

Cite as Det. No. 18-0149, 38 WTD 229 (2019)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition for Refund of )	<u>D E T E R M I N A T I O N</u>
Assessment of )	
)	No. 18-0149
)	
... )	Registration No. . . .
)	

[1] RCW 82.04.280; RCW 82.04.290: B&O TAX – CLASSIFICATION OF INCOME NEXUS WITH WASHINGTON. Income derived from the sale of extended warranties, vehicle service contracts, and GAP waiver agreements by a licensed insurance agent is, nevertheless, properly classified as service and other business activities income since none of these products qualify as insurance products.

[2] RCW 82.32A.020: TAXPAYER RIGHTS AND RESPONSIBILITIES – RIGHT TO RELY ON SPECIFIC WRITTEN ADVICE. Writing issued by the Department in connection with a prior audit did not constitute specific written advice on which a taxpayer could rely where the writing on which reliance is sought addresses different, albeit related, matters.

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.

L. Roinila, T.R.O. – An automotive finance and insurance company contests the business and occupation (“B&O”) tax reclassification of its commission income on two grounds. First, Taxpayer contends that its gross income from automotive financing and insurance was not correctly reclassified to the service and other activities B&O tax rate and, second, Taxpayer argues that it was entitled to rely on the results of an earlier audit when classifying its income. Taxpayer’s petition is denied.<sup>1</sup>

ISSUES

1. Was the gross income of an automotive finance and insurance corporation correctly reclassified from the Insurance Agents . . . B&O Tax Classification in RCW 82.04.280, to the Service & Other Business Activities B&O Tax Classification in RCW 82.04.290?

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<sup>1</sup> Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

2. May a taxpayer rely on income classifications made by the Department in a prior audit under RCW 82.32A.020 to avoid tax liability in connection with the reclassification of similar income streams to a different B&O classification in a later audit?

### FINDINGS OF FACT

. . . (Taxpayer) was a domestic automotive finance and insurance . . . services corporation located in [Washington].<sup>2</sup> As [a finance and insurance] corporation, Taxpayer marketed and sold a variety of products for automotive dealers, including extended warranties, vehicle service contracts, GAP [waiver agreements], sealants, and other related products.

. . . , Taxpayer’s president, held an insurance agent’s license, issued by the Washington State Office of the Insurance Commissioner . . . , from October 3, 1985, through July 1, 2009, and an insurance producer’s license from the latter date until April 25, 2016.<sup>3</sup>

In 2009, the Audit Division (Audit) examined Taxpayer’s records for the period February 28, 2005 (Taxpayer’s inception), through March 31, 2009, to verify that Taxpayer properly reported its business activities and transactions on its excise tax returns throughout the period.

During the course of this examination, Audit found that Taxpayer had neglected to report a total of \$ . . . of gross income over the five-year audit period.<sup>4</sup> Audit found no other discrepancies and, in its Auditor’s Detail of Differences (auditor’s narrative), explained:

#### **Schedule 2 – Insurance Agents/Brokers Tax Due on Unreported Commissions**

Reconciliation has been made of income taxable under the Insurance Agents/Brokers Commissions [B&O] tax classification through a comparison of the amounts recorded in the business records with the amounts reported. The taxable differences identified on this schedule were the result of failing to report gross commissions received.

Taxpayer paid the amounts owing. Audit launched a second audit covering the period of January 1, 2014, to September 1, 2017 [(“Audit Period”)].

At the conclusion of this examination, Audit again issued Taxpayer a written auditor’s narrative. This time, however, in reclassifying Taxpayer’s commission income, Audit stated:

<sup>2</sup> [Taxpayer] incorporated on February 28, 2005, and, on July 31, 2017, was acquired by [out-of-state] based finance and insurance company. At that point, [Taxpayer] ceased operations.

<sup>3</sup> On July 1, 2009, [the Insurance] Commissioner moved from a dual-license system (agents and brokers) to a single-license system (producers). Agent and broker licenses were converted automatically to a producer license. The “producer model,” used in most states, is based on guidelines from the National Association of Insurance Commissioners.

<sup>4</sup> The following chart breaks down the unreported commissions by year:

Year	2005	2006	2007	2008	2009
Unreported Commissions	\$ . . .	\$ . . .	\$ . . .	\$ . . .	. . .
Insurance Agents/Brokers B&O Tax Difference	\$ . . .	\$ . . .	\$ . . .	\$ . . .	. . .

