Cite as Det. No. 02-0070R, 23 WTD 6 (2004)

BEFORE THE 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. 02-0070R
. . .	)	
	)	Registration No. . . .
	)	Document No. . . .
	)	Docket No. . . .

[1] RULE 111: ADVANCES AND REIMBURSEMENTS -- APPLICATION OF. *WILLIAM ROGERS*. The court's construction of the City of Tacoma's Rule 111 in *William Rogers* applies to the construction of the Department's Rule 111 because the rules are identical and the court interpreted the City's rule by referring to decisions interpreting the Department's rule.

[2] RULE 111: MISCELLANEOUS -- ERRONEOUS APPLICATION OF A RULE. The Department's erroneous granting to William Rogers, Co. of the benefit of the Rule 111 exclusion need not be perpetuated by granting unrelated third parties the same erroneous application.

[3] RULE 111: PRINCIPAL-AGENT RELATIONSHIP. The court in *William Rogers* stated that before Rule 111 will apply, the person claiming the exclusion must prove that it acted as an agent.

[4] RULE 111: UNDISCLOSED PRINCIPAL. If a taxpayer acts as an agent for an undisclosed principal, then the taxpayer is personally bound to perform any contract entered into for the undisclosed principal as the principal. Therefore, an agent for an undisclosed principal does not qualify for Rule 111 exclusion, because the agent is liable as the principal and not solely as an agent.

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.

Coffman, A.L.J. – The Taxpayer, a wholly-owned subsidiary, which provided personnel to operate its parent's retail stores, requests reconsideration of Det. No. 02-0070 where we found it was not entitled to exclude from its gross receipts amounts it received from the parent corporation for providing such personnel. We denied the taxpayer pass-through treatment of such amounts, finding the amounts did not qualify under WAC 458-20-111 (Rule 111) as reimbursements for advances. The taxpayer requested we suspend our review of its reconsideration pending the Washington State Supreme Court decision in *City of Tacoma v. William Rogers Co*., 148.Wn.2d 169, 60 P.3rd 79 (2002). That decision has now been issued. We hereby affirm our decision in Det. No. 02-0070. We again conclude the Taxpayer is not entitled to treat the amounts it received from its parent corporation as reimbursements for advances under Rule 111.[1]

ISSUES

1. Does the analysis of the City of Tacoma's Department of Tax and License, Rule 111 (City Rule 111) in *City of Tacoma v. William Rogers Co.*, 148 Wn.2d 169, 60 P.3rd 79 (2002), apply to the interpretation of Department's Rule 111?
2. Has the Taxpayer presented sufficient evidence to prove that it was acting as an agent for Parent Corporation when it paid the salary and benefits to the personnel operating Parent Corporation's retail establishments?
3. If the Taxpayer was an agent of Parent Corporation, did it have any liability to the personnel other than as agent for Parent Corporation?

FINDINGS OF FACT

The Taxpayer is a wholly-owned subsidiary of a . . . retailer. The Parent Corporation formed the Taxpayer to manage and operate its . . . (retail stores) because Parent Corporation could reduce the net costs related to retirement plans, other employee benefits, and unemployment taxes. The Taxpayer's Board of Directors consisted of officers of the Parent.

According to the contract between the Taxpayer and the Parent Corporation, the Taxpayer employed personnel to manage and operate the retail stores owned by the Parent. The Parent paid the Taxpayer for its services based on the total payroll costs plus 6%. The contract between the Taxpayer and its Parent states that the Taxpayer was "solely responsible for compensating the employees." In addition, the Taxpayer was responsible for evaluating its employees, for determining benefits and wages, and for training the employees to operate and manage the [retail stores]. The Parent Corporation performed all administrative services for the Taxpayer; and determined the retail store hours of operation and prices of goods sold. The contract does not indicate that the taxpayer is acting as an agent of the parent.

