BEFORE THE BOARD OF TAX APPEALS
STATE OF WASHINGTON

RICHARD W. GERLITZ, Appellant, v. STATE OF WASHINGTON DEPARTMENT OF REVENUE, Respondent.	)	Docket No. 42017 Re: Excise Tax Appeal FINAL DECISION

This matter came before the Board of Tax Appeals (Board) for an informal hearing on January 26, 1994. Appellant, Richard W. Gerlitz, did not appear and was not represented at the hearing. J. Byron Norton, Administrative Law Judge, appeared for Respondent, Department of Revenue (Department).

This Board heard the testimony, reviewed the evidence, and considered the arguments made on behalf of both parties. This Board now makes its decision as follows:

ISSUES

Kenney, Member--RCW 82.04 levies a business and occupation (B&O) tax on all persons for the privilege of doing business in Washington State. An exemption for employees is created by RCW 82.04.360(1): "This chapter shall not apply to any person in respect to his or her employment in the capacity of an employee or servant as distinguished from that of an independent contractor."

The first issue before this Board is determining if Appellant is an employee and exempt from taxation under RCW 82.04, or if he is an independent contractor and subject to the tax.

If it is determined that Appellant is subject to the tax, we must decide if the Department acted in a manner which misled him as to his liability and, as a result, should be estopped from assessing the tax.

HISTORY OF THE DEPARTMENT'S EFFORTS TO IMPOSE TAX ON LIFE INSURANCE AGENTS

In 1973, the Department issued a letter that set out a five-point test for establishing life insurance agent employee status.[1] The information was made available to agents through the Washington State Association of Life Underwriters (WSALU). Agents were encouraged to register with the Department or to submit a letter describing the conditions that they believed entitled them to employee status. Apparently, reductions in the Department's budget reduced activities for the next several years, and the matter was not pursued further. In 1985, the Legislature made additional funds available to the Department for collection and enforcement activities. A review of several occupations, including life insurance agents, was begun. It was determined that there were some 40,000 life insurance agents in the state and that turnover in the industry was 25 percent per year. The Department began assessing the tax.

An effort was begun by the industry to obtain a legislative exemption. While the legislative proposals were being considered, efforts to collect the tax were put on hold. In addition, discus-sions were held with representatives from the industry to provide for orderly implementation of the tax. In 1991, the Legislature enacted an exemption for "statutory employees", as defined in the Internal Revenue Code. The exemption became effective July 1, 1991. The exemption was not retroactive, and the Department began assessing taxes for the previous seven years. By agreement with the industry, the Department said it would not go back more than four years or assess penalties on agents who had registered with the Department, even though they had not paid the tax.

PROCEDURAL FACTS

Appellant did not appear at the hearing and his position and arguments are drawn from materials he submitted and Deter-mination No. 91-165 of the Interpretation and Appeals Division of the Department

[1] The criteria in the 1973 letter are the same as those in the Department's 1989 Special Notice to Life Insurance Agents cited on pages 4 and 5 of this decision.

of Revenue, as well as testimony received in other hearings on this same issue involving this same employer.

Since June 1983, Appellant has been a District Agent in Kennewick, Washington, for Northwestern Mutual Life Insurance Company (NML), a national company with headquarters in Milwaukee, Wisconsin. When Appellant became a District Agent, he registered with the Departments of Labor and Industries and Employment Security, but not with the Department of Revenue. Although NML is the principal company Appellant represents, he also represents other companies. He is paid by commission for the policies he sells for those companies. That income is not at issue in this appeal.

In March 1989, the Department sent a "Special Notice to Life Insurance Agents" to Washington State life insurance agents out-lining the differences between an insurance agent's status as an employee or an independent contractor. In May 1989, Appellant states that he attended a meeting of the Spokane Underwriters Asso-ciation at which a representative of the Department discussed the issue and reviewed specific examples. Following that presentation, Appellant determined that he was an employee of NML and not liable for B&O tax on income he received from them.

In April 1990, the Department sent Appellant a Business Activity Statement to complete and return. Based on information supplied by Appellant, the Department assessed him for B&O tax, plus interest, under the insurance agent and broker classification for the years 1986 through 1989, taxing all commissions Appellant received. Interest was not charged for a short period in 1989 and 1990 for administrative reasons. No penalties were assessed.

Appellant protested the tax on the commissions from NML. He states that he is an employee of NML. In support of his position, he points out that NML makes contributions to a pension plan on his behalf and also provides medical, group life, and disability insurance. He contends that Social Security contributions are withheld from NML commissions, but he did not contend that federal income taxes were withheld.

Appellant states that he can be terminated by NML for "an unlimited number of reasons", including low production, failure to make timely reports or attend

company-sponsored meetings, or failure to give NML the first opportunity to be carrier of the policies he sells. He states that he is "obligated to Northwestern Mutual Life both ethically and production wise to adhere to a strict rule of conduct and productive nature." His contract with NML limits his solicitations to the Benton-Franklin County area unless he receives express authority from NML to solicit outside that area, he states.