*Commissions from Sale of 3<sup>rd</sup>-Party Warranties/Maintenance Agreements*

WAC 458-20-257 provides that amounts received as a commission or other consideration for selling a warranty or maintenance agreement of a third-party warrantor are taxable under the Services and Other Activities tax classification.

*Income Reclassified*

Throughout the audit period the business sold both extended auto warranties and GAAP [sic] coverage and incorrectly reported this income under the Insurance Agents/Brokers tax classification . . . .

Since B&O taxable income in the insurance agents . . . classification is taxed at .00484%, and that attributable to the services and other activities B&O tax classification at .015%, Audit assessed Taxpayer the \$ . . . difference, plus interest.

Taxpayer paid the balance and, now, asks for administrative review of that assessment. In support of its petition, Taxpayer makes two primary claims. First, Taxpayer disputes the B&O tax classification of extended warranty and related sales commissions and, second, that it was entitled to rely on the results of the first audit, which allegedly classified Taxpayer's commission income in the Insurance Agents . . . B&O classification.

As relevant here, Taxpayer received commissions from the sales of the following [third]-party warranties/maintenance agreement products during the Audit Period: GAP waivers and extended warranties/vehicle service contracts.

*GAP Waivers*

Several automobile insurance companies sell GAP insurance products designed to protect vehicle owners against depreciation.<sup>5</sup> Automobile and finance companies, on the other hand, often market and sell products in the name of GAP insurance when what they are really selling is not insurance at all, but rather guaranteed asset protection waiver agreements (GAP waivers).<sup>6</sup> GAP waivers are contractual agreements in which a creditor agrees, for an additional charge, to cancel or waive all or part of amounts due on a borrower's finance agreement with that creditor in the event the motor

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<sup>5</sup> Say, for instance, that a person buys a new car for \$25,000 and finances the car through an installment agreement. Assume further that, after a few years, the car depreciates to a fair market value [of] \$15,000 but the purchaser still owes \$20,000 on her installment agreement. Were the car to be "totaled" at this point, an auto insurance company would only reimburse the purchaser the value of the car at that time (\$15,000). The additional \$5,000 between the current value of the car and the amount the purchaser still owes, is "the GAP." Had the purchaser, in addition to her standard insurance also bought GAP insurance, the insurance company would then cover the \$5,000 GAP, as well.

<sup>6</sup> [See] WAC 284-160-100, which provides:

A guaranteed asset protection program must not use the term "insurance" to describe the program in its advertisements, marketing efforts, promotions, marketing materials, guaranteed asset protection program documents, brochures, or contracts, except when referring to the borrower's automobile insurance policy, or making the statement that the waiver is not insurance as required in RCW 48.160.050(10).

vehicle is totaled or stolen. *See* RCW 48.160.010. Under Washington law, GAP waiver agreements must be part of, or a separate addendum to, a purchaser's finance agreement. RCW 48.160.010(6).

A review of the record here reveals that the Taxpayer, acting as an agent, sold the GAP waiver products of several companies, including . . . . While these products vary slightly in their terms, their gist appears the same. All are agreements that are incorporated into, or become addendums to, a purchaser's finance agreement, and agree to cancel or waive amounts due in the event of total loss. Accordingly, we conclude these products are not insurance products, but rather, GAP waiver agreements.<sup>7</sup>

### *Extended warranties & Vehicle Service Contracts*

Similarly, a distinction must be drawn between traditional dealer provided auto warranties, on the one hand, and third-party extended warranties or vehicle service contracts . . . on the other. Most auto makers provide a manufacturer's or factory warranty with the sale of new vehicles. Typically, these warranties include a "bumper-to-bumper" warranty element, which covers the vast majority of a vehicle's parts, systems, and components for a specified amount of time or miles, and a powertrain warranty element that generally covers the engine, transmission, and drive train for an additional, preset amount of time or mileage.

Extended auto warranties and [vehicle service contracts] only come into play after the manufacturer's warranty has expired. Such products, which are not included in the purchase price of the vehicle and are sold as separate contracts, usually come in one of two forms. First, dealer extended warranties are sold by the auto dealership from whence the underlying vehicle purchase occurred. Dealer extended warranties may or may not be backed by the vehicle manufacturer, and they often contain specific limitations on where the vehicle may be serviced.

