Cite as Det No. 08-0301, 28 WTD 68 (2009)

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. 08-0301
. . .	)	Registration No. . . .
	)	Document No. . . ./Audit No. . . .
	)	Docket No. . . .

[1] RULE 159; RCW 82.04.480, RCW 82.04.270, RCW 82.04.290: SERVICE AND OTHER ACTIVITIES B&O TAX AND WHOLESALING B&O TAX – DAIRY COOPERATIVES – SALES OF MANUFACTURED DAIRY PRODUCTS – AGENCY. Taxpayer, a dairy cooperative which sells manufactured dairy products in its own name, and whose records do not show that it is an agent acting on behalf of its members, is liable for Wholesaling B&O tax on its gross proceeds. Taxpayer has not met its burden of showing that it is merely an agent of its members, and therefore only liable for Service and Other Activities B&O tax on amounts received from its members.

[2] RULE 159: AGENCY. There is no presumption in Department precedent or common law which holds that taxpayer is an agent of its members.

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.

Pardee, A.L.J. – Taxpayer, a dairy cooperative, petitions for correction of the Department of Revenue's (Department's) assessment of Wholesaling B&O tax on its gross proceeds from the sale of manufactured dairy products to Washington customers, arguing that it is an agent of its members, and therefore only subject to Service and Other Activities B&O tax on amounts received from its members. . . . We find that taxpayer is not an agent of its members under WAC 458-20-159, and is therefore subject to Wholesaling B&O tax**. . .** We deny the taxpayer's petition.[1]

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 Nonprecedential portions of this determination have been deleted.

ISSUES

1. Is a taxpayer who sells products in its own name and whose records do not show it is an agent acting on behalf of its members, liable for Wholesaling B&O tax (RCW 82.04.270) on its gross proceeds? Alternatively, has taxpayer met its burden under RCW 82.04.480, and shown that it is merely an agent of its members under WAC 458-20-159 (Rule 159), and therefore only liable for Service and Other Activities B&O tax (RCW 82.04.290(2)) on amounts received from its members?

2. Should taxpayer, whose records do not otherwise meet Rule 159 requirements, be presumed to be acting as an agent of its members? . . .

FINDINGS OF FACT

[Taxpayer] is a non-profit dairy cooperative, [with headquarters in another state, and organized under that state's law].

[Taxpayer describes its business as one that] assembles, processes and markets milk and related dairy products. . . .

Taxpayer is owned by . . . dairy farmers (members). It operates processing plants and transfer stations in [other states]. Taxpayer negotiates and contracts with larger-volume buyers such as food industry companies, wholesalers, retailers, and brokers to sell its members' products. Taxpayer sells some of its members' dairy products under specific labels . . . while other dairy products are sold to retailers who sell the product under their own name. Taxpayer also provides manufacturing services to its members by pasteurizing milk and processing cheeses. Taxpayer's products are delivered to customers in Washington via common carrier and/or customer arrangement.

Bylaw 2.01(a) . . . of Taxpayer explains that natural persons, partnerships, unincorporated associations and corporations which meet all of the following requirements are eligible for membership in Taxpayer:

1. They must be milk producers as owner or operators of farms.
2. They must be currently delivering their milk *to or through* the cooperative. . . .
3. They must have been duly assigned a patron identification number by the cooperative.

(Emphasis added). Cooperatives are also entitled to be members of Taxpayer. Bylaw 2.01(b).

Bylaw 9.01(a) . . . states that Taxpayer's gross receipts include both the total proceeds from the sale of patrons' (members') products *and* the total proceeds received for services performed for patrons (members):

> Gross receipts of the cooperative from patronage shall be the total proceeds from the *sale of products* marketed for patrons, total proceeds received for supplies, equipment, commodities, and other property procured for patrons, *total proceeds received for services performed for patrons*, and total proceeds received (including patronage dividends received) which reduce costs and expenses incurred in connection with these activities.

(Emphasis added). In addition, Bylaw 13.02 indicates that Taxpayer purchases milk from its members:

> The following language may be stated on the endorsement side of each patron payroll check and the same shall constitute fulfillment of the cooperative's contractual obligation therefore, namely:
>
> > "Receipt by patron of the amount of this check together with any advances, authorized deductions and patronage distributions which the cooperative may make out of net proceeds in accordance with its Articles of Incorporation and Bylaws *shall constitute the full purchase price obligation of the cooperative for all milk sold by patron to the cooperative for the pay period covered by this check*."

(Emphasis added). Taxpayer entered into a Sales Representative Agreement (Agreement) with a sales representative headquartered in . . . Washington. The preamble of the Agreement indicates that Taxpayer sells worldwide ingredients manufactured from dairy products:

> [Taxpayer] produces and *sells* throughout the world ingredients manufactured from dairy products . . .
>
> [Taxpayer] desires to appoint Representative, and Representative desires to accept that appointment, as a sales representative *for [Taxpayer's] Products* (as defined below) . . .