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

Further, the Taxpayer provided its employees with an employee handbook. This handbook provided information on salary, benefits, company policies, and rules of conduct, as well as other information. We summarized the handbook in our initial determination as follows:

> The Employee Handbook refers to Parent and Parent's products in three places. Specifically, the Employee Handbook's Introduction (page . . .), identifies the Parent-Subsidiary relationship and the fact that the retail outlets sell Parent's products. On page . . . , the Handbook states that employment is "at will" and that no employee or manager of either the taxpayer or the Parent has "the authority to enter an agreement" for employment for a fixed period of time. On Page . . . of the Employee Handbook, employees are reminded that they represent the Parent's products. The remainder of the Employee Handbook refers to the taxpayer's policies concerning leave, benefits, and other matters.

We determined in our original determination (Det. No. 02-0070) that the payroll amount and the 6% fee it received from the Parent Corporation constituted gross receipts and that the Taxpayer was liable for B&O tax measured by those gross receipts. We concluded that the Taxpayer was not entitled to exclude the payroll expenses from its gross receipts under Rule 111. In reaching this conclusion, we said that the taxpayer was liable for payment to the employees and the money it received was for its services of managing and operating the [retail stores].

The Taxpayer has requested reconsideration of Det. No. 02-0070. The Taxpayer again argues that Parent Corporation had pervasive control of the Taxpayer and therefore was the employer of the staff operating the retail stores. We now address both the Taxpayer's reconsideration request and its Supplemental Memorandum on *William Rogers, supra*.

ANALYSIS

WAC 458-20-111 (Rule 111) identifies an exclusion[2] from the measure of the business and occupation tax for amounts received as advances or reimbursements. Rule 111 is based on the theory that the payments are not "gross income of the business" or "gross proceeds from sales." In *Christensen, O'Connor, Garrison & Havelka v. Department of Revenue*, 97 Wn.2d 764, 768, 649 P.2d 839 (1982), the Court identified three conditions a taxpayer must show to claim a Rule 111 exclusion. The court said a reimbursement occurs when

> (1) [the payment] . . . is a customary reimbursement for an advance made to procure a service for a client, (2) the taxpayer does not or cannot render the service, and (3) the taxpayer was not liable for the payment [except as an agent].

In *William Rogers, supra,* the court addressed the application of the City of Tacoma's Rule 111 to a temporary staffing company's receipts it used to pay salaries and benefits to the temporary

[2] Department Rule 111 is frequently referred to as a deduction provision. Actually, Department Rule 111 clarifies that certain receipts are not taxpayer's revenue and therefore are not part of the measure of the business and occupation tax. That is, those receipts are excluded and need not be reported on an excise tax return.

workers it assigned to its customers. William Rogers had requested a refund of city business and occupation taxes paid on those receipts. The City denied the refund and William Rogers appealed. The Hearing Examiner and the Superior Court agreed with William Rogers and granted it a refund finding that the payments qualified for the City's Rule 111 exclusion. The Washington Supreme Court took the matter under direct review. The Washington Supreme Court reversed the Superior Court decision, finding that William Rogers was not entitled to exclude from the measure of the City B&O tax amounts used to pay the workers' salaries and benefits.

In its supplement to its petition for reconsideration, the Taxpayer now argues that *William Rogers, supra,* does not apply to the Department because the court was interpreting the City of Tacoma's Rule 111 (City Rule 111) and not the Department's Rule 111.[3] In support of this position, the taxpayer cites to the Department's *Amicus Curiae* brief for the proposition that the "Department, in construing Rule 111, concluded that *Rogers,* met the requirements and could take the deduction under Rule 111. . . . Thus, until the Department changes [its] construction, it remains the current, lawful construction of Rule 111." (Italics in original.) Taxpayer's Supplemental Memorandum, page 3.

[1] We need not decide whether the Department's construction of Rule 111 is binding on the City of Tacoma or whether the City of Tacoma's construction of its Rule 111 is binding on the Department. Rather, it is the Court's construction of these rules in the *William Rogers* decision that is binding on the Department.

We reach this conclusion because the two rules are identical[4] and in reaching its decision in the *William Rogers* case, the Court analyzed the City's Rule 111 in the context of Washington court decisions that have interpreted the Department's Rule 111. Therefore, we conclude the court's interpretation of City Rule 111 applies equally to the Department's Rule 111 and *William Rogers* is binding on the Department.

