Cite as 4 WTD 423 (1987)

BEFORE THE INTERPRETATION AND APPEALS 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. 88-7
. . .)	Registration No. . . .
)	Tax Assessment No. . . .

[1] **RULE 111 AND RCW 82.04.050:** REIMBURSEMENT -- ARCHITECT -- UNDISCLOSED AGENCY -- LIABILITY TO THIRD PARTY PROVIDERS. In addition to evidence of agency, there must be evidence to indicate that an outside provider recognized that the architect/taxpayer was dealing with it only as an agent, and that it was legally entitled to be paid only by funds supplied by the taxpayer's clients, or that the taxpayer would not be legally liable to it for compensation if such funds were not received for any reason. It is well established that an agent whose status is not communicated to a third person with whom he is conducting business is acting for an undisclosed principal, and that both agent and principal are liable for any contractual obligations incurred by the agent. Such liability, once the principal is revealed, is in the alternative. Maxwell's Electric, Inc. Thus, it is the third party vendor's knowledge and acceptance that it is dealing with an agent, and not just the existence of the agency relationship itself, which finally relieves the agent from liability.

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.

TAXPAYER REPRESENTED BY: . . .

DATE OF HEARING: December 18, 1987

NATURE OF ACTION:

Protest of disallowance by Department of taxpayer-architect's

exclusion from income of certain expenses which taxpayer passed on directly to its client.

FACTS AND ISSUES:

Dressel, A.L.J. -- . . . (taxpayer) is an architectural firm. Its books and records were examined by the Department of Revenue (Department) for the period January 1, 1983 through June 30, 1986. As a result, the above-captioned tax assessment was issued for excise taxes and interest totaling $ . . . . Part of that amount has been paid. The protested portion has not.

At issue here is the B&O taxation of certain expenses incurred by the taxpayer in the course of rendering architectural services for its clients. Specifically, the expenses are for travel, lodging, telephone calls, and the reproduction of architectural plans. Of those the greatest expense is the latter. As the taxpayer tells it, after it draws the plans for a particular project, copies of those plans are distributed to general and sub construction contractors so that they may make bids on the project and/or find out what it is they will be constructing. Plan copies are also sometimes ordered by clients for advertising purposes. The copies are not made by the taxpayer. They are produced by an outside printer. The architect's client will determine how many copies it needs and place an order for same with the taxpayer. The taxpayer, in turn, contacts the printing company which produces the copies. The printing company will then bill the taxpayer for the copies. The taxpayer then bills its client at the same rate (no mark-up) it was billed by the printer. The client writes a check in that amount to the taxpayer. The taxpayer deposits that check and writes one of its own to the printer. The statements sent by the printer to the taxpayer, incidentally, do not usually include the name of the client.

In its tax assessment the Department has included these amounts, which are paid by clients to the taxpayer for copies of architectural plans, as gross income of the business taxable under the business and occupation (B&O) tax. The taxpayer, on the other hand, claims that such amounts may be excluded from its gross income as advances or reimbursements under the authority of WAC 458-20-111 (Rule 111). It insists that it incurs these copy and other expenses as an agent for its clients, that it gratuitously undertakes the payment of same for the convenience of its clients, and that the "client alone is liable" for payment of the expenses.

In support of its contention that only the client is liable, the taxpayer supplied copies of the pertinent part of the standard American Institute of Architects (AIA) fee agreement which part reads as follows:

ARTICLE 5

REIMBURSABLE EXPENSES

> 5.1 Reimbursable Expenses are in addition to the Compensation for Basic and Additional Services and include actual expenditures made by the Architect and the Architect's employees and consultants in the interest of the Project for the expenses listed in the following Sub-paragraphs:
>
> 5.1.1 Expense of transportation in connection with the Project; living expenses in connection with out-of-town travel; long distance communications, and fees paid for securing approval of authorities having jurisdiction over the Project.
>
> 5.1.2 Expense of reproductions, postage and handling of Drawings, Specifications and other documents, excluding reproductions for the office use of the Architect and the Architect's consultants.
>
> 5.1.3 Expense of data processing and photographic production techniques when used in connection with Additional Services.

As indicated earlier travel, lodging and telephone expenses as well as the cost of plan reproductions are in question in this proceeding. Whether these items are subject to the B&O tax is the issue to be decided herein.

DISCUSSION:

[1] It is plain that the taxpayer is taxable under the Service and Other Business Activities classification of the business and occupation tax on the hourly fees it receives for rendering its architectural services. This 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. Such persons are taxable upon the "gross income of the business" defined at RCW 82.04.080 as follows:

> "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, gains realized from trading in stocks, bonds, or other evidences of indebtedness, interest, discount, rents, royalties, fees, commissions, dividends, and other emoluments however designated, <u>all without any deduction on account of the cost of tangible property sold, the cost of materials used, labor costs</u>, interest, discount, delivery costs, taxes, <u>or any other expense whatsoever paid or accrued</u> and without any deduction on account of

losses. (Emphasis added.)