Third-party extended warranties, on the other hand, are service contracts sold by independent providers. Generally a purchaser of a third-party extended warranty or [vehicle service contracts] can select the level of coverage desired, from the most basic (major engine and transmission components) to the most comprehensive (similar to a manufacturer's bumper-to-bumper coverage), with several options in between. Neither dealer extended warranties nor third-party extended warranties are insurance products.<sup>8</sup>

Like GAP insurance, however, many auto insurance companies also sell extended auto warranty like products, commonly in the name of mechanical breakdown insurance (MBI). MBI coverage is typically an optional add-on to basic vehicle insurance. Since most insurance companies that offer MBI coverage have specific requirements to determine whether a particular insured is eligible for such coverage, not everyone will qualify.<sup>9</sup> Like extended vehicle warranties, MBI covers major

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<sup>7</sup> *See, e.g.*, CNA National Warranty Corporation, *Guaranteed Auto Protection, GAP Elite Program, Debt Waiver Addendum*, available at <https://www.cnanational.com/documents/20147/0/Sample+GAP+Addendum.jpg> (last visited March 14, 2018). It is noteworthy that the addendums clearly state on their face "[t]his Addendum is not automobile insurance." *Id.*

<sup>8</sup> *See* RCW 48.110.015(1).

<sup>9</sup> These requirements usually pertain to the age or mileage on the vehicle to be covered.

mechanical failures. However, they are often less expensive than extended warranties, provide more flexibility regarding where the insured vehicle can be repaired, and carry lower deductibles.<sup>10</sup>

An examination of the record in the present case, Taxpayer, acting as an agent, sold the warranty and [vehicle service contracts] products of several independent companies; and, although the record does not contain sample contracts from all of these companies, we do have access to the warranty contracts issued by . . . and . . . and sold by Taxpayer.<sup>11</sup> In both instances, it is clear that the products Taxpayer sold were third-party extended warranties or [vehicle service contracts], and not insurance.<sup>12</sup>

## ANALYSIS

### 1. Income Classification

RCW 82.04.220 imposes a B&O tax “for the act or privilege of engaging in business” in the state of Washington. This tax is “extensive and is intended to impose . . . tax upon virtually all business activities carried on in the State.” *Analytical Methods, Inc. v. Dep’t of Revenue*, 84 Wn. App. 236, 241, 928 P.2d 1123 (1996) (quoting *Palmer v. Dep’t of Revenue*, 82 Wn. App. 367, 371, 917 P.2d 1120 (1996)). The law likewise defines “business” broadly to include “all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or to another person or class, directly or indirectly.” RCW 82.04.140; Det. No. 01-188, 21 WTD 289 (2002).

Depending on the nature of the business activity a taxpayer conducts, the tax is levied upon the “value of products, gross proceeds of sales, or gross income of the business, as the case may be.” RCW 82.04.220. The B&O tax rate also varies based on the type of business activity in which the taxpayer engages, and the statute provides numerous specific classifications of activities. *See generally* Chapter 82.04 RCW. Thus, the proper B&O tax classification is determined by the nature of the business activity, and not by any labels or terms that a taxpayer may choose to employ in its business records.

For instance, a taxpayer is taxed under the Insurance Agent B&O tax classification if it engages in:

[R]epresenting and performing services for fire or casualty insurance companies as an independent resident managing general agent licensed under the provisions of chapter 48.17 RCW . . . the amount of tax on such business is equal to the gross income of the business multiplied by the rate of 0.484 percent.

RCW 82.04.280(1).

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<sup>10</sup> *See e.g.* Consumer Reports, *Extended Car Warranties: An Expensive Gamble*, <https://www.consumerreports.org/extended-warranties/extended-car-warranties-an-expensive-gamble/> (April 27, 2018).

<sup>11</sup> The majority of Taxpayer’s income over the second audit period derived from the sale of [these] products.

<sup>12</sup> As is the case with CNA’s debt waiver addendum referenced in footnote 7, above, CNA’s “ZSeries” Vehicle Service Contract prominently contains the words “[t]his contract is not an insurance policy” on its first page.

If, on the other hand, a taxpayer is engaged in a business activity “other than or in addition to an activity taxed explicitly” and listed under Chapter 82.04 RCW, that activity is taxed under the service and other activities B&O tax classification at a rate of 1.5 percent of the gross income of the business. RCW 82.04.290(2); *see also* WAC 458-20-224; Det. No. 16-0045, 35 WTD 520 (2016). The service and other activities B&O tax classification is thus a “catch-all” provision, not only including certain defined services, but all other business activity not specifically listed in other parts of Chapter 82.04 RCW, as well. *See* RCW 82.04.290(2); WAC 458-20-224; *Steven Klein, Inc. v. Dep’t of Revenue*, 183 Wn.2d 889, 897, 357 P.3d 59 (2015). As a result, it is unnecessary for business activity to be in the nature of a “service” to fall within the service and other activities B&O tax classification.

