

Cite as Det. No. 16-0399, 36 WTD 412 (2017)

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

In the Matter of the Petition for Correction of)	<u>D E T E R M I N A T I O N</u>
Assessment of)	
)	No. 16-0399
)	
...)	Registration No. . . .
)	

[1] RULE 159; RCW 82.04.480: B&O TAX – CLASSIFICATION – SALES MADE BY AN AGENT. When a seller allows a third party to sell the seller’s property to a consumer, the third party will be deemed the purchaser of the property from the seller, and the third party will be treated as the reseller of the property to the consumer unless the seller or third party clearly establish that the third party was acting as the seller’s agent.

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.

Yonker, T.R.O. – A taxpayer objects to the reclassification of its income from the retailing business and occupation (B&O) tax classification to the wholesaling B&O tax classification. If the reclassification stands, the Taxpayer also objects to the measure of the tax being the income it received from the retail price of the goods.¹

ISSUE

Under RCW 82.04.480 and WAC 458-20-159, is Taxpayer subject to wholesaling B&O tax on sales of its goods, where such sales were completed by a third-party retailer pursuant to a licensing agreement?

FINDINGS OF FACT

. . . (Taxpayer) is in the business of selling footwear and associated accessories at its retail locations throughout the United States. On July 23, 1999, Taxpayer and . . . (Retailer); together with Retailer’s parents, subsidiaries, and affiliates; executed a License Agreement (Agreement) allowing Taxpayer to occupy designated spaces within Retailer’s stores.² Relevant terms of that Agreement are as follows:

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

² In addition to its arrangement with Taxpayers, [Retailer] operates stand-alone retail stores, where it sells its own merchandise.

- Retailer agrees to grant Taxpayer “the license and privilege to use” licensed space within Retailer’s stores. (Section 2.2.)
- The “licensed space” at each store consists of a “selling area” and a “storage area.” (Section 2.1.4.)
- The “selling area” means “the . . . department . . . within each [of Retailer’s stores] which shall be used by [Taxpayer]” for certain “permitted uses.” (Section 2.1.2.)
- The “storage area” means the area within the stock rooms of each of Retailer’s stores where Taxpayer’s “goods shall be stored, including the area used for processing deliveries.” (Section 2.1.3.)
- The “permitted uses” of the selling area are defined as Taxpayer’s “sole and exclusive right to display and sell” certain types of footwear and the “non-exclusive right to sell” other merchandise. (Section 4.1.)
- Taxpayer agrees to pay Retailer an “annual license charge” equal to 13.5 percent of Taxpayer’s “net sales” of its merchandise sold in Retailer’s stores. (Section 5.2.1.) This annual license charge was the only form of payment that Taxpayer paid to Retailer for all of the benefits Taxpayer received under the Agreement.
- Taxpayer “shall, in its own name and at its own expense employ and staff” the licensed space. (Section 10.2.)
- The proceeds of sales of Taxpayer’s merchandise in Retailer’s stores shall “be paid by customers directly to [Retailer’s] cashiers, and deposited by [Retailer] to [its] own account[s].” (Section 5.4.) Further, all sales of Taxpayer’s merchandise “shall be accounted for separately on [Retailer’s] cash register or scanning system.” (Section 5.8.)
- Retailer agrees to provide “security” for the licensed space, make their “loss prevention personnel reasonably available” to Taxpayer, and make “reasonable efforts” to work with Taxpayer to control “shrink” of Taxpayer’s merchandise in Retailer’s stores. (Section 5.10.)
- All of Taxpayer’s merchandise located at Retailer’s stores “shall be at the sole risk and hazard of [Taxpayer].” (Section 13.3.) Further, “[t]itle to all of [Taxpayer’s] property shall remain with [Taxpayer] and shall not be subject to any liability of [Retailer].” (Section 23.1.)
- Taxpayer “is and shall be an independent contractor,” and the relationship between Taxpayer and Retailer is specifically “not one of joint venture, partnership, agency, employment, or landlord and tenant and nothing herein contained shall be construed as to create any such relationship between the parties.” (Section 23.1.) Further, nothing in the Agreement “shall permit either party to obligate the other party in any way.” *Id.*
- [After the sales were completed, Retailer remitted the proceeds to Taxpayer, less a percentage of the sale amount that Retailer kept pursuant to the Agreement.]

