

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

In the Matter of the Petition        ) D E T E R M I N A T I O N  
For Correction of Assessment of        )  
  )               No. 88-383  
  )  
  )       Registration No. . . .  
  )       Assessment No. . . .  
  )

- [1] **RULE 164:** B&O TAX -- GROSS INCOME OF BUSINESS --  
INSURANCE -- GENERAL AGENT -- SUB-AGENT'S  
COMMISSIONS. General agent not liable for B&O tax  
on commissions earned by sub-agents where sub-  
agents' contracts were with the insurance company  
and the general agent, and only the sub-agents had  
the contractual right to the commissions. The fact  
that the sub-agents' contracts stated the general  
agent shall pay their commissions was not  
controlling.
- [2] **RULE 164 AND MISCELLANEOUS:** B&O TAX -- DEDUCTION --  
DEFERRED INCOME -- GROSS INCOME OF BUSINESS. The  
B&O tax applies to commission income which an agent  
receives or becomes entitled to receive, including  
income deferred for retirement. The federal tax  
treatment of retirement contributions and payments  
is not controlling for state tax purposes. Accord:  
88-205 5 WTD 387 (1988).
- [3] **RCW 82.32.060:** REFUND -- NON-CLAIM PERIOD. The  
Department of Revenue does not have authority to  
grant a credit or refund of taxes paid in error  
unless the request is made within the statutory time  
period. Guy F. Atkinson Co. v. State, cited.
- [4] **RULE 178:** USE TAX -- CONSUMABLE SUPPLIES -- TEST  
PERIOD. A correlation generally exists between a  
taxpayer's purchases of consumable supplies and its  
income. Taxpayer may compute the amount of use tax

owing for other periods where it believes test period is not representative of other periods. Use tax and/or deferred sales tax deleted on purchases which were not retail sales.

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: January 28, 1988

#### NATURE OF ACTION:

The taxpayer, a general agent for an insurance company, seeks a correction of a tax assessment. The primary issue concerns the assessment of B&O tax on the commissions earned by sub-agents and on his commissions which he deferred into a retirement account.

#### FACTS AND ISSUES:

Roys, A.L.J. -- The taxpayer is the general agent in Western Washington for the . . . Insurance Company. The taxpayer's records were examined for the period January 1, 1981 through March 31, 1985. The audit disclosed taxes and interest owing in the amount of \$ . . . . Assessment No. . . . in that amount was issued on December 19, 1985. A post audit adjustment, completed April 22, 1986, calculated tax credit on margins paid to district agents pursuant to instructions and tax credit given in the previous audit. The adjusted assessment was for \$ . . . .

The taxpayer protests the following portions of the assessment:

1) Schedule III--Reconciliation of gross income per federal income tax returns. The auditor assessed B&O tax on the commissions received by the taxpayer from the insurance company that were paid to the sub-agents. The auditor concluded the taxpayer was primarily responsible to pay the agents and that the full amount received from the company was taxable income to the taxpayer.

The taxpayer contends he hires the sub-agents for and on behalf of the insurance company and that the written contracts

between the sub-agents and the company show his representative capacity. The company sets the rates and commissions and permanent appointment of sub-agents by the taxpayer is subject to the company's approval. The soliciting agents are independent contractors and not employees of the general agent or the insurance company.

The company pays insurance commissions by means of a consolidated check sent to the taxpayer. The taxpayer stated he is given explicit instructions as to the pro-ration to be made for every dollar included in the consolidated commission payment. As general agent, he prepares the individual commission checks for the various sub-agents in accordance with the company's instructions.

The taxpayer has paid B&O tax on his commissions. He protests the assessment of tax on the commissions that are passed through to the sub-agents. He notes that in the preceding audit in 1979 and 1980, the auditor found the District Agent Commission contracts were three-way agreements between the agency, district agent and insurance company. The auditor's instructions stated, "[It] has been determined that the district agent is contracting with the insurance company and commissions put through the agency to the district agent are not taxable to the agency." The taxpayer stated that there has been no change in the sub-agent's contracts since the previous audit.

2) Schedule IV--Reconciliation of Gross Income. The taxpayer deferred some of his commission income into a retirement account which will be paid over a period of twenty years when he retires or if he terminates employment with the company. The taxpayer did not pay B&O tax on the deferred income. The auditor assessed tax on the deferred amounts concluding it was "gross income of the business" and taxable when earned rather than when actually received. The taxpayer argues he is a cash basis taxpayer and that the Department lacks authority to change his method of accounting merely to increase the amount of tax paid to the State or to change the timing upon which that tax will be paid to the State.

Also, the auditor assessed tax on deductions the taxpayer had taken for loan repayments to the insurance company. The taxpayer stated he paid B&O tax on the loan proceeds when they were received and that to deny a deduction for the loan repayment results in double taxation.

The auditor's instructions stated that loan proceeds are not taxable income as such amounts are not received as a result of taxable business activity. Because the Revenue Act provides no deduction for repayment of a loan from business income and because the taxpayer did not provide the auditor with evidence that the loan proceeds actually were reported, the deduction was denied.

3) Use tax or deferred sales tax on consumables and fixed assets.

