Cite as Det. No. 91-339, 11 WTD 535 (1992).

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of Tax Assessments of	D E T E R M I N A T I O N
	No. 91-339
. . .	Registration No. . . .
	. . ./Audit No. . . .
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	. . ./Audit No. . . .

[1] Rule 111: B&O TAX -- SERVICE -- THIRD-PARTY SERVICES -- PURCHASING AGENT. Where the taxpayer orally notified third-party service providers that it was acting solely as agent for log owners in procuring services, log tags and brands clearly identified the ownership of the logs to the third-party service providers, and the third-party providers submitted affidavits stating that they understood this relationship, amounts received by the taxpayer were excludable advance and reimbursements. Accord: Det. No. 88-255, 6 WTD 123 (1988).

[2] RULE 178: USE TAX -- SEEDLINGS -- REFORESTATION. Seedlings in a reforestation program are intended to permanently replace trees which have been harvested from the freehold. Once planted, these seedlings grow into trees and thereafter become part of the realty on which they grow. Because they become real property, they can no longer be considered tangible personal property held for resale. Accord: ETB 369.04.172.

[3] RULE 111 -- SERVICE B&O -- RPM 90-1 -- PAYMASTER -- AFFILIATES. An exclusion as an advance and

reimbursement was denied to a partnership involved in providing payroll functions for administrative employees when the partnership was the employer of record for state and federal purposes and did not clearly establish that all ten of the employee control factors remained with the affiliates. Accord: ETB 50.04.203, Det. 88-28, 5 WTD 67 (1988).

[4] RULE 111: B&O TAX -- SHARED OFFICERS -- AFFILIATES -- REIMBURSED TRAVEL EXPENSES. Amounts received by a corporation from a partnership for traveling expenses incurred by its executive officers while acting in its capacity as a partner of the partnership are not taxable income. Accord: Det. No. 88-28, 5 WTD 67 (1988).

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.

DATE OF ORIGINAL TELEPHONE CONFERENCE: . . .

TAXPAYER REPRESENTED BY: . . .

DATE OF SUPPLEMENTAL HEARING: . . .

NATURE OF ACTION:

Four taxpayers protest additional taxes and interest imposed in their respective audit assessments. Because of the close affiliation of the above taxpayers and the similarity of the issues involved, their petitions have been combined for purposes of hearing and determination.

FACTS:

Okimoto, A.L.J. -- [Taxpayer Inc.] is a general partnership consisting of [A] and [B]. [A] and [B] are engaged in the business of owning timberland and harvesting timber. [A] also owns some small amounts of timberland but primarily buys logs from unaffiliated third parties for sale to overseas customers. [Affiliate A] is a related partnership engaged in similar activities. The above entities will be referred to as "taxpayers" in the conglomerate and designated by their individual abbreviations when appropriate. The books and records of the above taxpayers were examined by a Department of Revenue (Department) auditor for individual audit periods. As a result of these examinations, the above tax assessments were issued.

The taxpayers have paid the unprotested portion of the assessments and the balance remains due.

TAXPAYER'S EXCEPTIONS:

We will first address the issues which involve multiple taxpayers and then deal with issues of individual taxpayers.

Reimbursements for Log-related Services: [Taxpayer Inc.], [A], and [B]

In the audit report, the auditor assessed Service B&O tax upon amounts received by [Taxpayer Inc.] from its affiliates for their share of third-party services (log scaling, stevedoring services, port charges, ocean freight and tug charges) performed on logs owned by the affiliates but arranged for and billed to [Taxpayer Inc.].

The taxpayer describes a sample transaction in its supplemental brief as follows:

1. [A] hires a logger to harvest its logs. (No involvement by [Taxpayer Inc.])
2. Pursuant to the contract, the logger brands each export log by imprinting [A]'s brand.
3. The logger prepares a "load ticket" which specifies the load ticket number, date of haul, logger, trucker, brand, log sort, piece count, destination, and purchaser.
4. Upon delivery to the yard, the trucker gives the log scaler a copy of the load ticket which he attaches to the scale ticket after determining the volume, specie, sort, and grade of the log. A copy of both is sent to [A].
5. The scaler attaches a [Taxpayer Inc.] log tag.
6. The logs are sorted by species and quality and sent to decks where they are commingled and stored with logs from other owners pending shipment.
7. [Taxpayer Inc.] arranges for truck, tug and stevedoring services to load the logs onboard the ship. These services are billed to [Taxpayer Inc.] and allocated to each affiliate based on the percentage of board feet owned by each affiliate.
8. [Taxpayer Inc.] bills the foreign buyer for the logs.