Relevant to either classification, “Gross income of the business” means:

[T]he value proceeding or accruing by reason of the transaction of the business engaged in and includes . . . compensation for the rendition of services, . . . commissions, . . . all without any deduction on account of . . . any other expense whatsoever paid or accrued . . . .

RCW 82.04.080(1).

*Extended warranties [ & vehicle service contracts ]*

As noted, extended warranties and vehicle service contracts are not insurance products regulated by the [Insurance] Commissioner. *See* RCW 48.110.015(1). Accordingly, commissions earned from their sale are not taxed under the Insurance Agent B&O tax classification [because the extended warranties and vehicle service contracts are not insurance under Ch. 48.17 RCW]. WAC 458-20-164(5). Rather, as here, when sold by a third party, the seller’s commissions are generally taxable under the service and other business activities B&O classification. WAC 458-20-257(4)(a); (5) (Rule 257).

In further addressing warranty and service contract sales by third parties, however, Rule 257(5) states, “[i]f the seller of the agreement is licensed under chapter 48.17 RCW *with respect to this selling activity*, the seller owes tax on commissions under the insurance producers B&O tax classification.” WAC 458-20-257(5)(b) (emphasis added).

Since, in the present case, Taxpayer’s president did possess an insurance license issued under Chapter 48.17 RCW, it falls . . . upon us to determine if Taxpayer was licensed with respect to the specific activity of selling extended warranties and vehicle service contracts. First, we note that Taxpayer did not have an insurance license. Taxpayer’s president held the license and would be treated as a separate “person” for tax purposes. *See* RCW 82.04.030. . . .

In defining “sell” for purposes of Chapter 48.17, RCW 48.17.010(13) states:

“Sell” means to exchange a contract of insurance by any means, for money or its equivalent, on behalf of an insurer.

In the instant case, Taxpayer did not sell insurance contracts<sup>13</sup> on behalf of an insurer. Rather, Taxpayer sold extended warranties and vehicle service contracts on behalf of third-party administrators.

Further, before a taxpayer's commission income may correctly be classified under the insurance producers B&O tax classification, the taxpayer must be engaged in business as an insurance producer. WAC 458-20-164(3)(d) (Rule 164). An "insurance producer" means a person required to be licensed under the laws of this state to sell, solicit, or negotiate insurance. RCW 48.17.010(6); WAC 458-20-164(2). Again, such was not the case here, [because] Taxpayer was not required to be a licensed insurance producer to . . . sell the extended warranties and [vehicle service contracts].

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#### *GAP insurance/GAP waiver agreements*

According to the [Insurance] Commissioner's Office, only licensed automobile insurance companies can sell GAP insurance.<sup>14</sup> Rule 164 provides that "[p]ersons engaging in business in this state as an insurance producer . . . licensed under chapter 48.17 RCW . . . are taxable on gross income earned from such licensed activities, including commissions, fees, and renewals, under the insurance producers . . . B&O tax classification." Accordingly, any income Taxpayer earned from the sale of GAP insurance would properly belong in the insurance agent B&O tax classification. Here, however, this is not the case.

Taxpayer sells GAP waiver agreements, which differ from GAP insurance as explained above. Although Audit correctly reclassified this income into the Service and Other Activities B&O tax classification, under the rubric of tangible personal property warranties and vehicle service contracts, the classification cannot be sustained on such reasoning. Both warranties and service contracts cover the physical replacement or repair of property. GAP waiver agreements, on the other hand, simply cancel or waive financial amounts otherwise due a creditor when that property is beyond repair.

It might be tempting, since GAP waiver agreements are associated with vehicle finance agreements, to consider them in the same light as finance or carrying charges, which are likewise classified in the Service and Other Activities B&O tax classification. *See* WAC 458-20-109. However, RCW 48.160.30 specifically states that "any cost to the borrower for a guaranteed asset protection waiver . . . must be separately stated and is not to be considered a finance charge or interest." RCW 48.160.030(3).<sup>15</sup>

Rather, unlike commissions earned from the sale of GAP insurance, since GAP waiver agreement commissions are not explicitly made subject to a specific B&O tax classification, these

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<sup>13</sup> The term "insurance contract" means "any contract of insurance, indemnity, suretyship, or annuity issued, proposed for issuance, or intended for issuance by any insurer." WAC 284-30-320.

