Cite as Det. No. 00-094, 21 WTD 58 (2002)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Joint Petitions For Correction of Assessments of	)	D E T E R M I N A T I O N
	)	No. 00-094
. . .	)	Registration No. . . .
	)	FY . . . /Audit No. . . .
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[1] RULE 110; RCW 82.08.020: RETAIL SALES TAX -- MAGAZINE SUBSCRIPTIONS -- PROCESSING AND HANDLING FEES. Processing and handling fees charged to buyers of magazine subscriptions in addition to the magazine subscription charge are part of the measure of the selling price and fully subject to retail sales tax.

[2] RULE 127: RETAIL SALES TAX -- MAGAZINE DISTRIBUTOR -- PARTY RESPONSIBLE FOR COLLECTING. A magazine clearinghouse that operates under independent distributor agreements authorizing it to market magazines to the general public, and that contracts with independent sales organizations to sell subscriptions door to door, is a "distributor" for purposes of WAC 458-20-127, and is the one responsible for the collection and payment of the retail sales tax.

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:

Magazine subscription clearinghouses protest assessment of uncollected retail sales tax on processing and handling fees charged customers at the time of sale, contending that door-to-door sales agents who sold the subscriptions were responsible for collecting and remitting the tax, and the taxpayers were not liable for the salespersons' errors.[1]

FACTS:

Prusia, A.L.J. -- The three taxpayers, . . . and . . . , are affiliated Washington corporations engaged in the magazine subscription business as subscription clearinghouses. They are separately owned but jointly operated, together with a fourth affiliated corporation that processes payments and disburses expenditures on their behalf.[2] At the request of the three taxpayers, we have consolidated for hearing and decision their petitions for correction of assessment, because the petitions involve common issues of fact and law.

The taxpayers are part of a multi-level marketing organization. The organization involves the following entities: 1) magazine publishers, which enter into independent distributor agreements with national/regional clearinghouses; 2) national/regional clearinghouses, which contract with magazine publishers to market the magazines and which enter into independent distributor agreements with other clearinghouses such as the taxpayers; 3) clearinghouses, such as the taxpayers, which operate under independent distributor agreements with a national/regional clearinghouse, and which enter into contracts with independent sales organizations to solicit magazine subscriptions; 4) independent sales organizations, which operate under contracts with clearinghouses authorizing them to solicit and sell orders for magazine subscriptions, and which contract with individual salespeople to solicit and sell orders for magazine subscriptions door-to-door; 5) the door-to-door salespeople; 6) [Payment Processing Co.], an entity which processes payments and disburses expenditures on behalf of the three taxpayers.

Beginning in 1998, the Audit Division of the Department of Revenue (Department) examined the records of the four affiliated corporations. All were examined at the same time, but for slightly different audit periods. The audit investigation found that the three clearinghouses had been remitting retail sales tax due on magazine subscriptions obtained by the door-to-door salespeople, but retail sales tax had not been paid on processing and handling fees charged to customers in addition to the magazine subscription charge. The Audit Division assessed, against the taxpayers, additional taxes and interest due on the processing and handling fees. The assessment periods, numbers, and amounts for the three clearinghouses are as follows:

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[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

[2] The fourth affiliated company is [Payment Processing Co.]. Subsequent to the time period relevant to this appeal, the taxpayer and related entities were reorganized. [Payment Processing Co.] is the surviving entity, and engages in the activities formerly engaged in by the three taxpayers.

. . .

The assessments remain unpaid.

The "Auditor's Detail of Differences and Instructions to Taxpayers," which accompanied each assessment, are nearly identical. Each explains that the additional tax is asserted on the processing and handling fees charged to the customers, and summarizes statutes and rules upon which the Audit Division based the assessment. Each states: "Since you have a multilevel agreement filed with the Department this schedule only asserts the retail sales tax on the processing and handling fees charged to your Washington customers throughout the audit period."

Each taxpayer petitioned for cancellation of the assessment. Each petition asserts that there was no multi-level organization contract in effect during the applicable audit period. Each contends the failure to collect and remit sales tax was an error of the door-to-door "sales agents," and the Department should look to the "independent sales agents" for payment of the taxes rather than the taxpayer. Each contends it only remitted sales tax on behalf of the door-to-door sales agents, and did not intend to be liable for any errors the sales agents may have made.

The Audit Division submitted identical responses to each of the three petitions. In each response, the Audit Division acknowledged there was no multi-level agreement in effect during the audit period, but concluded nonetheless the taxpayer was liable for the uncollected retail sales taxes on the processing and handling fees, based upon the actual practice of the business. The Audit Division's response states, in relevant part:

> In a letter dated August 5, 1993, the taxpayer's accountant expressed that the clearinghouse corporation should be considered the distributor and remit the sales tax collected on those sales originating in the State of Washington. This letter has been referenced and attached to the original audit. In the letter, the intent was for the clearinghouse to remit the sales tax collected by the door to door salespersons.
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> Based on the Independent Contractor Agreement, the door to door sales person is acting as an agent for the clearinghouse . . . . Per the contract, the company (clearing house) has control over the contractor (door to door salesperson). The company and publishers have the authority to accept or reject any orders collected by the contractor. The contractor is required to make the sale and turn over all funds to the company within 3 days of receiving an order. The clearing house company agrees to maintain accurate records of all orders processed, cancelled, points, and revenues. The contractor is then compensated on a shared revenue basis on the sales revenue of the magazines, as itemized in the monthly price list provided by the company.
>
> The company is in control of the price that is being charged by the contractor. The company also owns the names and addresses of the customers who have placed orders.

