Cite as Det. No. 99-300, 19 WTD 477 (2000)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment and Refund of	)	D E T E R M I N A T I O N
	)	No. 99-300
. . .	)	Registration No. . . .
	)	Refund
	)	FY. . . /Audit No. . . .

1. RULE 159, RULE 193C, RULE 254; RCW 82.04.480, RCW 82.32.070: B&O TAX – SALES OF GOODS VS. COMMISSION INCOME – AGENT – IMPORTER. To determine whether an importer takes title to goods it purchases and sells as the owner or acts as an agent receiving commission income, documents of sale to the U.S. customers offer the best evidence. Actual payment for the goods by the customers indicate exempt purchases from the owner, while commission payments for the services of an agent would be taxable. Letters of credit conditioned upon providing title indicate the party required to provide title has title.

2. RULE 159, RULE 193C, RULE 254; RCW 82.04.480, RCW 82.32.070: B&O TAX – SALES OF GOODS VS. COMMISSION INCOME – AGENT – IMPORTER. The commissions paid customers to an agent are taxed under the service and other activities classification. Because title to the goods did not flow to or through the agent, the income received by the agent was not for goods, but was commission income taxable under the service and other activities classification. Invoices, contracts, and payment records are evidence of the nature of the transaction.

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:

An importer protests service B&O tax imposed on income designated as "commissions."[1]

FACTS:

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

M. Pree, A.L.J. -- . . . (taxpayer) is a corporation domiciled in Washington. The taxpayer imports apparel manufactured in foreign countries for U.S. retailers. The taxpayer's role in these transactions varies. The taxpayer reported receipts it designated as "commissions" from retailers, but did not report receipts from its foreign affiliate.

The Department of Revenue (Department) reviewed the taxpayer's books and records. The Audit Division assessed business and occupation (B&O) tax under the service and other activities classification on commission income received from the taxpayer's foreign affiliate. The Audit Division allowed a credit for B&O tax paid on the taxpayer's wholesale sales into Washington. The taxpayer requested a credit or refund of service B&O tax paid on income it initially designated as commissions from retailers. The Department's Audit Division denied the credit in instances where it found the taxpayer acted as an agent of retailers who paid the taxpayer commissions for its services. The taxpayer contends it acted as the wholesaler/importer of the apparel, and is exempt under WAC 458-20-193C (Rule 193C)[2] on all transactions including the affiliate commissions in the assessment.

The taxpayer generally conducted business in the following manner. A U.S. retailer provided the taxpayer with apparel design and specifications. The taxpayer requested bids from various foreign-based manufacturers and suppliers. The taxpayer then presented offers to the retailer. The retailer submitted a purchase order, and delivered a negotiable letter of credit to the taxpayer, who used the retailer's letter of credit as collateral to secure another letter of credit provided to the foreign manufacturers and suppliers. Common carriers transported the apparel via ocean freighters or planes to the retailer's Washington location (drop shipment). A freight forwarder processed the goods through customs. The retailer was then invoiced for the goods.

The paper trail of the transactions varied. The Audit Division credited the tax in situations where the documents indicated the taxpayer took title. Provided the taxpayer showed the retailers purchased the apparel from the taxpayer, the Audit Division found the taxpayer sold the apparel as a wholesaler and allowed a credit under Rule 193C.

The disputed transactions involved situations where the taxpayer may have acted in an agent's capacity. The taxpayer booked those receipts as commissions. The taxpayer's petition distinguished between "commissions" paid by the affiliate, and "commissions" paid by retailers. Either an affiliate of the taxpayer or the U.S. retailers paid the disputed commissions to the taxpayer. We will track the paper trail of the affiliate separately from the other disputed transactions.

[2] In the alternative, the taxpayer argued the commissions resulted from a service "in respect to" a manufacturing/wholesaling activity, and reasons the services become a "component" of the exempt import property. This argument was not pursued and dismissed during the teleconference.

Affiliate transactions: The taxpayer provided a copy of a contract[3] entitled, "BUYING AGENCY AGREEMENT" with a purchasing agent (the entity identified in the petition as the affiliate) it used to contact foreign manufacturers. The taxpayer appointed the agent-affiliate to find manufacturers able to produce the apparel to the specifications, then place orders and inspect the goods. Under the express terms of the agreement, the taxpayer and the agent-affiliate understood the affiliate agent was not the seller of the goods.

The agreement provided the taxpayer would pay the manufacturers based upon the invoices issued directly by the manufacturers to the taxpayer. Usually, the retailers paid the affiliate who paid the manufacturers. The affiliate paid the commissions to the taxpayer. Nothing in the buying agreement indicted the taxpayer was acting as an agent for anyone, or anyone other than the taxpayer was taking title of the good from the manufacturers. The agreement addressed only the taxpayer's relationship with the agent-affiliate and manufacturers. It did not mention the U.S. retailers.

Under this scenario, retailers issued the purchase orders to the taxpayer. From the sales confirmation, it appears the contractual relationship existed between the manufacturer and the taxpayer. The manufacturer addressed the sales confirmation to the taxpayer and the taxpayer signed as the buyer with the affiliate-agent. The order did name the retailer as the client. The retailer's letter of credit listed the affiliate as the beneficiary. A common carrier shipped the apparel from the manufacturer to either the taxpayer or the retailer. The affiliate billed the retailer. At the end of the year, the affiliate sent a credit note to the taxpayer designating a "commission refund" to the taxpayer. The taxpayer explained the commission offset debt owed by the taxpayer to the affiliate.