The taxpayer contends that title to the logs passes from [A] to [Taxpayer Inc.] at the time they are loaded onto the ship and then instantaneously passes to the foreign buyer. The taxpayer argues that it is acting only as agent for its affiliate in procuring these third-party services and that these receipts are deductible under Rule 111 as advance and reimbursements. The taxpayer argues that the ownership of the logs is clearly communicated to the third-party providers orally and by the

plainly visible log brands. The taxpayer stresses that the third-party providers are well aware that they are performing services directly for the designated log owners and that the primary liability for the services rendered lies individually with them. The taxpayer has submitted several affidavits from third-party service providers supporting this contention.

The taxpayer also argues that the intent of the B&O statute is: "to tax only gross income which is `compensation for the rendition
of services' (RCW 82.04.080)" and cites Walthew, Warner, Keefe, Arron, Costello & Thompson v. Department of Rev., 103 Wn.2d 183, 188, 691 P.2d 559 (1984) as authority.

Using that statutory intent, the taxpayer further argues that because it did not perform any of the services involved, and did not retain any of the compensation for itself, no part of the reimbursement can be considered compensation to [Taxpayer Inc.]. Therefore, the taxpayer argues that the reimbursements are exempt from tax.

Use Tax Assessed on Reforestation Seedlings: [A] and [B].

The taxpayer also protests the assessment of use and/or deferred sales tax on seedlings that it uses in its reforestation program. The taxpayer contends that it purchased the seedlings for resale in the regular course of business. The taxpayer cites RCW 82.04.050(1) which defines a retail sale as:

> every sale of tangible personal property (including articles produced, fabricated, or imprinted) ... other than a sale to a person who ... (c) purchases for the purpose of consuming the property purchased in producing for sale a new article of tangible personal property or substance, of which such property becomes an ingredient or component.

The taxpayer argues that it bought the seedlings for a single purpose: "to grow them into harvestable timber and to sell the product of the process - the logs." It argues that although the seedlings are "used up" in the process, the matter contained in them becomes an essential, integral component of the entire tree, including the logs that are cut from the tree. Even though the process may take 40 years, the taxpayer believes that the tax principles to be applied are the same as for a short-term industrial process, ie. whether the primary purpose of the seedlings is to become an ingredient or component part of tangible personal property (logs) for resale. The taxpayer adds that 100% of the seedlings used by [Affiliate A], and 90-95% of

the seedlings used by [A] are for reforestation of their own logged-off lands.

[Taxpayer Inc.]

Schedule IV: Unreported Administration Fees

[Taxpayer Inc.] employs approximately 23 employees, 16 of which perform accounting functions and 7 of which perform forest related functions. For purposes of Federal withholding, Social Security, Employment Security, and Labor & Industries, the workers are reported as employees of [Taxpayer Inc.]. Each employee performs work for [Taxpayer Inc.] in addition to the related companies. At the end of the month, [Taxpayer Inc.] adds up the monthly overhead expenses of payroll, rent, office supplies, depreciation, etc. These administration expenses are then allocated back to [Taxpayer Inc.] and the related companies on a pro-rata share based on the percentage of board feet sales that each company has made that month. During the audit period, [Taxpayer Inc.] sold approximately 60% of the logs measured on a board feet basis and, therefore, its share of the overhead expenses was 60%, with the remainder being allocated to the other companies.

The taxpayer argues in its petition:

> ...[Taxpayer Inc.] serves as a clearing house and common paymaster of the obligations incurred by the various affiliates. The allocated costs paid by the affiliates were not income to [Taxpayer Inc.] because [Taxpayer Inc.] served as a conduit for payment of the expenses of its affiliates. The allocated charges in this cost-sharing arrangement constitute advances and reimbursements as defined in WAC 458-20-111.

In the teleconference, the taxpayer stated that each employee knows that it is working for the affiliate whose work it is currently doing. The taxpayer also stated that each employee is hired, through a joint effort of [Taxpayer Inc.] management and the affiliates management. The taxpayer also states that supervision is performed by the affiliates personnel when the employee is performing tasks for that affiliate.