Based on the photographs in the record, Taxpayer is identified in Retailer’s stores by a sign hanging above the designated “selling area,” by signage attached to shelving walls, and by a large sign attached to the exterior of Retailer’s stores. Additionally, Taxpayer represented that employees in the designated areas were identified by their name tag as being employees of Taxpayer.

A customer who wished to purchase Taxpayer's merchandise at Retailer's stores did so through the following sequential general steps:

1. The customer went to Taxpayer's designated "selling area" of Retailer's store to shop for merchandise.
2. Taxpayer's employees assisted the customer, as necessary, in making merchandise choices.
3. Once the customer chose the merchandise for purchase, the customer took the merchandise from Taxpayer's designated "selling area" to Retailer's cashiers for purchase.
4. Retailer's cashiers charged the customer for the purchase and collected payment from the customer, all through Retailer's point-of-sale (POS) system. Retailer's cashiers gave the customer a receipt that contained Retailer's trade name. Taxpayer's name was not identified on the transaction receipts.
5. The customer left Retailer's store with the purchased merchandise.

The Department's Audit Division reviewed Taxpayer's business records for the time-period of January 1, 2011, through June 30, 2014 (audit period). During the course of that review, the Audit Division found that the sales amounts for Taxpayer's goods that were sold in Retailer's stores should be reclassified from retailing to wholesaling. On December 24, 2015, as a result of the Audit Division's findings, the Department issued a tax assessment for a total of \$ Taxpayer sought review of the tax assessment only in relation to the reclassification of Taxpayer B&O tax from retailing to wholesaling, which represented \$. . . of the tax assessment's total amount.

ANALYSIS

Washington imposes a B&O tax "for the act or privilege of engaging in business" in this state. RCW 82.04.220(1). The B&O tax measure is "the application of rates against the value of products, gross proceeds of sales, or gross income of the business, as the case may be." *Id.* The rate used is determined by the type of activity in which a taxpayer engaged. *See generally* Chapter 82.04 RCW. There is no dispute that Taxpayer is subject to B&O tax in Washington; however, Taxpayer maintains that it should be subject to retailing B&O tax, as opposed to wholesaling B&O tax, which the Audit Division found.

Retailing B&O tax is levied upon every person engaging in the business of making retail sales. RCW 82.04.250. There is no dispute that the sales by Taxpayer of its merchandise at its stand-alone stores are subject to retailing B&O tax; however, the sales at issue here occurred at Retailer's store, and were completed by Retailer's cashiers through Retailer's POS system. Only after the sales were completed did Retailer remit the proceeds from those sales to Taxpayer less a percentage of the sale amount that Retailer kept pursuant to the Agreement.

This situation is addressed generally in RCW 82.04.480, "Sales in own name—Sales as agent," which states the following:

- (1) Every consignee . . . having either actual or constructive possession of personal property . . . with power to sell such personal property in that person's own name and actually so selling, is deemed the seller of such personal property within the meaning of

[the B&O tax]. Furthermore, the consignor . . . is deemed a seller of such property to the consignee

(2) 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.

Thus, under RCW 82.04.480(1), if a "consignee" (1) has "power to sell" personal property, (2) in its "own name," and (3) actually sells such property, that consignee is presumed to be the seller for B&O tax purposes and is liable for B&O tax on such sales. Correspondingly, under the last sentence of RCW 82.04.480(1), the "consignor" is "deemed" the seller of such property to the consignee and liable for B&O tax on the sale of the property to the consignee under either the retailing or wholesaling B&O tax classification, depending on the circumstances. As such, we must first determine as a threshold matter if Retailer is a consignee.