Regarding the Department's application of its Rule 111 to William Rogers, the Department stated, at page 15 of its *Amicus Curiae* brief:

> The Department does not dispute that its Audit Division, after initially denying a refund request filed by Evergreen [William Rogers], later reversed that decision. But for the reasons set forth in this brief, as well as Tacoma's briefs, the Audit Division simply erred in allowing Evergreen to deduct the wages and benefits it paid temporary workers as "pass-through" payments under WAC 458-20-111.

(Emphasis and bracketed material added.)

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[3] C*f. Commonwealth Title Ins. Co. v. City of Tacoma,* 81 Wn.2d 391, 502 P.2d 1024 (1972) (explaining that while a city is bound by the State's definition of a retail sale, a city is not bound by the State's business and occupation tax classification of the same activity). Although both the City of Tacoma and the Department argued that the Department's interpretation of Rule 111 to William Rogers was not binding on Tacoma, the court did not address this issue.

[4] *William Rogers,* footnote 5.

[2] The Taxpayer argues that the Department must apply the same treatment to it as the Department erroneously applied to the William Rogers Company. We disagree. We have consistently held that taxpayers may not rely on the Department's erroneous interpretation of a rule issued to a third party. Det. No 01-165R, 22 WTD 11 (2003); Det. No. 99-027, 19 WTD 44 (2000). The Department's error in granting William Rogers Company a refund does not mean the Department must perpetuate that error by repeating it with respect to other taxpayers. Indeed, granting a refund now would be at odds with the Supreme Court's decision in *William Rogers*.

Alternatively, the Taxpayer argues if the decision in *William Rogers* applies, then the Taxpayer's situation is factually distinguishable and it is entitled to exclude from the measure of the B&O tax certain amounts received from its Parent Corporation.

According to the Taxpayer, the distinguishing facts are:

(1) William Rogers was a corporation totally independent from its clients, while the taxpayer is wholly owned and managed by the officers of its Parent Corporation;
(2) William Rogers stated it employed the workers, while the Taxpayer "has never denied that its client is the employer,"[5] and,
(3) William Rogers had numerous clients and advertised/marketed its services, while the Taxpayer had only one client and did not advertise/market itself to the public.

We will address each one of the taxpayer's statements.

[3] The court in *William Rogers* stated that in claiming a pass-through exclusion under Rule 111, "taxpayer[s] had to prove that the advance in question was made pursuant to an agency relationship." 148 Wn.2d at 177. The Taxpayer has not met that burden. The mere fact that the same persons are officers and directors of both the Parent Corporation and the Taxpayer is insufficient to establish an agency relationship between the Parent Corporation and the Taxpayer relative to their dealings with the employees. As the Washington Supreme Court in *Rena-Ware Distributors, Inc. v. State of Washington*, 77 Wn.2d 514, 518, 463 P.2d 622 (1970), stated:

> For purposes of the taxing statutes, they are separate entities. Mere common ownership of stock, the same officers, employees, etc., does not justify disregarding the separate corporate identities unless a fraud is being worked upon a third party. [6]

[5] *See*, Taxpayer's Supplemental Memorandum, page 4.

[6] There is no reason to believe that the Taxpayer or Parent Corporation was attempting to defraud a third party. Further, it would be incongruous to allow a person to commit fraud and avoid tax by doing so. *Cf. Washington Sav-Mor Oil Co. v. State Tax Commission*, 58 Wn.2d 518, 364 P.2d 440 (1961) (Where a wholly-owned subsidiary made supply purchases and resold the supplies to its parent corporation, when the suppliers would not sell directly to the parent, the subsidiary's sales to the parent corporation were fully taxable.)

[Footnote added.] We affirm our original conclusion that the Taxpayer has not proved that it was the Parent Corporation's agent. In fact, the contrary is evident. The contract between the Taxpayer and Parent Corporation specifically stated that the Taxpayer was the employer of the employees for all purposes.[7] No evidence has been presented to indicate that the taxpayer and the Parent acted in any manner inconsistent with the terms of their agreement or with respect to the employees.

In fact, the [Taxpayer] Employee Handbook (Handbook) supports an opposite conclusion. It is replete with references to the Taxpayer's policies, employee benefit packages, and other indications that it was the employer. We list only three examples.