The taxpayer also relies on Det. No. 88-28, 5 WTD 67 (1988).

[A]

Schedule II: Unreported Wholesale Sales

[A] protests the assessment of Wholesaling B&O tax on two sales made to [a lumber company] and two sales made to [B] during the month of February 1986. [A] asserts that these sales were properly reported and taxes paid. This is a purely factual matter and will be referred to the Audit Division for verification.

[A] also protests the auditor's assessment of B&O tax on three "sales" to [the lumber company] dated [in December] which the taxpayer argues were brokered sales. The taxpayer states that it merely acted as a sales broker for the log owner (. . .) and that it was only entitled to a broker's fee of $2.50 per ton upon which it reported B&O taxes. Although the taxpayer concedes that it received the entire sales price for the logs from [the lumber company] and that [the lumber company] was not aware that the ownership of the logs was different, [A] nevertheless contends that it merely collected the sales price as a favor for the log owner and because [the lumber company] would not deal with the log owner
directly. During the teleconference, the taxpayer emphasized that it did not purchase the logs in its own name or take title to the logs in any way. For documentation, [A] submits raft reports which show the brand of the seller, as [log owner], and not [A].

Schedule V: Miscellaneous Retail Sales

The taxpayer protests the assessment of uncollected retail sales tax on two sales of Douglas fir seedlings on the basis that the buyers purchased them for resale.

[B]

Schedules VI & VII:

Health Insurance Payments from [Affiliate B]

In these schedules the auditor assessed tax on reimbursements to [B] from the [Affiliate B] for health insurance paid by [B] on behalf of [Affiliate B] employees. [B] believes that although it had been reporting some service tax on this income, it now believes that it is not taxable and requests a credit.

[B] explains that this reimbursement is for health insurance expenses covering employees who are solely employed by [Affiliate B]. The health insurance is purchased by [B] for a group of companies solely as their agent. [B] functions as the "common paymaster" for this limited purpose, but does not process any other payroll for or have any employment relationship with the [Affiliate B] employees.

Reimbursed Travel Expenses of [B] Executives

The auditor also assessed Service B&O tax on amounts paid by [Taxpayer Inc.] to [B] for travel expenses incurred by [B] executives while acting in its partnership capacity of [Taxpayer Inc.]. The taxpayer states that since [B] is a partner in [Taxpayer Inc.] its executives sometimes function as representatives of the partnership on business trips. On these trips, [B] will pay the travel expenses even though the executive acted in [B]'s partnership capacity. The taxpayer again relies on Det. No. 88-28, 5 WTD 67 (1988) in support of its argument.

ISSUES:

1) Has the taxpayer established that it was procuring the third-party services solely as agent of the log owners?
2) Are seedlings used in a reforestation program subject to use and/or deferred sales tax?
3) Are amounts received by [Taxpayer Inc.] from its affiliates for administrative personnel deductible as advance and reimbursements?
4) Are amounts received by a corporation from a partnership for traveling expenses incurred by its executive officers while acting in its capacity as a partner of the partnership taxable income?

DISCUSSION:

[1] Reimbursements for Log-related Services: [Taxpayer Inc.], [A], and [B]

The Service B&O tax is imposed by RCW 82.04.290 upon persons engaged in business activities other than or in addition to those for which a specific rate is provided elsewhere in Chapter 82.04 RCW. See also WAC 458-20-224. Such persons are taxable upon the "gross income of the business" defined in RCW 82.04.080 as:

> "Gross income of business" means the 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, ... 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.

In addition, affiliated corporations are each a "person" within the meaning of Washington's Revenue Act and, in general,

transactions between them are fully subject to the B&O tax[1]. However, under certain limited circumstances, third-party costs incurred by a taxpayer are excludable from its income if that taxpayer is only a conduit for payment. To be excludable, the taxpayer must meet the requirements of WAC 458-20-111 (Rule 111) by not being primarily or secondarily liable for payment of the fees or costs, other than as agent of the affiliate. Reimbursements for third-party costs which are shared between the taxpayer and its affiliate will be deductible only if both the taxpayer and the affiliate contracted for the services or the taxpayer contracted for the affiliate's services solely as its agent[2].