While RCW 82.04.480 does not define "consignee" and "consignor," WAC 458-20-159 (Rule 159), the Department's administrative rule implementing RCW 82.04.480, defines "consignee" as follows:

A consignee, bailee, factor, agent or auctioneer, as used in this ruling, refers to one who has either actual or constructive possession of tangible personal property, the actual ownership of such property being in another The term "constructive possession" means possession of the power to pass title to tangible personal property of others.

As such, someone is a "consignee" if they meet the following two requirements: (1) they have either actual or constructive possession of tangible personal property, and (2) the tangible personal property is owned by someone else. Because there is no dispute that the merchandise sold here was owned by Taxpayer and not by Retailer, if Retailer also had actual or constructive possession of the merchandise at issue here, then Retailer is a consignee.

As Rule 159 states, constructive possession simply means possession of "the power to pass title to tangible personal property of others." Here, the Agreement makes clear that the proceeds from the sales of Taxpayer's merchandise "shall . . . be paid by customers directly to [Retailer's] cashiers, and deposited by [Retailer] to [its] own account." Once the customers pay for the merchandise through Retailer's cashiers, the customers have "title" to the merchandise. Thus, we conclude that Taxpayer has granted Retailer the power to pass title to the merchandise from Taxpayer to the customers when Retailer's cashiers complete the sale transaction at Retailer's stores. As such, Retailer had constructive possession of the merchandise under Rule 159, and therefore, Retailer qualifies as a "consignee" under Rule 159. It follows, then, that Taxpayer, as the owner of the merchandise, is a "consignor."

As we have concluded that Taxpayer was a "consignor" and Retailer was a "consignee," we address the other elements of RCW 82.04.480(1) and specifically consider whether Retailer (1) had "power to sell" personal property, (2) in its "own name," and (3) actually sold such property.

Regarding the first element, we have already concluded that Retailer had “power to pass title” to Taxpayer’s merchandise sold in Retailer’s stores. We conclude that such power is equivalent to “power to sell” Taxpayer’s merchandise. Regarding the second element, we conclude that Retailer was authorized to sell the merchandise in its “own name” as the receipts produced from such sales only included Retailer’s trade name and contained no reference to Taxpayer. Regarding the final element, there is no dispute that the merchandise was sold through Retailer’s cashiers who collected retail sales tax from customers on such sales, and Retailer documented such sales in its records through its POS system; therefore, we conclude that Retailer actually “sold” the merchandise at issue.

Thus, Retailer meets all of the requirements of RCW 82.04.480(1), and is, therefore, presumed to be the “seller” of the merchandise in question to the customers. As the “seller,” Retailer is generally liable for retailing B&O tax on such sales pursuant to RCW 82.04.250. Accordingly, as the final sentence of RCW 82.04.480(1) makes clear, Taxpayer “is deemed a seller of such property to the consignee.” Since there is no dispute that Retailer did not use the merchandise itself, but sold it to individual customers, Taxpayer is deemed a wholesale seller to Retailer of the merchandise at issue, and is generally liable for wholesaling B&O tax on such sales pursuant to RCW 82.04.270 and RCW 82.04.060(3).

However, under RCW 82.04.480(2), a consignee may avoid both retailing and wholesaling B&O tax liability on the sale of a consignor’s merchandise, and the consignor may, correspondingly, be liable for retailing B&O tax as opposed to wholesaling B&O tax.³ This is so if the consignee or consignor can prove that the consignee was “acting merely as broker or agent” for the consignor, and the consignee’s “accounting records are kept” in accordance with the Department’s rule. *Id.*; see also Det. No. 08-0301, 28 WTD 68 (2009) (“Sellers of property are taxable on that activity unless they meet their statutory burden of proving that their status was something other than that of seller.”). As such, we must determine whether Taxpayer has met its burden of proving that Retailer was merely acting as Taxpayer’s agent and met the other requirements under Rule 159 in order to reclassify Taxpayer’s B&O tax classification from wholesaling to retailing.

Rule 159 addresses when a person is acting merely as an agent for a consignor:

Any person who claims to be acting merely as agent or broker in promoting sales for a principal . . . 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
- (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.

³ We note that depending on the specific facts of the case, a consignee may still be liable for service and other B&O tax on any commissions it received from the consignor.