> 1. "The [Taxpayer] Handbook sets forth the rules and procedures for you as a [Taxpayer] employee." Employee Handbook Receipt, Handbook, page . . . .
> 2. "It is the policy of [Taxpayer] . . . any employee is free to end his/her employment with [Taxpayer] at any time . . . ." Handbook, page . . . .
> 3. "The employees of [Taxpayer] are the Company's most important asset." Handbook, page . . . .

While the Taxpayer considers that William Rogers admitted being the employer of the workers distinguishable from its situation because it did not "deny" that the Parent Corporation was the employer, we find this statement disingenuous in light of the employee handbook and the contract with its parent. The Taxpayer, through its written employee management policies and contracts, has affirmatively stated that it is their employer.

There are no facts provided that indicate the Parent Corporation had any supervision, hiring, or terminating relationship with the employees.[8] Those were the functions for which the Taxpayer had been formed and for which the Taxpayer received compensation from the Parent Corporation. The sole business purpose of the Taxpayer is to manage the [retail stores]. To successfully perform this function, the Taxpayer hired employees. The Handbook clearly and unequivocally indicates that the Taxpayer was the employer with the specific obligation to pay its employees. No evidence has been presented showing the employees were notified that Parent Corporation employed them or that the Taxpayer's payroll obligation was contingent upon the Parent.

The third distinguishing fact the Taxpayer raises is that it had only one client: its Parent Corporation. The fact that the Taxpayer had only one client and did not advertise/market its services to the public does not prove the Taxpayer was that client's agent or that the Taxpayer was liable for the employees' wages solely as an agent. It simply shows that the Taxpayer was formed to engage in the business of operating and managing the Parent's [retail stores] and that it chose to do that by hiring employees. Thus, the fact that the Taxpayer's gross receipts were

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[7] We realize that reliance on this fact alone by the Board of Tax Appeals (BTA) was the reason the court remanded the case to the BTA in *Rho Co., supra*.

[8] In fact, if Parent Corporation was the employer, then the employees would have been entitled to the retirement benefits offered Parent's employees. 26 U.S.C.§§ 401 through 425.

derived from its exclusive contract with its Parent Corporation, does not remove its obligation to pay tax measured by those receipts. It is well established that transactions between related corporations are fully taxable. *See Washington Sav-Mor Oil Co., supra;* WAC 458-20-203.

Based on the foregoing discussion, we conclude that the Taxpayer was not the agent of Parent Corporation

[4] We note further that even if the facts had shown it was the intention of the parties that Taxpayer was to be liable to the employees solely as an agent of the Parent Corporation, that intention had not been disclosed to the employees. Under these facts, the Parent Corporation would be an undisclosed principal for whom the Taxpayer contracted with the employees. "An agent who acts for an undisclosed principal will be personally bound by the obligations of the contract *as principal* if the name of the principal is not disclosed." (Emphasis in original.) *Matsko v. Dally*, 49 Wn.2d 370, 374, 301 P.2d 1074 (1956). Therefore, the Taxpayer would be liable for the employee's salary and benefits other than as agent. "When a taxpayer meets its burden and establishes the existence of an agency relationship, a second question must be asked: whether the taxpayer's liability to pay the advance "constituted *solely* agent liability."" *William Rogers*, *Id.* at 178; *citing Rho Co. v. Department of Revenue*, 113 Wn.2d 561, 573, 782 P.2d 986 (1989) (emphasis in original).

The Taxpayer was liable to the employees for their salaries. . The Handbook clearly and unequivocally indicates that the Taxpayer was the employer with the specific obligation to pay its employees. There is no evidence that the Parent informed the employees that the Taxpayer was its agent and not liable to them for their salaries. The Taxpayer has not proved that it was liable for payroll expenses solely as the Parent's agent.

In summary, the Taxpayer was not the Parent’s agent with respect to the payroll amounts it received. The Taxpayer was liable to pay these employees. We conclude the Taxpayer is not entitled to Rule 111 exclusion.

DECISION AND DISPOSITION

The Taxpayer's request for correction of assessment is denied.

Dated this 27th day of June 2003