Cite as Det. No. 19-0072, 42 WTD 058 (2023)

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. 19-0072
. . .	)	. . .

[1] RCW 82.04.480; WAC 458-20-159: B&O TAX – CONSIGNMENT – ACTING MERELY AS AN AGENT. The Department will recognize a taxpayer's claim to be acting merely as agent in making purchases for a buyer only when the contract or agreement between such persons clearly establishes the relationship of principal and agent. Taxpayer, a purchasing cooperative making purchases for its members, who are independent retail dealers, failed to meet it burden to establish facts showing there was an agreement between the parties that clearly establishes the relationship of principal and agent.

[2] RCW 82.04.070; RCW 82.04.090; WAC 458-20-202: GROSS PROCEEDS OF SALES – VALUE PRCEEDING OR ACCRUING – POOL PURCHASES -- PURCHASERS IN INDEPENDENT BUSINESS ACTIVITIES -- WHOLESALERS -- RETAILERS. WAC 458-20-202 (Rule 202) contemplates that a pool purchase will be made by two or more persons engaging in independent business activities at the same level; e.g., retailers. Rule 202 was not intended to allow a taxpayer that engages in business essentially as a wholesaler to avoid the wholesaling B & O tax.

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.

Davis, T.R.O. – An out-of-state corporation engaged in the buying and selling of . . . [tangible personal property] (Taxpayer) contests the imposition of wholesaling business & occupation (B&O) tax on certain amounts it processed on behalf of others. Taxpayer asserts that in certain transactions it acted as purchasing agent for third-party sales between outside manufacturers and member purchasers. Taxpayer argues that, as a matter of law, it was neither a purchaser nor reseller in those transactions, that it was therefore not engaging in wholesaling, and it should be charged service and other activities B&O tax on the fees charged for its purchase agent service, not wholesaling B&O tax on the sale price. We deny Taxpayer's petition.[1]

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

ISSUES

1. Under RCW 82.04.480 and WAC 458-20-159 (Rule 159), is a purchasing cooperative entitled to exclude amounts received from member purchasers for certain transactions from its gross income?

2. Under WAC 458-20-202 (Rule 202), does any portion of Taxpayer's gross income from certain sales qualify for the pool purchase deduction?

FINDINGS OF FACT

. . . (Taxpayer) is an out-of-state . . . [tangible personal property] buying cooperative owned by its members, who are independent . . . [tangible personal property] dealers. Taxpayer is organized and operated as a purchasing cooperative. Taxpayer's business activities in Washington State during the relevant period included buying and selling [tangible personal property. Some] of Taxpayer's members are in Washington. . . .

Taxpayer uses the combined buying power of its member companies to negotiate volume discounts with various vendors. Taxpayer charges a commission in addition to the cost of the goods purchased of between . . . % and . . . %, which is used to cover Taxpayer's operating expenses. Any profits at the end of the year are then disbursed back to the member companies as dividends.

Taxpayer has explained that it engages in two general types of purchase transactions, "reload sales" and "agency sales." In a reload sale, Taxpayer may find a favorable price on a shipment of merchandise that can be resold quickly. Taxpayer purchases the merchandise in its own name, temporarily stores it in a public warehouse, then either ships it to a buying member's location or the member picks it up at the warehouse. In an agency sale, Taxpayer asserts that it acts solely at the direction and on behalf of its members [by] arranging and paying for a purchase from a vendor in its entirety (from initial negotiation through payment and delivery) . . . . Taxpayer receives an invoice for payment from the vendor, pays the vendor, and then bills the member for the purchase price plus Taxpayer's commission or fee. Agency sales make up the overwhelming majority of Taxpayer transactions in Washington.

In . . . agency sales, Taxpayer negotiates a basic sale price with a vendor, then takes orders from members and purchases the ordered amounts from the vendor. Taxpayer arranges for the purchased merchandise to be drop shipped directly from the vendor to the members. Taxpayer has acknowledged in its discussions with Compliance and in its post-hearing supplemental memorandum that Taxpayer is identified as the buyer on vendor invoices issued for these purchases.

. . .

In 2017, the Compliance Division (Compliance) of the Department of Revenue became aware of Taxpayer's unregistered business activities in Washington and began an examination into Taxpayer's activities for the period from January 1, 2010, through March 31, 2017 (assessment period), to determine Taxpayer's Washington excise tax liability, if any. As a result of its contacts

with Compliance, Taxpayer was registered with the Department and began filing quarterly excise tax returns. Its first return, filed in 2017, covered Quarter 4, 2016.

