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. 88-370
. . .	)	Registration No. . . .
	)	. . . /Audit No. . . .

[1] **RULE 164 AND RCW 82.04.255:** B&O TAX -- INSURANCE AGENTS -- BROKERS -- PYRAMIDING TAX. RCW 82.04.255 provides an exemption for real estate agents and brokers and does not apply to an insurance agent who is affiliated with a brokerage agency. Davenport, Inc. v. Department of Revenue, distinguished.

[2] **RULE 164:** B&O TAX -- INSURANCE COMMISSIONS -- BROKER -- SUB-AGENTS. An insurance broker who employs independent sales agents cannot deduct the commissions paid to agents from the measure of the B&O tax, if the broker alone has the contractual right to receive the commissions from the insurer. An agent who is not an employee of the broker, but is an independent contractor, is liable on commission income received unless the soliciting agent has a contractual relationship with the insurer.

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: November 19, 1987

NATURE OF ACTION:

The taxpayer, an insurance agent, protests the assessment of Service B&O on his commission income.

FACTS AND ISSUES:

Roys, A.L.J.--The taxpayer's records were examined for the period January 1, 1982 through September 30, 1986. The audit disclosed $ . . . in taxes, interest, and penalties owing.

The taxpayer is a licensed insurance agent in this state and is affiliated with the . . . Agency, Inc. Prior to January 1, 1982, the taxpayer was an employee of the agency. After that time, he became an independent contractor affiliated with the agency.

The agency holds a regular insurance agent's license and also holds several appointment contracts with various insurance companies. All insurance sold by the taxpayer is sold through the agency for companies having an appointment contract with the agency. All commissions are paid to the agency which then pays the taxpayer 60% of the commissions generated by his sales, as provided by the taxpayer's contract with the agency.

The agency remitted B&O tax on the total amount of commissions received. The taxpayer was not registered with the Department and did not pay B&O tax. He stated that he was a former agent for an insurance company and paid B&O tax when he was a "captive agent." When he affiliated with the . . . Agency, he stated he was told by the Department that he did not owe B&O tax. He contends the only "person" required to pay tax is the agency which has already remitted the B&O tax.

DISCUSSION:

[1] Washington's B&O tax is imposed on every person for the act or privilege of engaging in business activities in this state. The tax is measured by the application of rates against the value of products, gross proceeds of sales, or gross income of the business. RCW 82.04.220.

RCW 82.04.320 states, in pertinent part:

> This chapter [B&O tax] shall not apply to any person in respect to insurance business upon which a tax based on gross premiums is paid to the state: Provided, that the provisions of this section shall not exempt any person engaging in the business of representing any insurance company, whether as general or local agent, or acting as broker for such companies; . . ..

Both the taxpayer and the auditor relied on WAC 458-20-164 (Rule 164), the administrative rule which deals with the B&O tax

liability of insurance agents, brokers, and solicitors. Rule 164 provides in relevant part:

> Every person acting in the capacity of agent, broker, or solicitor is presumed to be engaging in business and is taxable under the insurance agents and brokers classification upon the gross income of the business unless such person is a bona fide employee. The burden is upon such person to establish the fact of his status as an employee. (See WAC 458-20-105 Employees.). . .
>
> The term "gross income of the business" includes gross income from commissions, fees or other emoluments however designated which the agent, broker, or solicitor receives or becomes entitled to receive . . .
>
> No deduction is allowed for commissions, fees, or salaries paid to other agents, brokers, or solicitors nor for other expenses of doing business.

The taxpayer contends the pivotal question is who is the "person" required to pay B&O tax on the commissions received by the agency. The taxpayer relies on the broad definition of "person" in RCW 82.04.030 which includes: "any individual,. . .,firm, co-partnership, joint venture,. . ., or any group of individuals acting as a unit,. . . ." The taxpayer contends that because the definition of person is so broad, the "taxing scheme is intended to insure that B&O taxation is paid only once in a particular sale." (petition p. 2)

The taxpayer relied on Davenport, Inc. v. Department of Rev., 6 Wn.App. 581 (1972). In Davenport, the court held that a real-estate brokerage office having a broker and associate brokers within the same office as independent contractors was "a group acting as a unit" as that phrase is used in RCW 82.04.030. The court found the B&O tax could only be levied once against each commission. The broker was liable for tax on the portion of the gross commission retained and the associate broker was liable for tax on the associate's share. The taxpayer stated that under the rationale of Davenport, he is not liable for the B&O tax since "person" encompasses the agency as well as the affiliated insurance agents.