> At no time does it appear that the contractor is making sales of their [sic] own. They are acting in an agency capacity for the clearinghouse, essentially standing in the place of the clearinghouse company when the sales are made. This was also the intent stated in the taxpayer's letter dated August 5, 1993 to the Department. This also is consistent with the taxpayer's actual operations.

At hearing, the taxpayers contended the Audit Division misidentified the parties to the "Independent Contractor Agreement," and misunderstood the relationships among the players in the marketing organization. The "Independent Contractor Agreements" are between the taxpayers and the sales organizations. Each taxpayer contracts with a number of sales organizations. It is the sales organizations that contract with the door-to-door sellers. The Independent Contractor Agreements do not give the taxpayers any control over the door-to-door sellers, nor do the taxpayers exercise any control over them.

The Audit Division misunderstood the control the taxpayers exercise over downstream players. The Independent Contractor Agreements with the sales organizations (which are labeled "contractors") provide that the sales organizations may not use the taxpayer's name or represent directly or indirectly that they have any relationship with the taxpayer. Checks and money orders must be made out to the sales organization. The taxpayer does not control the prices charged customers. The publishers mandate the price for subscriptions. The taxpayer does not require the sales organizations to remit all collections. The contractor agreements clearly provide only that the sales organizations must forward orders and customer checks to the taxpayer. The practice is for the door-to-door salespeople to collect the subscription price, retail sales tax, and a $7.50 processing and handling fee, and to remit all collections to the sales organization. The sales organization then forwards checks and money orders to [Payment Processing Co.] and retains cash collections. [Payment Processing Co.] retains the subscription orders, checks, and money orders for ten days to allow for cancellations, then deposits the payments to the various sales organizations' accounts. On behalf of each taxpayer, [Payment Processing Co.] periodically performs a hypothetical calculation of amounts due the publishers, the taxpayers, and for retail sales tax, based upon the orders received, bills or reimburses the sales organization for the difference.

The taxpayers state they always understood that the door-to-door salespersons were responsible for collecting and remitting retail sales tax on the magazine subscriptions and for paying retailing Business and Occupation (B&O) tax. They state they remitted retail sales tax on behalf of the door-to-door salespersons only as a favor to the Department and the salespersons, and it was never their intention to assume liability for payment of the tax. The taxpayers were unaware retail sales tax was due on the $7.50 processing and handling fees.

The taxpayers submitted a copy of the August 5, 1993 letter referenced in the Audit Division's response, as well as copies of correspondence between their accountant and the Department during 1994. The August 5, 1993 letter identified the various entities involved in the marketing network, stated the accountant's understanding that retail sales tax was due as provided in WAC 458-20-127 (Rule 127), sought clarification of the B&O tax liability of the various entities, and

expressed a desire to find a simplied method for the reporting requirements of the door-to-door salespersons. It stated: "Furthermore, we feel that the *clearing house corporation* should be considered the distributor and remit the sales tax collected on those sales originating in the State of Washington." (Italicization in the original.) The 1994 correspondence concerned a possible agreement between [two of the taxpayers] and the Department for those taxpayers to report under their accounts the sales tax collected and the B&O tax due on behalf of the door-to-door "sales agents." In an October 26, 1994 proposal, the accountant stated the taxpayers' understanding of their responsibility, under such an agreement, as follows:

> Any of the sales tax on those sales which are made within the State of Washington and cleared or processed through our company will be remitted to the State under our account, though the primary obligation for the collection of the sales tax is at the door to door sales agent's level. . . .
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> This agreement is being made with the WA State Dept. of Revenue in lieu of registration with your department by each of these sales agents who would not otherwise be required to register due to their minimal volume of sales. Our role, as a wholesaler or a distributor, should not be construed to have changed due to this proposal. We are only attempting to make certain that the State of Washington receives its proper tax and we are in a position to assist them in that effort.

During the audit investigation, and at hearing, the taxpayers also argued that if they are responsible for paying the uncollected retail sales tax, the Department should waive the tax. The taxpayers argued that they have never collected or remitted retail sales tax on processing and handling fees, and a 1995 audit of [one of the taxpayers] by the Department, for an earlier audit period, found no problem with the way [one of the taxpayers] was handling sales taxes. All the taxpayers have handled sales taxes the same as [one of the taxpayers], and relied upon the 1995 audit report and instructions in continuing to handle their tax obligations in the same way.

ISSUES:

1. Are the taxpayers liable for the uncollected retail sales taxes on processing and handling fees charged retail customers?