(Emphasis added). All orders must name Taxpayer as the "seller". Agreement, Paragraph 3.2(c).

The Department's Compliance Division (Compliance) became aware of Taxpayer's activities through an investigation into food products sold to Washington customers. On September 25, 2007, Compliance issued Taxpayer an assessment . . . for the period of January 1, 2000, through June 30, 2007, in the amount of $. . . which included $. . . in Wholesaling business and occupation (B&O) tax, a 25 percent delinquent return penalty in the amount of $. . ., a 15 percent delinquent return penalty in the amount of $. . ., a 5 percent assessment penalty in the amount of $. . ., an unregistered business penalty in the amount of $. . ., and interest in the amount of $. . . .

ANALYSIS

Washington levies a B&O tax for the act or privilege of engaging in business activities in Washington. RCW 82.04.220. The tax is measured by the application of rates against value of products, gross proceeds of sales, or gross income of the business, as the case may be. *Id*.

RCW 82.04.270 states that every person engaging within this state in the business of making sales at wholesale is subject to Wholesaling B&O tax at the rate specified therein.[2]

RCW 82.04.290(2) requires that every person engaging within this state in any business activity other than or in addition to an activity taxed explicitly under RCW 82.04.290(1) or another section of RCW Ch. 82.04 shall be subject to Service and Other Activities B&O tax on account of such activities at the rate specified therein multiplied by the gross income of the business.

[1] TAXPAYER, WHO SELLS PRODUCTS IN ITS OWN NAME AND WHOSE RECORDS DO NOT SHOW IT IS AN AGENT ON BEHALF OF ITS MEMBERS, DOES NOT MEET THE REQUIREMENTS OF WAC 458-20-159 TO BE DEEMED AN AGENT OF ITS MEMBERS

Taxpayers who claim to be agents in promoting sales for a principal, have a statutory burden to keep accounting records in such a manner as Department regulations require:

> The burden shall be upon the taxpayer *in every case* to establish that he is not engaged in the business of selling tangible personal property but is acting merely as broker or agent in promoting sales for a principal. Such claim will be *allowed only* when the taxpayer's accounting records are kept in such manner as the department of revenue shall by general regulation provide.

RCW 82.04.480 (emphasis added).

Taxpayers must adhere to the stringent requirements of Rule 159 to be taxed as an agent. Det. No. 98-192, 18 WTD 295 (1999)(citing Det. No. 88-367, 6 WTD 409 (1988)). With regards to the importance of taxpayers meeting the requirements of Rule 159, the Department states:

> Sellers of property are taxable on that activity unless they meet their statutory burden of proving that their status was something other than that of seller. WAC 458-20-159 (Rule 159) lists the requirements for proof necessary to qualify a taxpayer as an agent rather than as the seller of property.

6 WTD 409.

[2] "Sale at wholesale" or "wholesale sale" means any sale of tangible personal property which is not a retail sale. RCW 82.04.060.

Rule 159 explains that a person claiming to be an agent in promoting sales for a principal will have such claim recognized *only when*:

> [T]he contract or agreement between such persons clearly establishes the relationship of principal and agent and when the following conditions are complied with:
>
> (1) The books and records of the broker or agent show the transactions were made in the name and for the account of the principal, and show the name of the actual owner of the property for whom the sale was made, or the buyer for whom the purchase was made.
>
> (2) The books and records show the amount of gross sales, the amount of commissions and any other incidental income derived by the broker or agent from such sales.

Taxpayer asserts that the strict requirements of Rule 159 are not controlling due to the uniqueness of the business enterprise and mutual understanding of an agency relationship between the cooperative and its members. Rule 159 is clear, however, that a person will only be recognized as an agent when the contract between it and its alleged principal clearly establishes the relationship of principal and agent. Taxpayer's Bylaws do not expressly use the term "agency" to classify the relationship between itself and its members. In fact, Bylaw 9.01(a) indicates that Taxpayer's gross receipts include the gross proceeds from the sale of members' products. In addition, Bylaw 13.02 indicates that Taxpayer purchases milk from its members. Furthermore, the Agreement states that Taxpayer is the *seller* of manufactured dairy products,, and that all orders must name Taxpayer as the "seller". Therefore, Taxpayer does not satisfy Rule 159, in that its contracts or agreements do not demonstrate that it is a mere agent for its members.

Even though Taxpayer does not meet the requirements of Rules 159, it argues that department precedent and the common law renders it an agent of its members. Taxpayer relies on Det. No. 87-355, 4 WTD 383 (1987) and WAC 458-20-214 (Rule 214) to support its position that it is merely an agent of its members. A close reading of such precedent, however, shows that this is not correct.

