Cite as Det. No. 99-223, 20 WTD 1 (2001)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment	)	D E T E R M I N A T I O N
	)	No. 99-223
. . .	)	Registration No. . . .
	)	FY. . ./Audit No. . . .

[1] RULE 246; RULE 159; RCW 82.04.080; RCW 82.04.423: COMMISSION INCOME – MULTI-LEVEL MARKETERS. All commission income of a multi-level marketer must be included in its gross income for B&O tax purposes.

[2] EQUAL PROTECTION -- SELECTIVE ENFORCEMENT. Fact that another taxpayer may not properly be reporting taxes is not grounds for overturning an assessment, citing *Frame Factory, v. Depart. of Ecology*, 21 Wn. App. 50 (1978); accord Det. No. 93-16,13 WTD 170 (1993) and Det. No. 92-4, 11 WTD 551 (1992).

[3] RULE 194: B&O TAX -- SERVICES -- APPORTIONMENT -- COST METHOD -- OUT-OF-STATE. Under the cost of doing business for the cost apportionment formula under Rule 194, a taxpayer's out-of-state travel costs should be included in the denominator and excluded from the numerator.

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.

NATURE OF ACTION:

Taxpayer protests Taxpayer Account Administration's assessment of Service and Other Activities Business and Occupation tax against his commission income earned as a network marketer for multi-level companies.[1][2]

FACTS:

[1] Nonprecedential portions of this determination have been deleted. See RCW 82.32.410.
[2] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

Bianchi, ALJ. -- As part of its tax discovery program, Taxpayer Account Administration (TAA) of the Department of Revenue (Department) examines certain taxpayers' federal 1099 returns and matches them against the taxpayer's state excise tax returns. In 1993, TAA discovered $. . . in commission income earned by this taxpayer which had not been included in the taxpayer's state excise tax returns.[3] Taxpayer is a direct seller's representative operating as a network marketer for several multi-level companies. Taxpayer had moved to Washington from California in 1992. Taxpayer reports that his California tax preparer, whom he continued to use, did not know that Business and Occupation (B&O) tax applied to commission income. Taxpayer also stated that he had checked with several local accountants who were also surprised that B&O tax applied to commission income.

Taxpayer offers five arguments in opposition to TAA's assessment of Service and Other Activities B&O tax[4] on this commission income. First, he contends that the Department did not inform him that B&O taxes were due on his commissions until he was contacted by TAA in October 1997. Second, he asserts that applying B&O tax to his gross income and not permitting him to deduct expenses creates an unfair advantage between salespersons who are reimbursed for expenses and those who are not. Third, he contends that representatives of other multi-level marketers are not being taxed on their commission income. Fourth, he contends that the audit improperly calculated the deduction for interstate sales by taking into account only his air and bus expenses and not taking into account his automobile expenses. Finally, he requests a waiver in interest because he did not receive clear instructions.

ISSUES:

1. Must the Department give a taxpayer specific prior notice of its tax liability before an assessment is valid?
2. Does the legislature's failure to provide an exemption for expenses from the B&O tax create an unfair advantage between taxpayers whose expenses are reimbursed and those who are not?
3. Is Taxpayer's suspicion that the Department may not be taxing all multilevel marketers on their commission income grounds for overturning this assessment?
4. Did the Department improperly calculate the deduction for interstate sales by omitting the cost of out of state meals and automobile expenses from the taxpayer's total out of state expenses?

. . .

1) The Department is not required to give specific reporting instructions to taxpayers before an assessment is valid.

[3] The taxpayer had reported excise tax on its publishing business and wholesaling of . . . products.
[4] Authorized by RCW 82.04.290.

The taxpayer contends that it did not know, and that the several accountants he consulted did not know, that B&O tax applied to commission income. The taxpayer's position is that if the state expects a business to pay a tax, the state has the responsibility to make sure the business knows about the tax.

The state does try to provide accessible taxpayer information. There are 17 regional offices around the state to assist taxpayers and answer questions without charge. The state also maintains an office of taxpayer information. That office receives numerous inquiries from not only Washington residents, but residents from other states regarding Washington's tax structure.

Business taxes, however, are self-assessing in nature. The ultimate responsibility for properly reporting taxes rests on persons in business. The state is not required to make sure every business knows its tax obligation before it can assess taxes, interest, or penalties. As a practical matter, it would be impossible for the Department to audit every person in business in this state or give every person actual notice of potential tax liability. See Det. No. 86-249, 1 WTD 161 (1986). The assigned error of lack of notice is rejected.

[1] The B&O tax applies to the gross income of a business without deduction for expenses.

Gross income for B&O tax purposes is defined in RCW 82.04.080 as:

> 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, 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.

(Emphasis added.) Certain out-of-state sellers who only use direct seller's representatives to sell consumer goods in Washington state are exempt from wholesaling or retailing B&O tax, under RCW 82.04.423 and WAC 258-20-246 (Rule 246). Rule 246 clarifies, however, that the income received by the direct seller's representatives themselves is not subject to any similar exemption. The rule states clearly on its face that commission income of direct seller's representatives is taxable.

> SERVICE. The law provides no similar business and occupation tax exemption with regard to the compensation paid to the "direct seller's representative." Thus, the representative will remain subject to the business and occupation tax on all commissions or other compensation earned.

Det. No. 91-011, 10 WTD 381 (1990) clarifies that Service B&O tax is due on the commission income of salespersons under WAC 459-20-159 (Rule 159) even if they are not direct seller's representatives.

