

Cite as 9 WTD 286-17

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

In The Matter of the Petition )	F I N A L
For Correction of Assessment )	D E T E R M I N A T I O
<u>N</u>	
of )	
)	No. 90-148
)	
. . . )	Registration No. . . .
)	. . . /Audit No. . . .
)	

**[1] RULE 246:** B&O TAX--EXEMPTION--DIRECT SELLER'S REPRESENTATIVE--INTENT. The B&O tax exemption granted in Rule 246 was enacted by the legislature to avoid the situation in which the activities of independent direct seller's representatives were attributed to an out-of-state manufacturer or wholesaler to find nexus in this state.

**[2] RULE 246:** B&O TAX--EXEMPTION--DIRECT SELLER'S REPRESENTATIVE--OTHER ACTIVITIES. The exemption granted in Rule 246 is not lost where a taxpayer conducts other activities in this state, so long as the activities in this state do not generate sales to consumers.

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 AND PLACE OF CONFERENCE: July 20, 1988, Olympia, Washington

HEARING CONDUCTED BY DIRECTOR'S DESIGNEES:

Garry G. Fujita, Former Assistant Director  
Edward L. Faker, Sr. Administrative Law

Judge

## NATURE OF ACTION:

Taxpayer protests the disallowance of the direct seller's exemption for business and occupation tax on sales made in this state when taxpayer had other employees present who were not making sales.

## FACTS AND ISSUES:

Hesselholt, A.L.J. -- Taxpayer is a [out-of-state] corporation engaged in the business of selling [consumer] products to independent sales representatives in Washington and other states. Its records were examined by the Department of Revenue for the period . . . through . . . . An assessment was issued in the amount of \$ . . . , which remains outstanding. Taxpayer protested the imposition of wholesaling business and occupation tax (B&O tax) on the value of its sales to its independent sales representatives for the full audit period. For the period . . . through . . . , taxpayer argued that the tax was unconstitutional, relying on Tyler Pipe Industries, Inc. v. Washington, 483 US 232, 253 (1987). For the period from . . . , through the balance of the assessment, taxpayer argued that the assessment was contrary to RCW 82.04.423. Taxpayer finally requested adjustments on its monthly sales.

Taxpayer explains that it is represented to consumers in Washington exclusively through independent representatives. The independent representatives purchase taxpayer's products for resale to consumers. Otherwise, taxpayer states that its presence in Washington is limited to employees who recruit and train the independent representatives. The employees have no office or other business facility and do not maintain inventories.

## TAXPAYER'S EXCEPTIONS

Taxpayer argues as follows:

The applicable statute, RCW 82.04.423, is quite precise as to the contacts within this state which can cause loss of the exemption. These contacts include:

- a) Own or lease real property within the state;

b) Regularly maintain a stock of tangible personal property in this state for sale in the ordinary course of business;

c) Incorporated under the laws of this state.

None of the above three contacts are at issue here. We nonetheless recite them because we believe it important to note that the legislature was very precise as to the contacts which can cause loss of the exemption.

The exemption statute includes a fourth qualifying requirement which is the only one at issue here. That requirement provides:

Makes sales in this state exclusively to or through a direct seller's representative.

. . . Taken at its face, without any extension by implication, the fourth qualifying requirement of the statute will qualify sales that are made exclusively to or through a direct seller's representative. It does not say that the company cannot make other taxable sales by other means, e.g., through the company's own employees.

The Department's Rule 246 [WAC 458-20-146], however, carries the meaning one step further. In apparent reliance upon the word "exclusively," the Rule requires not only that the subject sales be made exclusively to or through a direct seller's representative, but also that there be no other sales made in the state through other kinds of representatives. The rule provides:

The exemption is available only where an out-of-state seller is present in this state and represented exclusively by a "direct seller's representative." If an out-of-state seller makes wholesale or retail sales of "consumer products" in Washington to or through a "direct seller's representative" and also has a branch office, local outlet, or other local place of business, or is represented by any other employee, agent, or other representative,

no portion of the sales are exempt from business and occupation tax.

In short, under the Department's rule, sales which themselves qualify under the plain language of the statute can be disqualified by other sales made through representation that is not of the "direct seller's representative" kind. Thus the qualified sales are "tainted" with taxability by the other sales.