We do not agree that Davenport is controlling. The case involved real estate brokers. The court noted that the department, prior to 1969, had interpreted the statutes defining gross income of the business and persons subject to tax in a way as to allow a broker to deduct commissions paid to associate brokers. Davenport was being taxed under an amended rule which denied the original or designated broker such a deduction. In 1970, the

legislature changed the law to eliminate the effect of the amended rule. RCW 82.04.255

The court found the amended rule did not reflect legislative intent. The court noted that the legislature had "silently acquiesced" in the earlier interpretation by the Department to allow a deduction for commissions paid to associates. That fact, coupled with the subsequent change of the statute after the amended rule became effective, was evidence that the double tax was not intended.

The Departments' position has been and is that Davenport and the exemption provided for salesmen or associate real estate brokers in RCW 82.04.255 only applies to real estate brokers. This is in accordance with the general rule of statutory construction that exemptions to taxing statutes must be narrowly construed. Unlike the situation in Davenport, the legislature has "silently acquiesced" in the Department's position that the tax does pyramid in situations where the broker is contractually entitled to the full commission from the insuring company and the agent's right to receive a commission is from the contract with the broker. Also, a real estate agent can only sell through an agency. An insurance agent can affiliate with an agency or can seek an appointment contract directly with an insurer.

There is no prohibition against double taxation as applied to excise taxes. Drury the Tailor v. Jenner, 12 Wn.2d 508, 514 (1942). The tax at issue is imposed on every person within this state engaging as an insurance agent. The only exception is for those agents who are employees rather than independent contractors. The taxpayer does not meet the Rule 105 definition of an employee, as the insurance companies do not withhold either FICA or income taxes.

Rule 164 clearly states that no deduction is permitted for commissions paid to other agents. The rule has not been declared invalid by the court; thus it has the same force and effect as if specifically included in the Revenue Act. RCW 82.32.300

[2] An unpublished Determination issued in 1982 stated the Department's position as follows:

> We find that the insuring companies have no contractual relationship with the soliciting agents and irrespective that the solicitor retains his commission from the premium collected prior to turning the balance over to the taxpayer, the taxpayer is entitled to the full commission forthcoming from the insuring company with whom it has a contractual relationship to represent the insurers business interests. Clearly,

> under RCW 82.04.080, the taxpayer's tax liability is measured by values proceeding or accruing by the reason of the transaction of the business engaged in which included commissions without deduction for expense.
>
> We recognize in this instance that factually the soliciting agents retain their commissions and forward the balance of the premium collected to the taxpayer; however, such agents have a right only to receive commissions from the taxpayer, and the taxpayer has the right to receive the entire premium. . .
>
> Under WAC 458-20-164, the tax assessment on brokerage commissions must be upheld since the taxpayer either received or was entitled to receive the commissions retained by such sub-agents. Rule 164 specifically provides that there is no deduction for commissions paid to other agents.

The Department distinguishes cases where the insurance company contracts directly with the agents to pay them the commissions. In such cases, even if the commissions are received by the broker, the Department has found the broker could deduct the commission income which only the agents had the right to retain. This position is consistent with the Department's position with other businesses, as contractors or service providers. Only "reimbursements or advancements" are excludable. See WAC 458-20-111.

In the present case, the agency is entitled to receive net written premiums, out of which the agents' commissions are to be paid. The agency is liable for B&O tax on the total commissions paid. The taxpayer is liable for B&O tax on the commission income which he had a contractual right to receive from the agency.

The fact that the taxpayer stated he was advised by the department he did not need to register when he affiliated with the agency is not grounds for relief. The department gives consideration, to the extent of discretion vested in it by law, where the failure of a taxpayer to report correctly was due to written instructions from the department. For example, the department has waived interest and or penalties where the failure to pay taxes was due to erroneous written instructions by the department. WAC 458-20-228.

The department does not give consideration to claimed oral instructions. Excise tax bulletin 419.32.99 states three reasons for this position:

(1) There is no record of the facts which might have been presented to the agent for his consideration.

(2) There is no record of instructions or information imparted by the agent, which may have been erroneous or incomplete.

(3) There is no evidence that such instructions were completely understood or followed by the taxpayer.

As the court stated in Kitsap-Mason Dairymen v. Tax Commission, 77 Wn.2d. 812, 818 (1970):

> the doctrine of estoppel will not be lightly invoked against the state to deprive it of the power to collect taxes. The state cannot be estopped by unauthorized action, admissions or conduct of its officers.

DECISION AND DISPOSITION:

The taxpayer's petition is denied.

DATED this 23rd day of September 1988.