Cite as Det. No. 17-0305, 37 WTD 197 (2018)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of Assessment of	)	D E T E R M I N A T I O N
	)	No. 17-0305
. . .	)	Registration No. . . .

WAC 458-20-111; RCW 82.04.080: GROSS INCOME – ADVANCEMENTS OR REIMBURSEMENTS – SHARED EXPENSES. A taxpayer is not acting as an agent of its tenant when it pays insurance or utilities in its name for building space shared with the tenant. Unless the taxpayer is an agent of its tenant, those payments do not qualify for exclusion under WAC 458-20-111.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

Simons, T.R.O. – A Washington dentist petitions for the correction of an assessment of service and other activities business and occupation ("B&O") tax on payments received for a tenant's portion of shared building insurance and building utilities . . . . Taxpayer's petition is denied.[1]

ISSUE

Whether payments from a tenant for building insurance, building utilities, and shared supplies, constitute advances or reimbursements under WAC 458-20-111 that are excluded from the gross income of the business.

. . .

FINDINGS OF FACT

. . . ("Taxpayer") operated a dental practice in . . . Washington.[2] Taxpayer owns the building where his dental practice is located. During the period at issue, and the preceding two decades, Taxpayer's dental practice occupied half of the building space and he rented the remaining half to his friend and fellow dentist, . . . ("Tenant"). Taxpayer and Tenant operated separate dental practices, in separate dental practice areas, but shared a common reception area.

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.
[2] Taxpayer has since closed his practice.

Taxpayer and Tenant's rental arrangement was entirely verbal and the two never executed a written lease agreement. Taxpayer and Tenant shared the costs of building insurance, building utilities . . . . However, to accommodate parties unwilling to accept more than one check for payment, Taxpayer would pay the entire costs of building insurance, building utilities, and the postage machine, and then Tenant would pay Taxpayer for his half of such expenses.

. . . On May 23, 2016, the Department . . . ruled that Taxpayer should report the payments it received from Tenant for building insurance [and] building utilities . . . under the service and other activities classification of the B&O tax. . . .

Taxpayer petitioned for review of the May 23, 2016, ruling. On December 6, 2016, while awaiting review of the May 23, 2016, ruling, the Department issued a $ . . . assessment against Taxpayer. This assessment is comprised of the $ . . . in service and other activities B&O tax and $ . . . . On December 15, 2016, Taxpayer withdrew its petition for review of the May 23, 2016, ruling and petitioned for review of the assessment.

ANALYSIS

Washington imposes the B&O tax on every person for the act or privilege of engaging in business activities in Washington. RCW 82.04.220. "[T]he legislative purpose behind the B&O tax scheme is to tax virtually all business activity in the state." *Impecoven v. Dep't of Revenue*, 120 Wn.2d 357, 841 P.2d 752 (1992). The tax is measured by applying particular rates against the value of products, gross proceeds of sale, or gross income of the business, as the case may be. RCW 82.04.220.

RCW 82.04.290(2) provides a "catch-all" B&O tax classification for taxpayers engaged in business activities not explicitly taxed elsewhere in Chapter 82.04 RCW. RCW 82.04.290(2). The statute provides:

> Upon every person engaging within this state in any business activity other than or in addition to an activity taxed explicitly under another section in this chapter or subsection (1) or (3) of this section; as to such persons the amount of tax on account of such activities shall be equal to the gross income of the business multiplied by the rate of 1.5 percent.

The service and other activities B&O tax is calculated based on the "gross income of the business." RCW 82.04.290. "Gross income of the business" is broadly defined and means:

> [T]he value proceeding or accruing by reason of the transaction of the business engaged in and includes gross proceeds of sales, compensation for the rendition of services, gains realized from trading in stocks, bonds, or other evidences of indebtedness, interest, discount, rents, royalties, fees, commissions, dividends, and other emoluments however designated, all without any deduction on account of the cost of tangible property sold, the cost of materials used, labor costs, interest, discount, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.

