includes only the \$10,500 gross commission. The Associate is not subject to B&O tax. Since the commission sharing agreement calls for the Broker to be responsible for and pay all expenses included in the written contract, there is no payment by the Associate for these expenses or any services provided by the Broker for which a charge is made and therefore no B&O liability at Broker level for these items.

Example B: Assume the same written contract language exists and the same formula applies to the following facts, but with a different gross commission. The gross commission is \$900. The expenses were \$600. In applying the formula, the Broker is entitled to retain \$960 and the Associate is entitled to receive no commission. The Expenses expressed as a percentage of the gross commissions is 67 percent. Under the formula and written contract, the Broker is entitled to 40 percent plus 67 percent for a total of 107 percent of the gross commission, or \$960 when expressed in dollars. However, since the gross commission is only \$900 and the Broker receives no additional payment from the Associate, the Broker is taxable on \$900. The Associate has no tax liability.

If under the terms of the written contract the Associate is required to pay the Broker the additional \$60, the Broker would then be taxable on \$960. Also, if the written contract calls for the \$60 to be deducted at any point from commissions payable to the Associate by the Broker, such amounts will be taxable to the Broker.

If a Broker who has elected Option 4 is found not to be in compliance at any time with the terms of its contract with an Associate, then this Option 4 shall not be considered by the Department to be applicable to the relationship between the Broker and Associate and Option 3 will be deemed to control the taxability of the expenses.

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