Taxpayer's suggestion that it would be fairer to distinguish between direct seller's representatives whose expenses are reimbursed by their sellers and those who are not is an argument that must be directed to the legislature, not the Department of Revenue. The Department can only enforce what the legislature has pronounced. It is doubtful, however, that such a rule would provide the relief suggested. Reimbursed expenses are counted as part of the gross compensation paid to direct seller's representatives. Reimbursement of expenses merely results in a higher amount subject to tax. The B&O tax is a gross receipts tax, not a net income tax. No deductions for expenses are allowed. At the hearing the taxpayer agreed that he now understood that he owed the tax and that expenses were not deductible.

[2] Selective Enforcement.

The taxpayer also argues it is improper for the Department to find the taxpayer subject to service B&O tax, because taxpayer suspects that not all other multi-level marketers are being taxed in the same way.

First and foremost, resolution of this manner would require that we discuss other taxpayers' activities with the Department of Revenue. That we cannot do. Our state's legislature has chosen to protect the privacy of every taxpayer in this state by enacting RCW 82.32.330, with its strong language. That statute provides:

> Returns and tax information shall be confidential and privileged, and except as authorized by this section, neither the department of revenue nor any officer, employee or representative thereof nor any other person may disclose any return or tax information.

RCW 82.32.330 further states:

> [a]ny person acquiring knowledge of any return or tax information in the course of his or her employment with the department of revenue . . . who discloses any such return or tax information to another person not entitled to knowledge of such return or tax information . . . shall upon conviction be punished by a fine . . . and, if the person guilty of such violation is an officer or employee of the state, such person shall forfeit such office or employment and shall be incapable of holding any public office or employment in this state for a period of two years thereafter. (Brackets supplied.)

Additionally, a correct assessment would not be overturned on grounds of selective enforcement. The B&O tax is self-assessing in nature. The responsibility for registering with the Department and properly reporting taxes rests on persons in business, not on the state. In *Frame Factory v. Dept. of*

Ecology, 21 Wn.App. 50 (1978), the Washington Court of Appeals rejected a claim that the defendant had engaged in "selective enforcement" against the plaintiff. The court noted that

> The Frame Factory does not allege that it was selected for "prosecution" on the basis of some prohibited grounds such as race, religion or other arbitrary classification. But it asserts there is no justifiable reason why it was selected for enforcement.

The court upheld the enforcement of the regulation against the Frame Factory. Here the taxpayer does not allege that he was selected for assessment for any prohibited reason. The *Frame* principal has frequently been applied in the excise tax arena. See e.g. Det. No. 93-16, 13 WTD 170 (1993); Det. No. 92-4, 11 WTD 551 (1992). In those determinations, we explained that the fact that another taxpayer may not be properly reporting its taxes is not sufficient grounds for overturning a valid assessment. Therefore, we cannot overturn the assessment based on a claim of selective enforcement.

[3] Improper calculation of [apportionment].

The taxpayer is entitled to apportion its income according to the ratio that his in-state costs bear to his total costs. RCW 82.04.460; WAC 458-20-194 (Rule 194).

> Any person rendering services taxable under RCW 82.04.290 and maintaining places of business both within and without this state which contribute to the rendition of such services shall, for the purpose of computing tax liability under RCW 82.04.290, apportion to this state that portion of his gross income which is derived from services rendered within this state. Where such apportionment cannot be accurately made by separate accounting methods, the taxpayer shall apportion to this state that proportion of his total income which the cost of doing business within the state bears to the total cost of doing business both within and without the state.

The taxpayer was assessed Service B&O tax under RCW 82.04.290. Travel costs incurred out of state are inherently out-of-state costs that should be included in the denominator (total costs) and excluded from numerator (in-state costs). Det. No. 89-448, 8 WTD 189 (1989). TAA included both the air travel and car travel in the denominator, but excluded only the air travel from the numerator.

Specifically, taxpayer contends that his total out-of-state expenses for 1993, as disclosed on Schedule C of his 1993 federal income return, were $. . . . These expenses consisted of use of his car and truck which he estimates he used 90-95% of the time for out-of-state travel ($. . . - 5%=
$. . .), by air and bus ($. . .) and meals ($. . .). His total expenses, disclosed on Schedule C, were $. . . ($. . . + $. . .). If the car and truck expenses were included and 95% of them were attributable to out-of-state business travel, the percentage of in-state expenses to total expenses

to be applied to his total income should have been 72.5%, rather than the 82% allowed by TAA. This would result in income subject to tax after apportionment of $. . . rather than $. . . .

If taxpayer is correct that he has used his car and truck 95 % of the time in out-of-state business travel, then such costs should have been excluded from the calculation of in-state costs in the apportionment formula. This issue is remanded to TAA for the purpose of examining the taxpayer's records showing the amount of time the car and truck were used out of state and correcting the assessment accordingly. Within 60 days of the issuance of the determination, Taxpayer shall provide TAA with records demonstrating the out-of-state usage of the car and truck in 1993. In the event such records are not produced within such time or such extension as TAA in its sole discretion may grant, the assessment shall be confirmed.

DISPOSITION

This appeal is remanded to the Taxpayer Account Administration for correction as set out in section 4 above, provided that taxpayer provides TAA with documentation as set forth in section 4 above within 60 days of the date of issuance of this determination, or such extension as Audit may, in its sole discretion, permit.

Dated this 30th day of June, 1999.