<sup>14</sup> *See e.g.*, Office of the Insurance Commissioner Washington State, *GAP Insurance*, available at <https://www.insurance.wa.gov/gap-insurance> (last visited March 14, 2018).

<sup>15</sup> This requirement also rules out classifying a GAP waiver sale as part of a "bundled transaction" along with the sale of the vehicle under RCW 82.08.190. Since GAP waivers must be separately stated, their cost cannot be included to form "one nonitemized price" with the underlying vehicle, as required by RCW 82.08.190(1) & (3).

[commissions] are taxed under the Service and Other Activities B&O tax classification pursuant to RCW 82.04.290(2). [Accordingly, Audit properly assessed Service and Other Activities B&O Tax upon the commissions that Taxpayer earned from being the selling agent of GAP waiver agreements.]

## 2. Prior Audit

Taxpayer also contends that, as a result of the written instructions provided in the 2009 Auditor's Narrative, it had no reason to second guess the appropriate B&O tax classification of its gross income in the years covered by the 2017 audit. In Taxpayer's view, it engaged in the same business and sold the same products in 2015 as it had in 2007. According to Taxpayer, the Department, by failing correctly to reclassify its income in 2009, essentially instructed Taxpayer to classify that business income in the insurance agent B&O tax classification.

In delineating the rights and responsibilities of Washington taxpayers, RCW 83.32A.020 provides taxpayers of this state:

The right to rely on specific, official written advice and written tax reporting instructions from the department of revenue to that taxpayer, and to have interest, penalties, and in some instances, tax deficiency assessments waived where the taxpayer has so relied to their proven detriment;

RCW 82.32A.020(2). Here, Taxpayer asserts that the auditor's details of differences from 2009 constitutes specific, official written advice and written tax reporting instructions, that Taxpayer relied upon these instructions in reporting and paying tax, and, accordingly, Taxpayer is entitled to have its assessment of tax waived under RCW 82.32A.020(2).

The auditor's detail of differences [may] constitute specific, official written advice from the Department; however, at no point, [does] the auditor's detail of differences address the taxation of GAP waivers or [vehicle service contracts]. The auditor's detail of differences lists Taxpayer's business activities as "selling insurance and warranties to auto dealers." Because the auditor's detail of differences do not specifically address the taxation of GAP waivers or [vehicle service contracts], they do not constitute specific, official written advice from the Department on the tax reporting of these items. As such, RCW 82.32A.020(2) does not authorize the Department to waive assessments of tax resulting from the reclassification of these items.

Taxpayer also suggests that the auditor erred in not finding income from GAP waivers or [vehicle service contracts] and making Taxpayer aware of their proper taxation. Taxpayers have the responsibility to know their tax reporting obligations. RCW 82.32A.030(2). Auditors are required to perform their own review and come up with their own conclusions based on the facts provided by the taxpayer. Det. No. 15-0276, 35 WTD 419 (2016).

In *Kitsap-Mason Dairymen's Ass'n. v. Washington State Tax Comm'n*, 77 Wn.2d 812, 467 P.2d 312 (1970), moreover, the Washington Supreme Court addressed the Department's ability to assess taxes even though the tax liability had been overlooked in a prior audit. There, in rejecting



the taxpayer's claim that the Department should be estopped from changing its method of collecting taxes under the circumstances, the court noted:

This is not a case in which auditors changed their interpretation of a statute or rule. It is one in which they overlooked through ignorance, neglect or inadvertence Kitsap's error in computing the tax. The fact that the oversight only recently has been discovered does not relieve Kitsap of its liability for the correct tax during the audit period now under consideration.

Likewise, in addressing the standard to which auditors are held when performing an audit, we have stated:

In Det. No. 93-191, [13 WTD 344 (1994)], 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. . . .

Det. No. 00-094, 21 WTD 58 (2002). Accordingly, because Taxpayer has not shown the Department provided specific, official tax reporting instruction with respect to sales commissions from GAP waivers and [vehicle service contracts], RCW 82.32A.020(2) does not authorize the Department to waive this assessment of tax.

#### DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 1st day of June 2018.