

Cite as 9 WTD 280-15

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In The Matter of the Petition)	<u>D E T E R M I N A T I O N</u>
For Correction of Assessment)	
of)	No. 90-132
)	
. . .)	Registration No. . . .
)	Assessment No. . . .
)	

[1] RULE 194: APPORTIONMENT--IN-STATE AND OUT-OF-STATE OFFICES--ADMINISTRATIVE OFFICES IN WASHINGTON--SEPARATE ACCOUNTING SYSTEMS. Taxpayer received commission income from sales as manufacturer's representative both in Washington and outside Washington. It paid taxes based on a separate accounting method, although its headquarters were located in Washington. Such separate accounting is acceptable when the in-state administrative services are not rendered to the customer.

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.

TAXPAYER REPRESENTED BY: . . .

DATE OF TELECONFERENCE: . . .

NATURE OF ACTION:

Taxpayer protests the disallowance of its apportionment method.

FACTS AND ISSUES:

Hesselholt, A.L.J. (successor to Potegal, A.L.J.) -- Taxpayer operates as a manufacturer's representative primarily in Washington and Oregon for a number of manufacturers of general merchandise and hardware to retail stores. Its records were examined by the Department of Revenue for the period . . . through . . . , and an assessment was issued. Taxpayer protested the assessment.

Taxpayer maintains a sales office and warehouse in [Washington] and a separate sales office and showroom in [Oregon]. Salespersons are assigned to each office. Taxpayer sells merchandise as a wholesaler/distributor to the stores and receives commissions on the direct manufacturer sales made by its salespersons to the stores. Taxpayer reports sales in the sales category and the commission income under the service category of the business and occupation tax.

Taxpayer's [Washington] office includes a warehouse which warehouses goods for the manufacturers it represents. Taxpayer receives a fee for the warehousing of these goods, which is reported as income. The [Washington] office also has the central administrative offices. All sales transaction paperwork is prepared by the salespersons at whichever sales office the salesperson is assigned. Sales orders are forwarded from the [Washington] office to the manufacturers. All commissions are received by the [Washington] office and the salesperson's commissions are calculated by the [Washington] office.

Because taxpayer does business both inside and outside of Washington, it is required to apportion its income. It analyzed methods by which it could make a separate accounting. Taxpayer determined that the coding of the specific sales office on each manufacturer's invoice would be accurate, but burdensome. It then determined that because of the manner in which the sales activity for various retailers is done, that to separate in-state and out-of-state commissions received by the address of the "sold to" box as noted on the manufacturer's invoices did in fact reflect a proper separate accounting of the gross income derived from services rendered to that customer location. Taxpayer explains the working of the system as follows:

. . . the . . . and . . . stores' central purchasing office is located in [Washington]. Normally then sales are made by the [Washington] sales office and the commission earned of these sales are reported by the "sold to" box of the manufacturer's invoice. Thus, no matter to which store in what state the goods are delivered, the commission earned on the sale is considered a Washington commission since the sale was made to the central purchasing office, as noted on the "sold to" box. However, from time-to-time individual sales to local stores will be made by sales persons contacting those stores. In such cases, the location of the commission earned, as noted by the "sold to" box, is that of the individual store. If a sales person from the Oregon sales office writes up an order to the local store in Oregon, the Oregon store is noted in the "sold to" box and the commission is recorded as Oregon service income. Also, the commission earned on

an item "sold to" a Washington central purchasing office but "shipped to" an Oregon retail store location would be reported as Washington service income.

Taxpayer believes that its method accurately reflects the apportionment of services it renders from the different sales office. Further, it believes that this method is "apportionment by separate accounting methods" as required by WAC 458-20-194 (Rule 194).

The Audit Division reapportioned taxpayer's service income. In the Detail of Differences given to taxpayer to explain the audit changes, the Division stated:

This schedule apportions certain amount[s] of Oregon branch service income to services contributed to the business activities undertaken in Oregon by your Washington State branch. The Washington services include accounting, sales commission reports, corporate officers overseeing the salesmen['s] performance and reviewing of sales order[s]. We believe [that] these activities are significant and contributory to its gross commission income and are not merely incidental, and therefore, have to be considered when determining amounts of income to be apportioned to this state.

The Audit Division then recalculated taxpayer's service taxable income, using Rule 194 by apportioning to Washington that portion of total income to which the cost of doing business within this state bears to the total cost of doing business both within and without the state.