Appellant contends that the initial notice sent to agents by the Department conflicts with the special notice of May 11, 1990, but he does not identify any specific differences. Appellant contends that the Department sent letters to his predecessors, associates, and members of his local association stating that they were exempt from B&O tax. He did not submit copies of those letters with this appeal. Finally, Appellant contends that he is being treated differently than other agents with identical contracts.

The general rule in the state of Washington is that exemp-tions from a taxing statute must be strictly construed. Budget Rent-A-Car, Inc. v. Department of Revenue, 81 Wn.2d 171, 500 P.2d 764 (1972); Evergreen-Washelli Memorial Park Co. v. Department of Revenue, 89 Wn.2d 660, 574 P.2d 735 (1978). Statutory language is to be construed strictly, though fairly, and in keeping with the ordinary meaning of the language employed (Group Health Coop. of Puget Sound, Inc. v. Wash. State Tax Comm'n, 72 Wn.2d 422, 433 P.2d 201 (1967))--in favor of the public and the right to tax. Thurston County v. Sisters of Charity of House of Providence, 14 Wash. 264, 44 P. 252 (1896). Taxation is the rule; exemption is the exception. Spokane County v. City of Spokane, 169 Wash. 355, 13 P.2d 1084 (1932). Exemptions are not to be extended by judicial construction. Pacific Northwest Conference of the Free Methodist Church v. Barlow, 77 Wn.2d 487, 463 P.2d 626 (1969). Nevertheless, statutes must be construed to effect their purpose, and unlikely, absurd, or strained consequences should be avoided. State v. Stannard, 109 Wn.2d 29, 742 P.2d 1244 (1987).

The determination of employee status is a question of fact that must be based upon the particular circumstances of each case. Washington courts have emphasized control or the right of control. Hollingbery v. Dunn, 68 Wn.2d 75, 80, 411 P.2d. 431 (1966). The court, in that case, said: "A servant or

employee may be defined as a person employed to perform services in the affairs of another under an express or implied agreement, and who with respect to his physical conduct in the performance of the service is subject to the other's control or right of control." Hollingbery, at 79.

In Hollingbery, the court provided a test to determine whether one is an employee or an independent contractor, emphasizing that with the exception of the element of control, it is not necessary that all the other factors be present. No one factor is conclusive, the court said. Hollingbery, at 81. The factors listed by the court are more extensive and more general than the five crite-ria cited below, used by the Department for life insurance agents, but are consistent with those criteria.

WAC 458-20-164(3)(c) states:

> Every person acting in the capacity of agent, broker, or solicitor is presumed to be engaging in business and subject to the business and occupation tax unless such person can demonstrate he or she is a bona fide employee. The burden is upon such person to estab-lish the fact of his or her status as an employee.

(Emphasis added.)

The March 1989 Special Notice to Life Insurance Agents outlined five criteria for determining whether an agent is an employee or an independent contractor. The Department emphasized: "The first three criteria are critical. If the life insurance agent's relationship with the life insurance company fails to meet any one of these three criteria, then the agent is an independent contractor." (Emphasis added.) The notice stated that an employee is:

> 1) One who has no direct interest in the income or profits of the business other than a wage or commission.

To meet this criterion, the Department stated in the notice, "the life insurance agent's sole compensation must be in the form of wages or commissions for insurance policies **which he or she has sold.** If the agent receives commissions for insurance

policies sold by others, he or she is not an employee . . .". (Emphasis in original.)

> 2) One who has no liability for the expenses of main-taining an office or place of business, or for overhead or for compensation of employees.

The Department's notice stated that even if office expenses are ultimately reimbursed, the agent is not an employee if he or she is responsible for those costs. The notice also stated that an agent required to file a Schedule C, Profit or Loss from a Business or Profession, on his or her federal income tax return for the purpose of claiming deductions for business expenses is not an employee.

> 3) One who has no liability for losses or indebtedness incurred in conducting the business of selling life insurance.

The Department emphasized that the liability referred to is not for the debts or losses of the insurance company which issues the policy, but the actual "business of selling".

> 4) One for whom the insurance company provides office space, a telephone and office supplies.

> 5) One for whom the insurance company provides training, continuing supervision and clerical service.

In April 1990, the Department issued Excise Tax Bulletin 546.04.164 stating that the bulletin did "not change the way that life insurance agents are taxed but formalizes criteria for making that determination of taxability."

The bulletin set the following criteria for employees:

> 1. They have no direct interest in the profits or losses of the insurance business including no liability for maintaining a place of business and overhead; and
> 2. Meet one of the following:
> A. They are subject to the control or right of control of the insurance

> company in the perform-ance of the details of the work; or
> B. They are treated as employees for Federal income tax purposes as evidenced by the filing of a W-4 form, and the withholding of income tax, when necessary.