It is abundantly clear that the tax under consideration is a tax on gross receipts; furthermore, it is equally clear that a service provider may not deduct any of its own costs of doing business. The Department has always recognized, however, that sometimes in the regular course of business a taxpayer may pay costs or fees which are properly the obligation of its client, and for which the taxpayer itself has no personal liability. When a taxpayer receives an advance of funds for such a purpose, or when a taxpayer having already expended its own funds for such a purpose receives reimbursement for such an expense, then such amounts may be excluded from the measure of the tax.

Accordingly, the Department has promulgated Rule 111 in order to explain the distinction between a taxpayer's own business costs and other payments a taxpayer might make merely as an accommodation for its client. That rule provides in pertinent part:

> The word "advance" as used herein, means money or credits received by a taxpayer from a customer or client with which the taxpayer is to pay costs or fees for the customer or client.
>
> The word "reimbursement" as used herein, means money or credits received from a customer or client to repay the taxpayer for money or credits expended by the taxpayer in payment of costs or fees for the client.
>
> 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 therefor, either primarily or secondarily, other than as agent for the customer or client.
>
> There may be excluded from the measure of tax amounts representing money or credit received by a taxpayer as reimbursement of an advance in accordance with the regular and usual custom of his business or profession.
>
> 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 out the business in which the taxpayer engages.
>
> . . .
>
> On the other hand, no charge which represents an advance payment on the purchase price of an article or a cost of doing or obtaining business, even though such charge is made as a separate item, will be construed as an advance or reimbursement. Money so received constitutes a part of gross sales or gross income of the business, as the case may be. For example, no exclusion is allowed with respect to amounts received by . . . (5) any person engaging in a service business or in the business of installing or repairing tangible personal property for charges made separately for transportation or traveling expense. (Emphasis added.)

Strictly speaking, Rule 111 does not provide an exemption or deduction from the business and occupation tax, nor could it, since there is no statute authorizing such an exemption or deduction. Rather, Rule 111 merely recognizes that "advances" and "reimbursements," as defined therein, may be excluded from the measure of the tax because they do not fall within the definition of "gross income of the business."

Thus, to be excludable from gross income under Rule 111, the payments received by the taxpayer must, first, be made as part of the regular and usual custom of the taxpayer's business or profession and, second, must be for services or products that the taxpayer does not or cannot render. Third, the taxpayer must not be liable for paying the bill, either primarily or secondarily, except as an agent of the client. Christensen, O'Connor, Garrison & Havelka v. Department of Revenue, 97 Wn.2d 764 (1982).[1]

The Department is satisfied that the first two requirements have been met in this case. The sole dispute, then, involves the third requirement. The taxpayer argues that its liability, if any, to

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[1] The court in Walthew v. Department of Revenue, 103 Wn.2d 183 (1984), subsequently limited Christensen. It found that attorneys were unique among service providers in that they were bound by the Disciplinary Rules of the Code of Professional Responsibility, which prohibited them from financing the expenses of contemplated or pending litigation unless the client remained ultimately liable for such expenses. Attorneys, because of this rule, could act only as agents for their clients when financing litigation. The Department has thus interpreted the Walthew decision to be applicable only to attorney taxpayers; other service providers have remained subject to the three Christensen requirements for excludability.

the third party providers was that of an agent, based on the AIA fee agreements it had with its clients.

Those fee agreements suggest that as between the taxpayer and its clients there is an agency relationship and that the burden for the enumerated expenses is to be borne by the clients. There is no evidence, however, to indicate that the outside providers themselves recognized that the taxpayer was dealing with them as such, that they were legally entitled to be paid only by funds supplied by the taxpayer's clients, or that the taxpayer would not be legally liable to them for compensation if such funds were not received for any reason.

It is well-established that an agent whose status is not communicated to a third person with whom he is conducting business is acting for an undisclosed principal, and both are liable for any contractual obligations incurred by the agent. Such liability, once the principal is revealed, is in the alternative. Maxwell's Electric, Inc. v. Hegeman-Harris Company of Canada, Ltd., et al, 18 Wn. App. 358 (1977). Thus, it is a third party vendor's knowledge and acceptance that it is dealing with an agent, and not just the existence of the agency relationship itself, which finally relieves the agent from liability.

In this case, no evidence has been presented to the effect that third party vendors knew of, recognized, or agreed to deal with the taxpayer merely as an agent of its clients, or that they would hold the taxpayer harmless in the event of default. In fact, invoices were sent directly to the taxpayer in the taxpayer's name. That being the case, it is most likely that, in the event of default, the vendors would pursue the taxpayer for payment. Even if the vendors knew the identity of the taxpayer's client, they would not pursue the client for payment without some further indication of an agency relationship. After all it was the taxpayer that ordered the service and it was the taxpayer who was billed for the service, so it is only logical that the taxpayer is the party from whom the vendor expected compensation. Without a doubt the taxpayer has primary or secondary liability to the vendor, which under the third test of Rule 111, means the amounts at issue do not qualify as advances or reimbursements.

DECISION AND DISPOSITION:

The taxpayer's petition for correction of assessment is denied and the assessment is sustained.

DATED this 19th day of January 1988.