The Audit Division assessed service B&O tax on these transactions, which the taxpayer did not report. The taxpayer contends they were exempt wholesale sales.

Commissions paid by retailers: Under this scenario, the U.S. retailer issued the purchase order to the manufacturer. The manufacturer's sales confirmation named the retailer and the taxpayer. The retailer's letter of credit listed the manufacturer as the beneficiary. The manufacturer and the taxpayer billed the retailer. The retailer paid the taxpayer a commission.

The taxpayer paid B&O tax on these receipts from retailers it booked as commission income and requests a refund, contending these were actually exempt wholesale sales. The Audit Division denied a credit, asserting this was in fact commission income subject to B&O tax under the service and other activities classification.

Other transactions: The Audit Division allowed a credit for tax paid in instances where the retailer purchased the goods from the taxpayer under WAC 458-20-193C (Rule 193C) to the

[3] The contract was effective from July 1996 through June 1998. The taxpayer should produce the actual contract in effect during the audit period for the Audit Division's review. For the instructional purposes of this determination, we will consider the contract representative. Any changes in relevant terms during the audit period could affect the application of our instructions.

extent the taxpayer verified these transactions. If additional documentation is provided in a timely manner, the Audit Division agrees to adjust the assessment accordingly.

ISSUES:

1. In transactions involving the affiliate, was the taxpayer selling the apparel as a wholesaler or as an agent?

2. Were commissions paid by retailers to the taxpayer taxable under the service and other activities classification, or classified as wholesaling, exempt under Rule 193C?

DISCUSSION:

Sales of imports by an importer or his agent are not taxable and a deduction will be allowed with respect to the sales of such goods, provided at the time of sale, such goods are still in the process of import transportation. Rule 193C. However, no exemption exists for commissions earned by an agent for services performed in Washington regarding the sales. Therefore, we must determine whether retailers paid the taxpayer for the goods, or whether the retailers paid the taxpayer a commission to act as an agent.

The Audit Division examined the invoices to determine whether the taxpayer took title and sold the goods. If the Audit Division found the taxpayer took title, the Audit Division allowed an exemption from tax under Rule 193C. In situations where the Audit Division found the taxpayer never took title to the goods, but was merely paid a commission for its services, the Audit Division denied a refund or credit. The Audit Division assessed service B&O tax on commissions from the taxpayer's affiliate.

RCW 82.04.480 and WAC 458-20-159 (Rule 159) address how we distinguish between sellers of property, and agents or brokers acting as agents promoting sales for a principal. Agents selling property in their own name are deemed the sellers of the property. *Id.* A presumption exists when persons sell goods in their name that they are selling property, and not acting as agents. However, the taxpayer bears the burden of keeping records suitable to establish the nature of these transactions for the Department to examine. *See* RCW 82.32.070. The records include all purchase and sales invoices or such other supporting documentation to substantiate sales. WAC 458-20-254 (Rule 254).

[1] In its dealings with the affiliate-agent, the taxpayer, through its agent, may have purchased the goods and sold them to the retailers. Under Rule 254, the best evidence of the nature of the transactions are the documents of sale to retailers. The taxpayer needs to provide the invoices, payment records, and any evidence of the applicable contracts to document these transactions through its affiliate-agent. Rule 159 and RCW 82.32.070 focus on the sale of the goods rather than the purchase of the goods. In other words, rather than the taxpayer's relationship with the affiliate-agent or manufacturers, we need to look at the documents of sale to the U.S. retailers, as

the best evidence of the transactions the taxpayer seeks to exempt. Actual payment for the goods by the retailers would be exempt. Payment for the services of an agent would be taxable.

Under its agency agreement with the affiliate, in instances where the affiliate appeared to have purchased the goods, title actually went to the taxpayer. If the retailers paid the affiliate-agent for the goods, because the agreement vested title in the taxpayer rather than the affiliate-agent, we will consider those goods sold to the retailers by the taxpayer. Such transactions would be classified as wholesale sales, and exempt if the conditions of Rule 193C are met.

We do not find all transactions involving the affiliate are necessarily wholesale. The taxpayer must provide suitable records.[4] Rule 254. Also, payments or letters of credit from the retailers to the manufacturers would not be considered payment to the affiliate or taxpayer for the goods. Only letters of credit listing either the taxpayer or affiliate-agent as beneficiary qualify. These letters of credit should be conditioned upon either the taxpayer or the affiliate-agent providing title.

[2] The commissions paid by the retailers to the taxpayer are taxed under the service and other activities classification. Unless the taxpayer sold these goods in its name, the presumption under RCW 82.04.480 and Rule 159 would not be applicable. The Audit Division did not find the taxpayer sold these goods in its name. The retailers paid others directly for the goods, and the taxpayer a commission for its services. Title to the goods did not flow to or through the taxpayer. The income received by the taxpayer was not for goods. It was commission income taxable under the service and other activities classification.

Credit will be allowed in instances where the retailer purchased the goods from the taxpayer. To establish these wholesale sales, the taxpayer must provide invoices, contracts, and payment records to the Audit Division to verify retailers paid the taxpayer for the goods, rather than a commission for purchasing or import services. The Audit Division will adjust the assessment accordingly, and process a refund if warranted.

DECISION AND DISPOSITION:

We remand the case to the Audit Division for adjustment in accordance with this decision.

Dated this 17th day of November 1999.

[4] As noted earlier, contracts in effect for the applicable transactions must be reviewed together with the appropriate contracts, invoices, and payment records.