The "taint" provision of the regulation applies only where an out-of-state company is "represented" by someone other than a direct seller's representative. Given that language and the underlying statutory provision which contains no express "taint" provision of its own, we submit that the "represented by" refers to representation in the market place, i.e., a selling type of representation to consumers. If the regulation is applied with that interpretation, the taxpayer will qualify for the exemption and we need not reach the question, on these facts, as to whether the regulation goes too far. The company is not "represented by" employees in the marketplace. Its presence in the state is exclusively through employees -- not connected with any office, facility or inventory -- whose job it is to recruit and train independent representatives. It is the independent representatives who are the exclusive representatives of the company in the market place. Every company using direct seller's representatives must have some kind of liaison with them and support for them. That is all that the company is doing in this state.

[Emphasis taxpayer's, brackets ours.] The taxpayer researched the legislative history of the statute. The taxpayer explains that the legislature was concerned about a "double tax" on out-of-state manufacturer-sellers:

The "double tax" problems arise from the fact that an out-of-state company which sells in Washington through its own employees will pay a single tax on the privilege of selling; but if it exercises the selling privilege through an independent representative, a second or "double" tax results from a single act of selling within the state. The act of the independent representative in soliciting

sales for the manufacturer's products results in a tax on the independent representative and a tax on the manufacturer as well.

The legislative solution was to reduce the "double tax" to a single tax. It is worth emphasizing that the "exemption" of the statute does not in fact exempt the sales. The independent representatives continue to pay the tax on their resales (or commissions). What has been eliminated is the double tax that the out-of-state firms threatened to avoid either by withdrawing from the state, utilizing their own employees instead of independent representatives, or passing on the second tax to the local independent representatives.

The legislative concern for the "double tax" is particularly pertinent because it shows that the legislature was trying to convert a somewhat abnormal situation to a normal one. In the ordinary or normal situation, a single act results in a single tax. Where manufacturers act through "independent" representatives, however, the single act of selling resulted in two taxes. The statute, therefore, achieves a desirable end by creating a more usual or normal situation, i.e., limiting the tax consequences of solicitation by independent representatives to just one tax. (In that sense the term "exemption" is a misnomer since the act of solicitation by independent representatives continues to be taxable.)

Taxpayer continued by tracing the legislative evolution of the bill, noting that one version of the bill had expressly designated the presence of employees in the state as a cause for a loss of the exemption granted. Taxpayer argues that the legislature was

quite capable of expressly providing that the presence of employees would cause loss of protection if that were its intent. Further, when that provision was dropped from the legislation in later drafts, a clear inference arose that the legislature did not intend to include the presence of employees in the state among the kinds of contacts that would cause the loss of protection. . . .

#### DISCUSSION:

RCW 82.04.423 was enacted by the legislature in 1983. It took effect August 23, 1983. The statute provides as follows:

(1) This chapter shall not apply to any person in respect to gross income derived from the business of making sales at wholesale or retail if such person:

(a) Does not own or lease real property within this state; and

(b) Does not regularly maintain a stock of tangible personal property in this state for sale in the ordinary course of business; and

(c) Is not a corporation incorporated under the laws of this state; and

(d) Makes sales in this state exclusively to or through a direct seller's representative.

(2) For purposes of this section, the term "direct seller's representative" means a person who buys consumer products on a buy-sell basis or a deposit-commission basis for resale, by the buyer or any other person, in the home or otherwise than in a permanent retail establishment, or who sells, or solicits the sale of, consumer products in the home or otherwise than in a permanent retail establishment; and

(a) Substantially all of the remuneration paid to such person, whether or not paid in cash, for the performance of services described in this subsection is directly related to sales or other output, including the performance of services, rather than the number of hours worked; and

(b) The services performed by the person are performed pursuant to a written contract between such person and the person for whom the services are performed and such contract provides that the person will not be treated as an employee with respect to such purposes for federal tax purposes.

(3) Nothing in this section shall be construed to imply that a person exempt from tax under this

section was engaged in a business activity taxable under this chapter prior to the enactment of this section.