In the taxpayer's case, it has testified that it orally communicated to the third-party providers that it was acting only on behalf of the log owners in procuring the services. In addition, the ownership is visually communicated to the service providers by the imprinted brands. Finally, the taxpayer has submitted affidavits signed by the third-party service providers corroborating that they understood that the taxpayers were acting solely as agents of the log owners in procuring the contracted services and that each owner was primarily liable for its respective share. Under these circumstances, we believe that the taxpayer and its affiliates have jointly contracted for the third-party services and to the extent that the services were performed on logs not owned by the taxpayer, its liability was only as agent. Therefore, we find that the reimbursements for third-party charges are excludable under Rule 111. The taxpayer's petition is granted on this issue.

[2] Use Tax on Reforestation Seedlings

Although we would agree that seedlings which are sold to a nursery and planted temporarily in nursery soil and later sold to consumers are purchases for resale[3], this does not apply to seedlings used as part of a reforestation program. This is because reforestation seedlings are not planted temporarily pending resale, but intended to permanently replace trees which have been harvested from the freehold. Once planted, these seedlings grow into standing timber and become part of the realty on which they grow. RCW 84.04.090 defines the term "real property" as including "...the land itself, ...and...all standing timber growing thereon, except standing timber owned separately

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[1]RCW 82.04.030 and WAC 458-20-203.

[2]Det. No. 88-255, 6 WTD 123 (1988).

[3]See WAC 458-20-158.

from the ownership of the land upon which the same may stand or be growing;..."[4]. Since the taxpayer has testified that virtually all of the seedlings are used to reforest its own land, we must conclude that the seedlings were purchased for incorporation into the realty and not for sale as tangible personal property[5]. Therefore, the exemption in RCW 82.04.050 does not apply. Nor do we believe that taxpayer's speculation that the trees will be severed from the realty and sold as tangible personal property 40 years later is sufficient to bring these purchases within the exemption. The taxpayer's petition is denied on this issue.

[Taxpayer Inc.]

Schedule IV: Unreported Administration Fees

[3] To determine whether worker payroll costs were the obligation of [Taxpayer Inc.] or to the various affiliates, we must first determine who was the actual employer. Normally, if the payor of the workers is also listed as the employer for federal withholding, Social Security, and other state taxes, the Department will presume that the payor is the employer for state B&O taxes as well. However, the recent court case, Rho Company, Inc. v. Department of Revenue, 113 Wn.2d 561 (1989), provides that even if a payor is the employer of record for some state and federal taxes, it may be considered a mere payrolling agent for B&O tax purposes under certain limited situations. Whereas a true employer is subject to tax on all its receipts resulting from that worker's labor, a mere payrolling agent may exclude employee salaries and benefits paid to them by their clients and passed through to the workers pursuant to Rule 111.

To qualify for the exclusion, the payrolling agent must show that the client business exercised pervasive control over the paper employees of the paymaster. In RPM 90-1, issued after the Rho decision, the Department of Revenue outlines the 10 factors of control that were considered in the Rho decision to determine whether pervasive control existed. These are:

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[4]WAC 458-20-130 states: "Sales of standing timber,... are sales of real estate, and are not subject to tax under the business and occupation tax or the retail sales tax."

[5]Even as to the 5 to 10% of the seedlings used to reforest lands owned by other persons, we think the taxpayer's petition must fail. The taxpayer has not contended that it retains any ownership interest in those seedlings after planting.

1. Ultimate decision as to hiring and firing the worker;
2. Ultimate decision as to duration of employment;
3. Setting the rate, amount, and other aspects of compensation;
4. Determining the worker's job assignments and instructions;
5. Exercising exclusive guidance and supervision over the work performed;
6. Evaluating the worker's performance;
7. Determining the days and hours of work performed;
8. Providing the office space or other controlled work premises;
9. Providing the tools and materials applied in the workplace;
10. Compensating workers for vacation time, sick leave, and insurance benefits.

RPM 90-1 goes on to state:

> When these elements of control exist only in behalf of the business to whom the workers are provided, that business will be treated as the employer and the business providing the workers will be treated only as a payrolling agent, notwithstanding the terms in any contract between the businesses.
>
> When one or more of these elements exist in behalf of the business providing the workers, and any contract between the parties designates this business as the "employer," then it will be treated as the employer for state tax purposes as well.
> When there is no written contract between the businesses, the elements of control, to the extent that they are determinable, must exist exclusively in the business to whom the workers are provided such that the business providing the workers is acting solely as an agent in procuring and paying the workers.