Taxpayer disputes the Audit Division's conclusion. Taxpayer argues that:

[it] earns its commission income from making a sale to a retail store or a group of stores. The activity includes the contacting of the purchasing organization, the continuous nurturing of a relationship to ensure goodwill toward the company and the specific activities in ensuring a complete sale. Such activities include the negotiations with the customer, the identification of the item to be sold, the preparation of the sales paperwork including purchase orders and sales invoices and the follow-through to ensure final delivery of the items sold. All these activities are performed primarily and almost exclusively by the salespersons.

The administrative staff in [Washington] receives the purchase orders and invoices prepared by the corporation's salespersons, groups them by

manufacturer, maintains invoice control, receives the copy of evidence of shipping and receives the commissioned income from the manufacturer once the items have all been satisfactorily received by the customer. The activities which these administrative people provide are activities which are incidental to the performance of the salesmen and are not activities which are contributory to the commission itself. The activities for which the commissioned income is received are in this corporation the full responsibility of the salespersons assigned to the accounts.

* * *

With [taxpayer], the responsibility of the services rendered to the client is that primarily and solely of the salesperson rendering services to the customer. The salesperson is the contact of the customer. The salesperson negotiates the items to be sold and their prices; the salesperson writes up the purchase order and the manufacturer's invoices. The sales person follow-up on the complaints from the customer concerning items received for services rendered. The salesperson ensures that the items are received, complete and in a timely fashion. The administrative office merely provides the salesperson with administrative backup. To say that the administrative office's activities are contributory to the gross commission income would grossly overstate their responsibility to the sales on which the commission is made.

Further, once the item has been received, complete and in a timely fashion and the commission income received from the manufacturer, the transaction is complete. There is no follow-[up] services which are provided with the administrative office as was the case with the examples provided by the auditor.

Finally, taxpayer argues that it was audited by the Department about four years ago, and the issue of the separate accounting was examined and considered. At that time, the Department determined that taxpayer's accounting was accurate and allowed it to stand. Taxpayer has made no change in its business practices since that time.

DISCUSSION:

RCW 82.04.460 provides, in relevant part, as follows:

(1) Any person rendering services taxable under RCW 82.04.290 and maintaining places of business both within and without this state which contribute to the rendition of such services shall, for the purpose of computing tax liability under RCW 82.04.290, apportion to this state that portion of his gross income which is derived from services rendered within this state. Where such apportionment cannot be accurately made by separate accounting methods, the taxpayer shall apportion to this state that proportion of his total income which the cost of doing business within the state bears to the total cost of doing business both within and without the state.

Rule 194 is the Department's duly authorized administrative rule administering that statute. It repeats the above language, and adds the following:

When the business involves a transaction taxable under the classification service and other business activities, the tax does not apply upon any part of the gross income received for services incidentally rendered to persons in this state by a person who does not maintain a place of business in this state and who is not domiciled herein. However, the tax applies upon the income received for services incidentally rendered to persons outside this state by a person domiciled herein who does not maintain a place of business within the jurisdiction of the place of domicile of the person to whom the service is rendered.

From either the statute or the rule, it is clear that separate accounting methods are the preferred manner of apportioning income.

In this case, the Audit Division concluded that the taxpayer's separate method was inadequate because it believed that the services rendered by the taxpayer's [Washington] office contributed in a significant way to the making of the sales in Oregon. The taxpayer maintains that the services it performs at the administrative office are only incidental to the customer, although they may be significant to the salesperson.

[1] The Department has held that the provision of administrative services in Washington to customers located outside of Washington was sufficient to require apportionment on a cost-of-doing business basis. This holding has been sustained by the Washington Supreme Court. Department of Rev. v. J.C. Penny Co., 98 Wn.2d 38 (1981). This case is factually distinguishable. Here, the administrative services are not rendered to the clients--the services are performed for the salespersons and the taxpayer. The salesperson writes up the invoice; the

administrative office merely forwards the order to the manufacturer. The commissions are received by the Washington office, but the actual billing of the customers is apparently handled by the manufacturers. Thus the [Washington] office is not rendering services to the out-of-state customers at all. Taxpayer's method of attributing sales by the "sold to" box on the invoice is an acceptable method of separate accounting in this situation, where the in-state administrative offices render no services to the customer.

DECISION AND DISPOSITION:

Taxpayer's petition is granted.

DATED this 27th day of March 1990.