During its examination, Compliance requested a schedule of Washington sales, gross revenue, or both for the assessment period. In response to Compliance requests, Taxpayer provided a completed Washington Business Activities Questionnaire signed by its Director of Finance, a list of gross sales titled as "reload sales" and "agency sales" in a letter dated April 4, 2017, and an amended list of combined gross sales in an email dated August 23, 2017. Taxpayer also provided Quarter 4, 2016 and Quarter 1, 2017 Washington excise tax returns filed by Taxpayer after registering with the Department. The investigation did not include a detailed review of Taxpayer's accounting records.

During its examination, the Department determined Taxpayer's gross income included amounts received from both reload sales and agency sales, and that both activities were wholesale sales as defined by RCW 82.04.060. Compliance also noted that Taxpayer's two quarterly returns had reported income under both the wholesaling and service and other activities B&O tax classifications. In these returns, Taxpayer described income derived from a percentage-based markup over the cost of the goods sold, which Taxpayer charged its members, as "commission income," and listed this under the service and other activities B&O tax classification. Compliance gave Taxpayer credit for the wholesaling B&O tax Taxpayer paid with its two filed returns and reclassified Taxpayer's claimed service and other activities B&O tax income to wholesaling B&O tax income. Compliance then estimated Taxpayer's gross wholesaling B&O tax income for the reclassified service and other activities B&O tax income using the reported commission amounts and the average markup rate for 2016 . . ., which was included in financial information previously provided by Taxpayer in its April 4, 2017, letter.

As a result of the Compliance examination, on October 11, 2017, the Department issued an assessment against Taxpayer, asserting wholesaling B&O tax on Taxpayer's unreported sales of . . . [tangible personal property] to Washington retailers for resale.

After the Department issued its initial assessment, Taxpayer provided more complete and accurate sales records, and Compliance agreed to re-examine Taxpayer's assessment using Taxpayer's previously provided Questionnaire and an amended list of Taxpayer's gross sales during the assessment period.

On February 6, 2018, the Department issued two amended assessments against Taxpayer for the period from January 1, 2010, through March 31, 2017 (assessment period).[2] The total amended amount assessed was $. . . , including taxes of $. . . , interest of $. . . , and penalties of $. . . . Taxpayer timely petitioned for review, seeking adjustment of the amended assessments.
Taxpayer does not dispute that it had substantial nexus with Washington during the assessment period and does not contest the Department's assessment of wholesaling B&O tax on "reload sales" in which it purchases and later resells goods to its members. Taxpayer also does not object to the imposition of penalties and interest due.

[2] . . .

However, Taxpayer argues that it is not properly subject to wholesaling B&O tax on "agency sales" made by third-party vendors to its members because Taxpayer is not selling the goods. Instead, Taxpayer asserts that it is a purchasing agent under RCW 82.04.480 and WAC 458-20-159 (Rule 159) and its agency sales should be excluded from gross income. Taxpayer also argues in the alternative that if Taxpayer's agency sales are found to be included in its gross income, Taxpayer is entitled to the deduction for pool purchases under WAC 458-20-202 (Rule 202).

ANALYSIS

Washington imposes B&O tax on all businesses "for the act or privilege of engaging in business" in the state. RCW 82.04.220(1). Wholesaling is defined by RCW 82.04.060 to [include] any sale of tangible personal property to persons who are not consumers; that is, sales for resale. [*See also* RCW 82.04.050(1)(a) ("retail sale" of tangible personal property); RCW 82.04.190(1)(a) ("consumer" defined).] . . . In general, all sales of goods or services to persons in Washington are subject to the B&O tax.

Businesses engaged in making "sales at wholesale" within Washington generally owe wholesaling B&O tax equal to the gross proceeds of sales of the business, multiplied by the applicable tax rate. RCW 82.04.270. "Gross proceeds of sales" is defined in RCW 82.04.070 as follows:

> [T]he value proceeding or accruing from the sale of tangible personal property, . . . and/or for other services rendered, without any deduction on account of the cost of property sold, the cost of materials used, labor costs, interest, discount paid, delivery costs, taxes, or any other expense whatsoever paid or accrued . . . .

RCW 82.04.090, in turn, defines "value proceeding or accruing" as "the consideration, whether money, credits, rights, or other property expressed in terms of money, actually received or accrued." (Emphasis added.) Thus, generally, a taxpayer is liable for wholesaling B&O tax on the consideration or full selling price of the property sold, unless some specific deduction or exemption applies. The taxpayer has the burden of showing qualification for any tax deduction, exemption, or credit. *Budget Rent-A-Car of Wash.-Oregon, Inc. v. Dep't of Revenue*, 81 Wn.2d 171, 174-175, 500 P.2d 764 (1972); *Group Health Co-Op v. Tax Comm'n*, 72 Wn.2d 422, 429, 433 P.2d 201 (1967).

Agency Sales under Rule 159

In this case, Taxpayer argues that it is taxable as an agent under RCW 82.04.480 and Rule 159. Under both RCW 82.04.480 and Rule 159, the gross income of agents that make retail or wholesale sales [or purchases] in the name of the actual owner, or principal, is considered the amount derived from making such sales [or purchases], which is generally a commission. [*See* Det. No. 16-0243, 36 WTD 467, 478 (2017); Det. No. 13-0338, 33 WTD 166 (2014)].