We first note that all workers were reported as employees of [Taxpayer Inc.] for purposes of federal withholding, Social Security, Employment Security, and Labor & Industry reporting purposes. This creates a presumption that the workers were employees of [Taxpayer Inc.] and not of the individual affiliates. This presumption must be overcome by clear evidence that all of the above ten control elements were exclusively with the affiliates.

After considering all of the evidence presented by the taxpayer, we find that the taxpayer has failed to overcome this

presumption. Therefore, all amounts received for services performed for affiliates is fully subject to the B&O tax under the Service and Other tax classification. Taxpayer's petition is denied on this issue.

[A]

Schedule II: Reconciliation of Logging Income

WAC 458-20-159 (Rule 159) is the duly promulgated rule governing persons who attempt to sell goods as agents. It states:

> RETAILING AND WHOLESALING. Every consignee, bailee, factor, agent or auctioneer having either actual or constructive possession of tangible personal property, or having possession of the documents of title thereto, with power to sell such tangible personal property in his or its own name and, actually so selling, shall be deemed the seller of such tangible personal property and taxable under the retailing or wholesaling classification of the business and occupation tax, depending upon the nature of the transactions. In such case the consignor, bailor, principal or owner shall be deemed a seller of such property to the consignee, bailee, factor or auctioneer and taxable as a wholesaler with respect to such sales.
>
> The mere fact that consignee, bailee or factor makes a sale raises a presumption that such consignee, bailee or factor actually sold in his or its own name. This presumption is controlling unless rebutted by proof satisfactory to the department of revenue.
>
> AGENTS AND BROKERS. 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 ours)

[A] has presented no invoices or other evidence showing that the transactions were made on behalf of [log owner]. Raft reports showing the origination of the logs are insufficient. Therefore, we find that [A] has not presented sufficient evidence to overcome the presumption that [A] sold the logs on its own behalf. The taxpayer's petition is denied on this issue.

Schedule V: Miscellaneous Retail Sales

WAC 458-20-102, Rule 102 provides, "... all sales are deemed to be retail sales unless the seller takes from the buyer a resale certificate...." Whether [A] has retained a proper resale certificate from the purchaser is purely a documentation issue and will be remanded to the Audit Division.

[B]

Schedules VI & VII:

Health Insurance Payments from [Affiliate B]

We agree that reimbursements received by [B] from [Affiliate B] for payments made for health insurance benefits of a person employed entirely by its affiliate are exempt advance and reimbursements. Health insurance benefits are normally the sole responsibility of the employer. We therefore find that [B] is acting solely as an agent in procuring these third-party services. The taxpayer's petition is granted on this issue.

Reimbursed Travel Expenses of [B], Inc. Executives

[4] The taxpayer cites Det. No. 88-28, 5 WTD 67, (1988). We agree that determination controls the treatment of compensation of the shared officers who:

> ...cannot be deemed employees but rather as employers. Thus, they cannot be considered as the taxpayer's loaned servants to the partnerships for conduct of the affiliates' business. Similarly, when they conduct the taxpayer's corporate business and the business of the affiliate corporation, . . ., we do not believe that the taxpayer should be considered to have loaned its servants to the affiliate corporation. Rather, we view the situation as one where . . . individually exercised his prerogative by his status in each corporation to serve one corporation or the other. Because the principals and the affiliates' employees were not taxpayer's loaned servants to the affiliates, amounts received by the taxpayer as common paymaster on their

behalf from the affiliates are not subject to Service B&O tax.

The taxpayer's facts match the situation of the shared officers. Corporate executive officers may exercise their prerogative to serve in one capacity or the other. They are controlled solely by the entity for whom they perform a particular service. We find no distinction between advanced salaries and advanced travel expenses. Both are the primary liability of the entity for whom the services are performed. The taxpayer's petition is granted on this issue.

DECISION AND DISPOSITION:

The taxpayer's petition is granted in part and denied in part. The taxpayer's file shall be remanded to the Audit Division for the proper adjustments consistent with this determination.

DATED this 24th day of December, 1991.