(Emphasis added.)

Therefore, we must look to the Agreement to determine if that document “clearly establishes the relationship of principal and agent.”

We conclude that the Agreement does not “clearly establish the relationship of principal and agent” as required under Rule 159. The Agreement specifically states the following:

The relationship between [Taxpayers] and [. . . Company] **is not one of . . . agency**, employment, or landlord and tenant and nothing herein contained shall be construed as to create any such relationship between the parties hereto. Nothing in this [Agreement] shall permit either party to obligate the other party in any way.

Thus, the Agreement does not “clearly establish” an agency relationship. Indeed, its language expressly states the precise opposite, that the Agreement “is not” one of agency.

Taxpayer points to the [Washington Supreme Court] decision, [*Rho, Co., Inc. v. Dep’t of Revenue*, 113 Wn.2d 561, 782 P.2d 986 (1989)], which states that “determination of an agency relationship is not controlled by the manner in which the parties contractually describe their relationship.” [*Rho*, 113 Wn.2d at 570.] While Taxpayer’s argument under *Rho* is correct in the case of general agency law, *Rho* specifically recognized the distinct analysis of agency required under Rule 159:

We note that Washington’s tax regulations have placed additional restrictions on the definition of “agent” at least for one category of taxpayers. Taxpayers who buy and sell tangible personal property on behalf of another will not be treated as agents **unless they have a contract expressly creating an agency relationship** and their records indicate that the transactions were entered into in the name of the principal. WAC 458-20-159.

(Emphasis added). *Rho*, 113 Wn.2d at 573, n.6. As such, the Washington Supreme Court has recognized that, at least for consignment situations under Rule 159, the required agency relationship must be “expressly” included in the contract at issue. Because the Agreement here contains no such express language and expressly declares the opposite, we conclude Taxpayer has failed to prove the existence of an agency relationship between it and Retailer as required under RCW 82.04.480(2) and Rule 159.

Based on the fact that the Agreement does not “clearly establish” an agency relationship between Taxpayer and Retailer, we conclude that the Audit Division properly assessed wholesaling B&O tax on the sales of Taxpayer’s merchandise at Retailer’s stores.

Taxpayer also argued on review that if the sales of its merchandise at Retailer’s stores subject Taxpayer to wholesaling B&O tax liability instead of retailing B&O tax, then the Department must provide guidance on [what] the proper sale amount should be used to calculate the tax liability. In other words, if the Department is going to “deem” Taxpayer to have sold the merchandise in question to Retailer, then Taxpayer argues that some wholesale amount, as opposed to the retail sale amount evident through Retailer’s POS system, should be used to calculate Taxpayer’s tax liability.

RCW 82.04.270 states that wholesaling B&O tax is calculated from the “gross proceeds of sales of such business” multiplied by the applicable tax rate. RCW 82.04.070, in turn, defines “gross proceeds of sales” as follows:

[T]he value proceeding or accruing from the sale of tangible personal property . . . 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 and without any deduction on account of losses.

Here, the value accruing from the sale of the merchandise at issue is the retail sale price, as recorded in Retailer’s POS system. Thus, even though Retailer is presumably subject to retailing B&O tax on the sales of Taxpayer’s merchandise in Retailer’s stores, and such tax liability is calculated using the sale price as recorded in its POS system, Taxpayer is likewise required to calculate its own wholesaling B&O tax liability using the same sale prices.

This is consistent with Rule 159, which states that when, as here, a consignee is “deemed” the seller of tangible personal property to the seller, that consignee is “taxable as a wholesaler **with respect to such sales.**” (Emphasis added). In essence, so long as an agency relationship between consignor and consignee is not clearly established, both parties are liable for B&O tax on the same sales amounts. Therefore, the Audit Division properly calculated Taxpayer’s wholesaling B&O tax liability based on the sales amounts recorded through Retailer’s POS system, as opposed to some lower wholesale price amount.

DECISION AND DISPOSITION

Taxpayer’s petition is denied.

Dated this 20th day of December 2016.