RCW 82.04.080 (emphasis added). The phrase "value proceeding or accruing" is defined as "the consideration, whether money, credits, rights, or other property expressed in terms of money, actually received or accrued." RCW 82.04.090. "Business" includes "all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or to another person or class, directly or indirectly." RCW 82.04.140. Under these broad definitions, a service provider may not deduct any of its costs of doing business from its gross income. *See Pilcher v. Dep't of Revenue*, 112 Wn. App. 428, 49 P.3d 947 (2002) (citing *Rho Co. Inc. v. Dep't of Revenue*, 113 Wn.2d 561, 570, *782 P.2d 986 (1989)*). Thus, unless a specific exemption, deduction, or exclusion applies, a taxpayer's gross income is subject to B&O tax without any deduction for overhead or other expenses. Here, Taxpayer provided insurance [and] utilities . . . to his Tenant, and, in exchange for these items, he received the payments at issue. These payments constitute a "value proceeding or accruing" under RCW 82.04.090, by reason of the transactions of Taxpayer's business of providing insurance [and] utilities, . . . as such, they are included in Taxpayer's gross income of the business under RCW 82.04.080, without deduction for Taxpayer's cost of acquiring these items. *Id*.

However, Taxpayer asserts that such payments are excluded from the gross income of the business because they are reimbursements under WAC 458-20-111 [(Rule 111)]. . . . . .

1. Reimbursements

. . . Rule 111 is the Department's administrative rule that sets forth criteria for excludable advances and reimbursements. [The rule recognizes that certain payments are mere reimbursements for expenses advanced by an agent for a client and thus are not the gross income of the business.] Rule 111 provides, in relevant part:

> The words "advance" and "reimbursement" apply only when the customer or client alone is liable for the payment of the fees or costs and when the taxpayer making the payment has no personal liability therefore, either primarily or secondarily, other than as agent for the customer or client.
>
> * * *
>
> The foregoing is limited to cases wherein the taxpayer, as an incident to the business, undertakes, on behalf of the customer, guest or client, the payment of money, either upon an obligation owing by the customer, guest or client to a third person, or in procuring a service for the customer, guest or client which the taxpayer does not or cannot render and for which no liability attaches to the taxpayer. It does not apply to cases where the customer, guest or client makes advances to the taxpayer upon services to be rendered by the taxpayer or upon goods to be purchased by the taxpayer in carrying on the business in which the taxpayer engages.

(Emphasis added.)

Rule 111 requires the existence of an agency relationship between the client and the taxpayer. *See Washington Imaging Services, LLC v. Dep't of Revenue,* 171 Wn.2d 548, 562, 252 P.2d 885 (2011) and 33 WTD 160 (2014). Agency requires a factual determination that both parties consented to the agency relationship and that the principal exercised control over the agent. *Id.; see also Nordstrom Credit, Inc. v. Dep't of Revenue,* 120 Wn.2d 935, 941, 835 P.2d 1331 (1993); Det. No.

05-0206E, 25 WTD 72 (2006); Det. No. 03-0128, 24 WTD 168 (2005); Restatement (Third) of Agency § 1.01 (2006). Once this element is satisfied, it must be determined if the taxpayer's liability is "solely agent liability." *City of Tacoma v. Wm. Rogers Co.*, 148 Wn.2d 169, 178, 60 P.3d 79, 83 (2002). The court in that case determined that if a taxpayer is at all liable outside of its role as an agent, the payments may not be excluded. *Id.*

In this case, Taxpayer purchased building insurance [and] utilities . . . , solely in his name, and Tenant paid Taxpayer for these items. Rule 111 requires that, in order for a payment to qualify as a reimbursement, the client (Tenant), alone, must be liable for the payment of the fee or cost and the taxpayer (Taxpayer) must have no personal liability for the fee or cost. Taxpayer has not presented any evidence that shows or suggests that Tenant had any liability for payment of building insurance [and] utilities . . . . The evidence shows the opposite: Taxpayer had personal liability for the payment of building insurance or utilities. Thus, the payments for building insurance [and] utilities . . . , fail to qualify as reimbursements under WAC 458-20-111.

. . .

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 15th day of December 2017.