In Schedule V the auditor assessed \$ . . . in use tax or deferred sales tax on fixed assets--used furniture, typewriter and camera--on which sales or use tax had not been paid. In Schedule VI, the auditor assessed tax on consumable supplies on which tax had not been paid. The auditor used a test period of 1983 and determined the percent of taxable income that was for purchases on which tax had not been paid. That percentage was applied to income for other years of the audit to arrive at a taxable amount of \$ . . . .

The taxpayer contends the test year was not an accurate statistical sample as it contained items related to the personal boat owned by the taxpayer. Also, the taxpayer contends some of the purchases were not retail sales but were purchases of services. The taxpayer has provided a list of all items which were purchased without payment of retail sales tax during the audit period. The taxpayer separated those which it agrees are taxable and those which it contends are not taxable. The taxpayer contends the total for taxable purchases is \$ . . . .

#### 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; . . .

Rule 164 is 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.

In following this rule, the Department has distinguished situations where the sub-agent has a contractual relationship with the insurance company from situations where the only contractual relationship is with a broker, district manager or general manager. In cases where the insurance company contracts directly with the soliciting agents to pay them their commissions, a broker or manager who receives the commissions does not incur B&O tax liability on the portion of the commission income earned by the sub-agents. In such cases, the broker or manager is not primarily or secondarily liable to pay the commissions to the sub-agent if not paid by the insurer. 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.

On the other hand, where the insuring companies only have a contractual relationship with the broker or manager, the broker or manager is liable for B&O tax on the total amount of commission income received. The broker or manager may not deduct commissions paid to sub-agents, even though the broker

or manager may have a contractual obligation with the sub-agents to pay them a portion of the commission income.

In the present case, the previous audit of the taxpayer's records determined that a sub-agent has a contractual relationship with both the taxpayer as general agent and the insurance company. We agree with that conclusion. The soliciting agent's contract has the insurance company name on the top of the form; the agent is appointed to solicit insurance issued by the Company; and an agent's duties and responsibilities are to the general agent and the company.

In the audit at issue, the auditor relied in part on section 16 of the agent's contract which states that the general agent shall pay commissions to the agent. The section adds, however, that the commissions are to be paid "at the rates, and subject to the regulations, set forth in the Standard Full Time Special and Soliciting Agents' Commission and Fee Schedule, published by the Company from time to time, in effect on the date of Part I of the Application for the policy or contract with respect to which commissions are to be paid." That section goes on to add that the Company reserves the right to change the agents' Commission and Fee Schedule. The insurance company sends instructions with the commission checks as to the amount of commission income to be retained by the taxpayer and the amount to be paid to the various agents.

The taxpayer pays the sub-agents their commissions as general agent of the insurance company. We agree with the previous audit instructions that the commissions earned by the sub-agents are not part of the taxpayer's gross income. Accordingly, the taxpayer's petition is granted as to this issue.

[2] Deferred compensation. Rule 164 clearly provides that the B&O tax applies to commissions which an agent "receives or becomes entitled to receive." The taxpayer was provided a copy of Rule 164 with a letter sent to him in 1969 after he inquired about Washington's excise tax laws. The letter stated that "gross income of the business means all commissions, fees and other emoluments however designated that the agent receives or becomes entitled to receive." (letter from audit section, October 31, 1969).

Unlike the federal tax provisions, Washington's Revenue Act contains no provisions which allow a taxpayer to defer a portion of gross income for retirement purposes and exclude the income in the year that it is earned. The federal tax

treatment of retirement contributions and payments is not controlling for state tax purposes. The taxpayer's petition is denied as to this issue.

[3] Commutations. The auditor denied a deduction for the taxpayer's repayments of the loan proceeds in part because of lack of evidence that the loan proceeds actually were reported. The taxpayer has the burden to provide evidence showing entitlement to a deduction. If that was not done, the taxpayer's bare assertion that taxes were paid on the loan proceeds when received was not grounds for relief.

The Department does not have authority to grant a credit or refund of the taxes paid in error if the refund request is not within the four year period stated in RCW 82.32.060. Guy F. Atkinson Co. v. State, 66 Wn.2d 570 (1965). Washington's Revenue Act does not contain mitigation provisions to relieve the harsh effect of non-claim statutes. The taxpayer's petition on this issue also is denied.

[4] Use tax/deferred sales tax. The taxpayer agrees that the tax applies to its purchases of tangible personal property on which sales or use tax has not been paid. A correlation generally exists between a taxpayer's purchases of consumable supplies and its income. The taxpayer contends, however, that the test period used was not representative of other periods.

Also, the taxpayer contends that the auditor included purchases of services which are not subject to the sales or use tax. The taxpayer stated that the purchases of the professional and management services meet the definition of information or computer services in WAC 458-20-155.

We will accept the taxpayer's schedule of all taxable transactions which were made during the audit period. Our acceptance is subject to audit review and verification. The taxpayer's petition is granted as to this issue.

#### DECISION AND DISPOSITION:

The taxpayer's petition is granted as to the assessment in Schedule III of B&O tax on sub-agents' commissions. The assessment of use tax in Schedules V and VI will also be adjusted as provided herein.

The petition is denied as to the assessment of B&O tax in Schedule IV on deferred income and commutations.

An amended assessment will be issued and due on the date provided thereon. As the delay in issuing this Determination was not due to any action of the taxpayer, extension interest shall be waived from December 1, 1987 through the new due date.

DATED this 14th day of October 1988.