WAC 458-20-246 (Rule 246) is the Department's duly adopted administrative law implementing the above statutory provision. It has the force and effect of law until overturned by a court of record not appealed. RCW 82.32.300. In large part, it repeats the statute. However, it contains the following language, which leads to the dispute here:

The exemption is available only where an out-of-state seller is present in this state and represented exclusively by a "direct seller's representative." If an out-of-state seller makes wholesale or retail sales of "consumer products" in Washington to or through a "direct seller's representative" and also has a branch office, local outlet, or other local place of business, or is represented by any other employee, agent, or other representative, no portion of the sales are exempt from business and occupation tax.

(Emphasis ours.)

Taxpayer's argument is essentially that the legislature was attempting to eliminate a perceived "double tax" on out-of-state manufacturer-sellers. Taxpayer contends that the act of selling a product made by an out-of-state seller is a single act in Washington, and should only be taxed once.

[1] When a manufacturer sells a product to a wholesaler or retailer, a sale takes place. For our purposes, that sale is one transaction. When that wholesaler or retailer sells the merchandise, a second transaction has taken place. If all the parties are Washington residents, the sale from the manufacturer to the wholesaler is subject to tax, as is the sale from the wholesaler or retailer. Thus, there are two taxable sales occurring in this scenario. When the manufacturer uses its own employees to sell its products, there is only one transaction. When the manufacturer sells its products through a broker, acting as an agent, there is only one transaction. When the manufacturer is an out-of-state corporation, there are still the same number of transactions in all instances. The difference in the two transactions is whether the manufacturer has itself taken any steps to subject itself to Washington's jurisdiction, as opposed to the resident manufacturer's deliberate actions

taken within the jurisdiction of the state. There is no "double tax" burden here. In this case, taxpayer sells its products to its independent representatives. That is one transaction. The representatives then sell the products to consumers. That is a second, separate transaction. The exemption was meant to, and does, apply to those situations when the actions of an in-state independent representative were used to create the taxable nexus between Washington and the out-of-state manufacturer or wholesaler.

Taxpayer has a number of employees in this state. Over the years, the number of employees has declined. The employees serve as liaison between the taxpayer and its independent representatives, recruiting representatives and providing their training. They make no sales of any kind in this state. We find, in fact, that the taxpayer was making sales in this state exclusively to or through direct seller's representatives.

[2] Taxpayer is not a corporation organized under the laws of Washington, it neither owns nor leases any property here, it does not maintain any stock of goods in this state, and it makes sales only through its independent representatives. The rule requires that the taxpayer be represented by no one else in Washington, lest it lose the exemption. The Department has previously held that the exemption provided by Rule 246 is available to a manufacturer that makes sales in this state both through direct seller's representatives and through the mail. Det. 87-232, 3 WTD 353 (1987). Similarly, the exemption was not lost when other sales were made by an employee of the taxpayer because delivery on those sales took place in Oregon. Det. 87-233, 3 WTD 357 (1987). We find, in this case, because taxpayer meets the requirements in the statute and has no other representatives making taxable sales in this state, the exemption applies to its sales. Even under strict construction of the exemption statute (the rule by which we are bound), there is no evidence in this case supporting denial of the exemption.

Taxpayer has also argued that it should not have to pay the wholesaling B&O tax for the period . . . through . . . , because the U.S. Supreme Court rendered the tax unconstitutional in Tyler Pipe, supra. However, the Washington Supreme Court has ruled that the decision in the Tyler Pipe case should be applied prospectively only from the June 23, 1987 date on which the U.S. Supreme Court's opinion was issued. National Can Corporation, et. al v. Department of Rev. 109 Wn.2d 878 (1988). The U.S. Supreme Court refused to



hear an appeal of that decision. National Can Corporation, et. al v. Department of Rev., cert. denied, 108 S. Ct. 2030 (1988). Taxpayer's petition is denied as to this issue.

The issue as to Taxpayer's monthly sales is a factual issue and is remanded to the Audit Division.

DECISION AND DISPOSITION:

Taxpayer's petition is granted in part and denied in part. Taxpayer shall be granted the exemption in RCW 82.04.423 as of August 23, 1983.

DATED this 28th day of March 1990.