(Emphasis in original.)

ANALYSIS AND CONCLUSIONS

Appellant has not provided us with the information we need to determine if the Department's decision is incorrect. The Depart-ment's regulations and the Washington State Supreme Court make it clear that the burden of proof is on those who seek an exemption from a taxing statute.

Appellant was asked to provide copies of his federal income tax returns to determine what, if any, business deductions had been claimed or if he had filed a Schedule C. He did not do so.

Appellant stated that he would provide copies of his W-2 forms to the Department. He failed to do so.

Appellant included in the materials he submitted, a letter he wrote to a Department excise tax examiner. He included in the letter a colloquy taken from a videotaped presentation by the deputy director of the Department at the Spokane underwriters meeting. We have reviewed the videotape and find that the ques-tions selected by Appellant were not representative of the entire presentation. The Department's position can best be summarized by the phrase, "It depends." As Appellant notes in his letter "the role of the Department was to impose the tax on a 'uniform' basis and that each case was open to interpretation."

In the materials he submitted to this Board, Appellant failed to adequately address the issue of control. Beyond an assertion that his contract with NML can be terminated by NML for any of several reasons and that he is required to attend regular meetings, he gives no examples that would indicate that he is subject to excessive control. Termination clauses are standard in most contracts. Requiring regular

attendance at meetings is standard in consulting contracts.

Appellant did not distinguish among the various classes of agents used by NML. In the appeals of Neal W. Springer and Kenneth E. Wagar (BTA Dockets Nos. 42420 and 42434), in which we found appellants--"special agents" of the same company--to be employees, appellants stated that the responsibilities of district agents are different from those of special agents. Both appellants in that case believed that district agents would probably not be considered employees. District agents, according to those appellants, are liable for office and overhead costs.

ESTOPPEL

Appellant asserts that several actions of the Department were misleading and that he relied upon those actions to his detri-ment. He should not, he contends, be liable for taxes during the period of this appeal, and the Department should be estopped from assessing them.

The Department may be prevented from assessing tax only when certain conditions are met. Guidelines have been developed by the Washington Supreme Court in a number of cases:

> Equitable estoppel is defined as requiring three elements: (1) an admission, statement, or act inconsis-tent with the claim afterward asserted; (2) action by the other party on the faith of such admission, statement, or act; and (3) injury to such other party resulting from allowing the first party to contradict or repudiate such admission, statement, or act.

Public Util. Dist. No. 1 of Lewis County v. Washington Pub. Power Supply Sys., 104 Wn.2d 353, 365, 705 P.2d 1195 (1985), citing Leonard v. Washington Employers, Inc., 77 Wn.2d 271, 280, 461 P.2d 538 (1969) and Arnold v. Melani, 75 Wn.2d 143, 147, 437 P.2d 908 (1968).

Further, an estoppel argument is available only to a person who has been misled to his hurt and to those

who are in privity[2] with him. Inland Finance Co. v. Inland Motor Car Co., 125 Wash. 301 (1913). Such reliance must have been reasonable. Liebergesell v. Evans, 93 Wn.2d 881, 613 P.2d 1170 (1980). "The doctrine of estoppel will not be lightly invoked against the state to deprive it of the power to collect taxes." Kitsap-Mason Dairymen's Ass'n v. State Tax Comm'n, 77 Wn.2d 812, 818, 467 P.2d 312 (1970).

In the Kitsap-Mason case, the taxpayer had been improperly reporting its tax for more than fifteen years. The Tax Commission had not made any changes even though the taxpayer had been audited. The Supreme Court denied estoppel when the taxpayer contended that the State should be estopped from changing its method of collecting taxes in those circumstances.

In this case, the Department has not assessed any penalties. Appellant is liable only for those taxes he was liable for and should have paid during the period of this appeal. Appellant has not met the requirements of equitable estoppel outlined above. The Department will not be estopped from collecting the taxes due.

DECISION

The Determination of the Department of Revenue is upheld.

DATED this _____ day of _____, 1994.

BOARD OF TAX APPEALS

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LAWRENCE KENNEY, Member

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[2] Privity is the mutual or successive relationship to the same rights of property. Duffy v. Blake, 91 Wash. 140 (1916).

I concur:

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LUCILLE CARLSON, Vice Chair

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Pursuant to WAC 456-10-755, you may file a petition for reconsideration of this Final Decision. You must file the petition for reconsideration with the Board of Tax Appeals within ten days of the date of mailing of the Final Decision. You must also serve a copy on all other parties. The filing of a petition for reconsideration suspends the Final Decision until action by the Board. The Board may deny the petition, modify its decision, or reopen the hearing.