2 Is the taxpayers' reliance on an earlier audit a basis for canceling or waiving the tax assessment?

DISCUSSION:

All sales of tangible personal property to consumers in the state of Washington are subject to retail sales tax, unless there is a specific exemption. RCW 82.08.020 and 82.04.050. RCW 82.08.050 states that in case any seller fails to collect the tax imposed in Chapter 82.08 RCW, the seller is personally liable to the state for the amount of the tax, unless the seller has taken from the buyer in good faith a resale certificate.

WAC 458-20-110 (Rule 110) explains that freight and delivery costs charged to the buyer are generally part of the selling price. This interpretation is based upon the definitions of "gross proceeds of sales" and "gross income of the business" at RCW 82.04.070 and .080. Rule 110 provides the following example, at subsection (5)(e):

> Jones Computer Supply, a distributor located in Seattle, sells computer products primarily by mail order. It is the practice of Jones Computer Supply to make a three-dollar handling charge for each order. No separate charge is made for the transportation. The handling charge is part of the measure of the selling price of the product and fully subject to the wholesaling or retailing [B&O tax] and retail sales tax.

Thus, the Audit Division correctly determined that the processing and handling fee that is charged the consumer at the time of sale is part of the measure of the selling price of the magazines, and fully subject to retail sales tax.

Who was responsible for collection of retail sales tax on those fees under the facts presented? As a general rule, if the person making the actual retail sale is engaging in business and not an employee, he or she is deemed the seller, and is responsible for collecting the retail sales tax. *See* WAC 458-20-105 (Rule 105) and WAC 458-20-106 (Rule 106). However, a specific Department rule, WAC 458-20-127 (Rule 127), addresses who is responsible for collecting retail sales tax on sales of magazines. Rule 127 provides, in pertinent part:

> When magazines or periodicals are distributed to the final purchaser by a distributor who effects such distribution through organizers, captains, or others selling from house to house or upon the streets, the news company or distributor is the one responsible for the collection and payment of the retail sales tax.

Rule 127 does not define the term "distributor." When a term is not defined, commonly understood definitions will apply. *King County v. City of Seattle*, 70 Wn.2d 988, 425 P.2d 887 (1967). A "distributor" commonly means any "individual, partnership, corporation, association, or other legal relationship which stands between the manufacturer and the retail seller in purchases, consignments, or contracts for sale of consumer goods," *Black's Law Dictionary* 427 (5th ed. 1979), or "one that markets a commodity; *esp:* WHOLESALER," *Webster's Third New International Dictionary* 660 (1993).

The taxpayers fit the definition of "distributor." The taxpayers are the parties the publishers authorize to market the magazines to the general public. The taxpayers effect the distribution through the independent sales organizations and the door-to-door salespeople with whom those organizations contract. Moreover, the taxpayers characterized themselves as the "distributor" in the multi-level organization in the August 5, 1993 letter to the Department.

We conclude that the taxpayers are the "distributors" of the magazines for purposes of Rule 127. Therefore, the taxpayers were responsible for collecting and remitting the retail sales tax on sales

made by the door-to-door salespersons during the audit period. The taxpayers are the parties liable for the uncollected retail sales tax due on the processing and handling fees.

Because a specific rule addresses the issue, the taxpayers' and the Audit Division's arguments based upon more general provisions, which would impose the obligation to collect and remit retail sales tax on the door-to-door salespersons if they are "engaged in business," are beside the point. A specific statute or rule takes precedence over a general statute or rule. *State v. Q.D.*, 102 Wn.2d 19, 685 P.2d 557 (1984).

We now address the taxpayers' requests that the Department waive or cancel the uncollected tax, based upon the taxpayers' reliance on the 1995 audit of [one of the taxpayers]. The Department's only authority to waive a tax deficiency is set out in RCW 82.32A.020. That statute authorizes the waiver of interest and, in some instances, taxes, if the taxpayer has relied upon specific, official written advice and written tax reporting instructions from the Department.

RCW 82.32A.020 does not apply here, because the 1995 audit report and instructions were silent as to whether retail sales tax was due on processing and handling fees. There is no specific reporting instruction to the taxpayer that it need not collect retail sales tax on those fees. The Audit Division apparently overlooked [one of the taxpayers] obligation to collect, report, and remit retails sales tax on the processing and handling fees.

It is well established that the Department is not barred from asserting a tax liability because its auditors failed to find the error in an earlier audit. *See Kitsap-Mason Dairymen's Ass'n v. State Tax Comm'n*, 77 Wn.2d 812, 467 P.2d 312 (1970); *Dept. of Rev. v. Martin Air Conditioning*, 35 Wn.App. 678, 668 P.2d 1286 (1983); Det. No. 99-056, 19 WTD 54 (2000); Det. No. 93-191, 13 WTD 344 (1994).

In Det. No. 93-191, *supra*, the Department noted that auditors generally try to discover deficiencies as well as credits in the course of their audits in order to arrive at an accurate determination of tax liability. Auditors, however, cannot be held to a standard of perfection. The Revenue Act does not impose a duty on auditors to discover every error in taxpayers' reporting during the course of an audit.

DECISION AND DISPOSITION:

The taxpayer's respective petitions for correction of assessment are denied.

Dated this 26th day of May, 2000.