RCW 82.04.480(2) places the burden on taxpayers claiming to be acting as an agent for tax purposes and states:

> The burden is on the taxpayer in every case to establish the fact that the taxpayer is not engaged in the business of making retail sales or wholesale sales but is acting merely as broker or agent in promoting sales for a principal. Such claim will be allowed only when the taxpayer's accounting records are kept in such manner as required by rule by the department.

Rule 159, the rule the Department adopted implementing RCW 82.04.480, [explains when the Department will recognize a claim that someone is acting merely as an agent in making purchases or sales of tangible personal property for another. Rule 159] provides the following conditions regarding the burden placed on persons claiming to be acting as agents for tax purposes:

> Any person who claims to be acting merely as agent or broker in promoting sales for a principal or in making purchases for a buyer, will have such claim recognized only when the contract or agreement between such persons clearly establishes the relationship of principal and agent and when the following conditions are complied with:
>
> (1) The books and records of the broker or agent show the transactions were made in the name and for the account of the principal, and show the name of the actual owner of the property for whom the sale was made, or the actual buyer for whom the purchase was made.
>
> (2) The books and records show the amount of gross sales, the amount of commissions and any other incidental income derived by the broker or agent from such sales.

(Emphasis added.) The Department has consistently held that for Rule 159 to apply, all elements of the rule must be met.[3]

A principal-agent relationship "results from the manifestation of consent by one person that another shall act on his behalf and subject to his control, with a correlative manifestation of consent by the other party to act on his behalf and subject to his control." *Moss v. Vadman*, 77 Wn.2d 396, 402-3, 463 P.2d 159 (1969). Consent and control are the essential elements of agency. *Id.*; *see also Washington Imaging Services, LLC. v. Dep't of Revenue,* 171 Wn.2d 548, 562, 252 P.3d 885 (2011). The relationship is created by law, but if no facts exist to satisfy both elements of control and consent, "then no agency exists despite the intent of either or both of the parties." *Moss*, 77 Wn.2d at 403 (emphasis added).

In this case, the threshold requirement of Rule 159—a precondition for the application of the two enumerated conditions—has not been met. There must be a contract or agreement between the purchasing agent and the buyer or principal clearly establishing the relationship. In discussions with Compliance during examination, and in its pre-hearing supplemental memorandum, Taxpayer conceded that no written agreement exists between Taxpayer and its members regarding the relationship of the parties in sales and purchase activity. [Taxpayer also failed to provide any other evidence that clearly established the relationship of principal and agent.] Because this element is

[3] . . .

not satisfied, Rule 159 cannot apply.[4] It is not necessary to examine the remaining elements. As a result, based on the information currently in the record, the Department lacks authority to exclude any of Taxpayer's agency sales from Taxpayer's gross income.

Pool Purchasing Deduction

We next turn to the pool purchasing deduction. Taxpayer argues, in the alternative, that if the Department determines that amounts Taxpayer received from agency sales should be included in its gross income, the amounts should be deductible because the sales were pool purchases by Taxpayer and its members under WAC 458-20-202 (Rule 202).

In general, "[t]axation is the rule and exemption is the exception." *Budget Rent-A-Car*, 81 Wn.2d at 174; *Spokane County v. City of Spokane*, 169 Wash. 355, 13 P.2d 1084 (1932). Exemptions . . . must be [strictly construed in favor of the application of the tax and against the person claiming the exemption. *In re All-State Construction Co., Inc.*, 70 Wn.2d 657, 665, 425 P.2d 16, 20 (1967). Exemptions, in case of doubt or ambiguity, must be construed strictly, though fairly and in keeping with the ordinary meaning of their language, against the taxpayer." *Group Health Coop.*, 72 Wn.2d at 429.]

. . .

There are a number of statutory [exclusions], exemptions, and deductions set out in chapter 82.04 RCW. [The Department's rules also recognize some circumstances where amounts received fail to fall within one of the measures of a tax.] One of these is the deduction for pool purchases under Rule 202, the Department's administrative rule on pool purchases. Rule 202 says, in full:

> The term "pool purchase" means the joint purchase by two or more persons, engaging in independent business activities, of commodities in carload or truck load quantities for the purpose of obtaining a purchase price or freight rate which is less than when purchased or delivered in smaller quantities.
>
> The term "principal member" means that member of the pool to whom the goods are charged by the vendor of the commodities purchased.
>
> In computing tax liability of the principal member under chapter 82.04 RCW, there may be deducted from gross proceeds of sales the amount received by him from other members of the pool of their proportionate share of the cost thereof of the commodities purchased.
>
> This deduction is allowed only when all of the following conditions are met:
>
> (1) The amount received is included in gross proceeds of sales.
>
> (2) The pool purchase agreement was entered into prior to the time of placing the order for the commodities purchased.