[2] . . . THERE IS NO PRESUMPTION IN DEPARTMENT PRECEDENT OR COMMON LAW WHICH HOLDS THAT TAXPAYER IS AN AGENT OF ITS MEMBERS.

Taxpayer in Det. No. 87-355, 4 WTD 383 (1987) sought guidance in determining its correct tax reporting classification as well as instructions for restructuring so as to be entitled to report as a wholesaler of fruit. Taxpayer was organized under Chapter 24.32 RCW as an agricultural cooperative association. In 4 WTD 383, the Department reviewed the articles of incorporation, bylaws, and marketing agreement, and other accounting and shipping documents submitted by the taxpayer. The Department asserted: "As a matter of both fact and law these documents establish the agency relationship of the taxpayer to its grower/members." In addition, the Department found that the marketing agreement was a legally binding and enforceable contract

which created a principal-agent relationship and established the consideration to be paid to the taxpayer for rendering its services as an agent, stating:

> The taxpayer derives its income only pursuant to its agreement with members, as an agent for those members, not as a wholesaler of fruit. The taxpayer neither owns the proceeds from fruit sales nor treats this income as its own for any purposes. To do so would not only violate its marketing agreements but would also circumvent the very statutes and cooperative marketing purposes under and for which the taxpayer was formed. The taxpayer was formed and incorporated on a "cooperative basis as agent for its members." (Article II of Articles of Incorporation) . . .
>
> RCW 24.32.050 enumerates the powers of an agricultural cooperative association, including,
>
> > (3) To act as the agent or representative of any member or members in any of the above mentioned activities. (Emphasis supplied.)
>
> The taxpayer is an agent by operation of law. Most importantly, it derives its income only from its grower/members and only as a commissioned marketing entity, not as an outright seller of fruit in its own right.

4 WTD 383 also explained that Rule 214 applied to taxpayer and that Rule 159 did not, and therefore taxpayer was subject to service and other activities B&O tax:

> [T]he taxpayer is a unique entity which is organized and structured expressly for the exclusive purpose of marketing fruit which it does not own. *It is for this very special reason that Rule 214 even exists*. The rule deals with a unique kind of business entity performing a unique kind of business activity. *Since its inception this rule has provided that fruit and produce marketing cooperatives are subject to Service B&O tax upon their gross receipts from commissions, fees, and all other charges recovered from members for handling and marketing their produce. . . .*
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> *As a fruit marketing association, the taxpayer's liability is ruled exclusively by Rule 214. The appropriate tax classification is that of Service and Other Business Activities (RCW 82.04.290)* and the tax measure is the gross receipts retained by the taxpayer as its commissions, fees, and compensation for all of its own costs of doing business (RCW 82.04.080). *This has been the uniform and consistent position of the Department throughout the many years of administration of the Rule. . .*
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> Conversely, WAC 458-20-159 (Rule 159) is a procedural rule which explains the methods by which persons who act as agents for principals should keep their accounting records and report tax. This rule raises merely the rebuttable presumption that a person who has possession and the right to sell tangible personal property in its own name is deemed to be the "seller" for tax purposes rather than a mere commissioned agent of the seller. However, when the facts of the relationship establish otherwise, they are the

> substance of the transaction and the relationship, and will control. *Rules 214 and 159 are not conflicting in their provisions. Notwithstanding the overlapping provisions of these rules, however, Rule 214 is the exclusive rule for application in this case.*
>
> Thus, . . . the taxpayer is a fruit marketing association which derives income from handling and marketing fruit as an agent for grower/members. It is subject to Service B&O tax, not Wholesaling-Other B&O tax.

(Emphasis added).[3] Rule 214 only applies to persons engaged in the business of buying and selling fruit or produce. Taxpayer does not handle fruit or produce. Therefore, Rule 214 does not apply to Taxpayer.[4] Even if we were to apply Rule 214 to Taxpayer's activities, that does not resolve the question of whether Taxpayer is an agent of its members. Rule 214 only applies if Taxpayer is an agent of its members. Therefore, 4 WTD 383 is correct when it states that Rule 214 and Rule 159 are not in conflict. . . .

In this present case, Taxpayer was never organized under RCW Ch. 24.32, and therefore the facts in 4 WTD 383 are easily distinguished from the present case. We must analyze Rule 159 to determine whether Taxpayer is an agent prior to determining if Rule 214 applies. In other words, Rule 214 assumes a taxpayer is an agent, it does not analyze whether a taxpayer is an agent. The Department's holdings in 6 WTD 409 and 18 WTD 295 state that this is the role of Rule 159.

