

Cite as Det. No. 04-0252, 24 WTD 242 (2005)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of)	<u>D E T E R M I N A T I O N</u>
Assessment of)	
)	No. 04-0252
)	
...)	Registration No. . . .
)	Document No. . . .
)	Audit No. . . .
)	Docket No. . . .

RULE 246; RCW 82.04.423: DIRECT SELLER'S REPRESENTATIVE -- PERMANENT RETAIL ESTABLISHMENT. In order for a direct seller who sells to wholesalers to qualify for the direct seller's exemption, neither the buyer, which is the direct seller's representative, nor any other person may resell the direct seller's products in a permanent retail establishment. Regardless of to whom the representative sells, the retail sale of the product must take place either in the buyer's home or in a location that is not a permanent retail establishment for the direct seller to qualify for the exemption.

STATEMENT OF CASE

M. Pree, A.L.J. -- An out-of-state manufacturer that sells goods to Washington retailers through an independent representative disputes the assessment of wholesaling business and occupation tax. Because the goods were resold in permanent retail establishments, the manufacturer's Washington sales were not exempt. We sustain the Department's assessment.¹

ISSUE

May a manufacturer deduct wholesale sales into Washington under the direct seller's representative exemption if its products were subsequently resold in permanent retail establishments?

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

FINDINGS OF FACT

. . . (taxpayer) manufactures . . . products at an out of state location. It sells and distributes the [product] throughout the United States, including into Washington. The taxpayer directly solicits national accounts outside of Washington. It delivers these products to its customers' distribution centers. These customers deliver the [product] to their retail outlets. The taxpayer also contracted with a representative located in Washington who obtains [product] orders from smaller retailers. The representative lacks authority to make sales on behalf of the taxpayer and forwards the orders to the taxpayer's out-of-state headquarters for approval.

Most of the taxpayer's products are ultimately sold in permanent retail establishments. The taxpayer deducted sales through the representative from its measure of Washington's business and occupation (B&O) tax under the direct seller's representative exemption (RCW 82.04.423).

The Department of Revenue (Department) audited the taxpayer's books and records for the period from January 1, 1999 through September 30, 2002. The Department's Audit Division determined that wholesale sales through the representative failed to qualify as sales through a direct seller's representative because the representative was not paid on a deposit-commission basis. The Audit Division assessed wholesaling B&O tax on the taxpayer's post-1999 sales into Washington through the representative.²

The taxpayer contends the Audit Division erred by not allowing the taxpayer to deduct any sales through its representative under the direct seller's exemption. While the taxpayer acknowledges most of its [product] was eventually resold through permanent retail establishments, the taxpayer contends that because neither it nor its representative sold the [product] in permanent retail establishments, its wholesale sales were exempt because they did not occur in permanent retail establishments.

ANALYSIS

Washington imposes a B&O tax "for the act or privilege of engaging in business" in the State of Washington. RCW 82.04.220. The measure of the B&O tax is 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 measure and rate are determined by the type or nature of the business activity in which a person is engaged. Ch. 82.04 RCW.

² In addition, the Audit Division notes the taxpayer told the auditor that it maintained inventory in Washington. The Audit Division considers this an additional reason that the taxpayer could not claim the direct seller's representative exemption. Following our hearing, the taxpayer also provided a declaration to further explain its response to the auditor regarding its inventory in Washington. The taxpayer states it did not store inventory in Washington until December, 2002. At that time the taxpayer stored a small amount of inventory in Washington to fill [certain] orders, a national account. After December 2002, when the taxpayer began storing inventory in Washington, it failed the requirement under RCW 82.04.423(1)(b). Given this contact, had it been an issue, sales through national accounts into Washington could not be dissociated. See WAC 458-20-193.

RCW 82.04.423 provides an exemption from B&O tax for wholesale and retail sales made by a direct seller. In order to qualify for this exemption, businesses must meet four requirements:

- (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.

RCW 82.04.423(2) defines the term “direct seller’s representative” to mean:

[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.

The first paragraph of subsection (2) describes two kinds of direct seller’s representatives, those making or soliciting wholesale sales, and those making or soliciting retail sales. *See Stroh Brewery Co. v. Department of Rev.* 104 Wn. App. 235, 240, 15 P. 3rd 692 (2001); *see also* WAC 458-20-246 (Rule 246, effective 12/31/99). The taxpayer received payment from its buyers, after which it paid commissions to its representative.

The taxpayer acknowledges that its representative does not qualify under the first clause as a wholesaler direct seller’s representative, because the representative does not buy products on a buy-sell basis. The taxpayer also recognizes under amended Rule 246 the representative was not paid on a “deposit-commission basis.”³

³ RCW 82.04.423 substantially matches Internal Revenue Code § 3508, which also defines “direct seller” using the term “deposit-commission basis.” On January 7, 1986, the IRS defined “deposit-commission basis” in Prop. Reg.

A transaction is on a "deposit-commission basis" if the direct seller's representative performing the selling or soliciting services is entitled to retain part or all of a purchase deposit paid in connection with the transaction. The part retained is remuneration from the direct seller for the selling or soliciting services performed by the representative.

The taxpayer contends that it qualifies under the second clause in the first paragraph of RCW 82.04.423(2): "or who sells, or solicits the sale of, consumer products in the home or otherwise than in a permanent retail establishment." Under this clause, the taxpayer states that its representative need not be compensated on a "deposit-commission" basis to qualify for the exemption. The taxpayer asserts this second clause is applicable to its wholesale sales as well as retail sales. We disagree. The second clause does not apply to wholesale sales.

The second clause of RCW 82.04.423(2) describes a retail sale by the direct seller. Rule 246(4)(b)(i). In order for a direct seller who sells to wholesalers to qualify for the exemption, neither the buyer, which is the direct seller's representative, nor any other person may resell the direct seller's products in a permanent retail establishment. *Stroh*, 104 Wn. App. at 241. Regardless of to whom the representative sells, the retail sale of the product must take place either in the buyer's home or in a location that is not a permanent retail establishment. Rule 246(4)(b)(i)(B).

The taxpayer insists limiting the second clause to retail sales is inconsistent with legislative history. The taxpayer refers to a May 18, 1983 memorandum written by a senior research analyst, Paul F. Gronnert, to State Senator Eleanor Lee.⁴ Senator Lee had requested the analyst's opinion regarding the effect the direct seller's representative legislation would have on the Seattle Trade Center's fiscal problems. In the memo, the analyst emphasized the permanent retail establishment requirement, and stated, "the Center is not a retail establishment and so it would appear that method of solicitation would be included." In this context, the basis for relief afforded the Trade Center was based on whether the Center was a permanent retail establishment, not the location of subsequent product sales (if any). Rule 246 recognizes that persons selling at temporary venues, such as trade shows, are not considered to be selling at a permanent retail establishment. Rule 246(4)(b)(i)(B).

The effect of subsequent sales in permanent retail establishments on the direct seller's representative exemption has been addressed by the Court of Appeals in *Stroh* and Rule 246(4)(b)(i). Because the [product] is subsequently sold in permanent retail establishments, we conclude that the taxpayer may not claim the direct seller's exemption.

DECISION AND DISPOSITION

§31.3508-1(g)(2) using the same definition as in amended Rule 246. We are unaware of the Department deviating from this 1986 interpretation of the "deposit-commission."

⁴ From [http://dor.wa.gov/rulesfiles/Rule246/246\(1984\)/Page39.htm](http://dor.wa.gov/rulesfiles/Rule246/246(1984)/Page39.htm)

Taxpayer's petition is denied.

Dated this 23rd day of November 2004.