[4] . . .

> (3) The pool purchase agreement provides that each member shall accept a specific portion of the shipment.
>
> (4) Division of the shipment is made prior to warehousing of the commodities by a member of the pool.
>
> In no event will a "pool purchase" deduction be allowed when an agreement relative to the amount of the share to be distributed to any member is made after the date of the purchase order, or where one member of a pool pays an amount for his portion in excess of the proportionate amount paid by another member.

[In these circumstances, the amounts received for proportionate shares of members in the pool purchase do not represent "value proceeding or accruing" because the principal member does not receive "consideration" for the goods purchased. *See* RCW 82.04.090. Rather, the receipts from other pool members are more like a reimbursement to another for making a purchase on the group member's behalf.]

We have addressed pool purchases before, most recently in Det. No. 92-237R, 13 WTD 126 (1993). In that case, as here, the taxpayer was a cooperative that acquired products for its members, who then sold the goods at retail. We identified "a basic problem with the taxpayer's arguments because Rule 202 contemplates that a pool purchase will be made by two or more persons doing substantially the same type of business; i.e., two or more retailers. . . . [T]he members make retail sales to the public, but the principal member does not." 13 WTD 126, 134. As in the fact scenario addressed in 13 WTD 126, the Taxpayer here is not in the same type of business as its members. *See* Det. No. 88-219, 6 WTD 19 (1988) (holding that in order to gain the pool purchase deduction, there must be an agreement, there must be a joint purchase, and the principal member must retain some of the goods for its own inventory). *See also* Det. No. 86-282, 1 WTD 303 (1986) (upholding the pool purchase deduction where Taxpayer and one other similar business made joint purchases, Taxpayer retained its share of goods, and Taxpayer billed the other business for its proportionate share, per an agreement entered into prior to the order).

For Taxpayer's agency sales here, the requirements of the rule have not been met. The taxpayer was not participating in a joint purchase. Rather, it bought all goods for resale to the putative pool members. As we have previously held, the plain language of Condition number 3 in Rule 202 contemplates that the principal member retains some of the commodities for its own inventory. That was not the case here, as Taxpayer does not retain a proportional share of goods for its own business purposes. In Taxpayer's agency sales, Taxpayer does not pay for the purchase of any products except the quantities ordered by its members—it is not purchasing any products for itself, and does not share the costs of the purchase, billing members for the entire cost of goods. There is no evidence in the record supporting the position that the commission or fee Taxpayer adds to its invoice to members has any relationship to [proportionate share of] the "cost of the goods being purchased" under the rule.

As we did in 13 WTD 126, we hold here that Rule 202 was not intended to allow taxpayers to avoid wholesaling B&O tax imposed by RCW 82.04.270. Taxpayer has been formed as a separate

entity to fulfill what is essentially a wholesaling function. Its business activities are more like that of a wholesaler in that it acquires goods from suppliers on behalf of, and for resale to, retailer members, even though the taxpayer's cooperative structure is probably not representative of most wholesale-retail relationships. Accordingly, we find Taxpayer was not a pool purchaser and is thus ineligible for the Rule 202 deduction.

Conclusion

Here, Taxpayer, an independent business entity, is engaged in the purchase of goods from vendors on behalf of Taxpayer's members. Taxpayer asks us to determine that it is engaged in providing services to its members as a purchasing agent, and thus the amounts it receives from its members for these purchases should be excluded from its gross income, and only commissions charged to its members on the purchases should be included.

However, based on the information currently in the record, Taxpayer's activities fail to satisfy the threshold . . . element of Rule 159. . . . [Taxpayer cannot properly be classified as an agent for Rule 159 purposes without a written contract or other evidence that clearly establish an agency relationship]. . . . In all cases for which records exist, vendors bill and receive payment solely from Taxpayer, not from members who ultimately receive shipment of the purchased goods. Taxpayer then bills members for the purchase price with an amount added as commission. We therefore find that amounts Taxpayer received from its members for purchases were properly included by Compliance in Taxpayer's gross income.

Finally, Taxpayer seeks the deduction for pool purchases under Rule 202. However, again, Taxpayer's activity does not meet the requirements of the rule. There is no joint purchase, Taxpayer is not acting at the same level as its members in the transaction, and Taxpayer does not retain any of the purchased product. The information available in the record fails to meet Taxpayer's burden of demonstrating that Taxpayer's activities qualify as pool purchases under the rule. As a result, we lack authority under the strictly applied exclusion rules to apply the pool purchase deduction against Taxpayer's gross income.

We therefore affirm the assessment and deny Taxpayer's petition.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 7th day of March 2019.