In 18 WTD 295, two fruit packers formed taxpayer to sell their fruit, and the fruit of a third party. Fruit buyers from around the world ordered fruit from the taxpayer. Taxpayer prepared a sale order and mailed it to its buyers. Taxpayer was liable to the supplier for the invoiced amount. Department found that taxpayer did not have any contract or agreement establishing a principal-agent relationship. In that case, however, the Department's Audit Division referred to oral agreements between the taxpayer and firms for whom taxpayer was the exclusive marketing agent. The taxpayer denied it entered into any such oral agreements. The Audit Division was

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[3] Rule 214 addresses the taxability of persons engaged in the business of buying and selling fruit or produce as agents of others, and states:

> (1) Persons engaged in the business of buying and selling fruit or produce, *as agents of others*, are taxable under the provisions of the business and occupation tax and the retail sales tax as provided in this section. Tax is due on the business activities of such persons, irrespective of whether the business is conducted as a cooperative marketing association or as an independent produce agent.

(Emphasis added). Rule 214(3)(d) states that Service and Other Activities B&O tax applies to commissions for buying and selling.

[4] Taxpayer claims in a document entitled "History of WAC 458-20-214 (Rule 214)" that there is no indication why Rule 214 was written specifically to discuss the activities associated with the marketing of fruit and produce and did not specifically address other agricultural products such as dairy products. Taxpayer surmises that it may be that dairy cooperatives were not in existence when rule 214 was enacted in 1939. . . . However, a report by the United States Department of Agriculture, entitled "Cooperatives in the Dairy Industry", indicates that the volume of milk handled by cooperatives was 31 billion pounds in the mid-1930's, and that during this same time period, the share of all milk delivered to plants and dealers in the United States by cooperatives was 48 percent. . . . Given this, Taxpayer's suggestion that Rule 214 only addressed fruit and produce cooperatives because dairy cooperatives did not exist when Rule 214 was enacted is incorrect**. . . .**

unable to prove any basis for asserting that such agreements existed. Therefore, the Department held that this underlying requirement of Rule 159 was not met, and taxpayer was not an agent.[5] As explained in part A. above, Taxpayer does not meet the requirements of Rule 159 either. Taxpayer argues, however, that Rule 159 should not apply to cooperatives. The Department's position in 18 WTD 295 states otherwise. Therefore, consistent with this department precedent, we conclude that Taxpayer is not an agent of its members. . . . To reiterate, Bylaw 9.01(a) states that Taxpayer's gross proceeds include both the sale of its members' products *and* proceeds for services it performs for its members. If Taxpayer was truly an agent, it would only include the latter in its gross proceeds. In addition, Bylaw 13.02 indicates that Taxpayer's members sell milk *to* Taxpayer. Paragraph 3.2(a) of the Agreement states that all orders from Washington customers *must* name Taxpayer as the "seller". Finally, Taxpayer does not meet the requirements of Rule 159. Given this, Taxpayer has not met its burden of establishing that it is acting merely as a broker or agent. . . .

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 29th day of October 2008.

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[5] In response to the Audit Division's contention that 4 WTD 383 controlled, the Department disagreed in 18 WTD 295, and distinguished the facts of that determination from those in 4 WTD 383, and found that taxpayer was liable for wholesaling B&O tax:

> Finally the Audit Division contends . . . 4 WTD 383 . . . controls. We disagree. In that advisory ruling, we held that the receipts of an agricultural marketing association *organized under Chapter 24.32 RCW* [FN 6] were taxable under the service and other activities classification. We recognized that the very purpose of agricultural marketing associations was to sell the agricultural products **of its members**. We found that the agricultural marketing association was an agent by operation of law. . . . That taxpayer derived its only income as a commissioned marketing entity, not as the seller of fruit in its own right. . . . Finally, we stated the intent of *Chapter 24.32 RCW* was to provide for well-defined, nonprofit business associations to serve the interests of the members, **not to serve the interests of the associations themselves as distinct business entities**. . . .
>
> The taxpayer was incorporated under the Washington Business Corporation Act, Title 23B RCW, to engage in any business activity (including the sale of fruit) as a distinct business entity. The taxpayer sells fruit in its own name for its own gain or profit. As discussed above, the taxpayer derives its receipts from the outright sales of the fruit as a dealer, not as a commissioned marketing entity. The taxpayer's Washington gross receipts are taxable under the wholesaling classification of business and occupation tax.
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> FN 6. Chapter 24.32 RCW was repealed by [sic] 1989. Laws 1989, Ch. 307, Sec. 44.

(Italics added for emphasis). Taxpayer is not organized pursuant to the laws of RCW Ch. 24.32. Therefore, this statement from 18 WTD 295 is of no precedential value to Taxpayer.