

Cite as Det. No. 16-0243, 36 WTD 467 (2017)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS 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. 16-0243
)	
...)	Registration No. . . .
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...)	Registration No. . . .
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[1] RULE 118; RCW 82.04.390: B&O TAX – LICENSE TO USE REAL ESTATE – EXCLUSIVITY AS KEY ELEMENT. When determining whether a contract creates a lease for real estate or merely a license to use real estate, a lack of exclusive control granted by the contract language is a key factor in determining that the contract creates only a license to use the real estate.

[2] RULE 159; RCW 82.04.480: B&O TAX – CONSIGNMENT – ACTING MERELY AS AN AGENT. A contract must clearly establish the relationship of principal and agent to support an agency relationship and, thereby, allow the agent to avoid being treated as the seller of the consigned goods for B&O tax purposes.

[3] RULE 159; RCW 82.08.040: RETAIL SALES TAX – CONSIGNMENT – SALES MADE IN CONSIGNOR’S NAME. Where the records of consignment sales, such as receipts, do not indicate that the sale was made in the name of the consignor, the consignee must collect retail sales tax from such sales and remit such tax directly to the Department, and is not allowed to remit such tax to the consignor instead.

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.

Yonker, T.R.O. – Two affiliated entities that operate retail stores in Washington (Taxpayers) protest the assessment of service and other activities business and occupation (B&O) tax on certain amounts received from a third-party retailer with which Taxpayers contracted. Taxpayers argue that the amounts received from the third-party were for a lease of real property and not subject to B&O tax. Taxpayers further protest the assessment of retailing B&O tax on sales of the third-party’s merchandise that Taxpayers completed in their stores on behalf of the third-party retailer. Finally, Taxpayers protest future reporting instructions in which they were instructed to remit directly to the Department – as opposed to the third-party retailer – all retail

sales tax they collected on their sales of the third-party's merchandise. We deny Taxpayers' petition on all issues.¹

ISSUES

1. Under RCW 82.04.390, WAC 458-20-118, and WAC 458-20-200, are amounts received by Taxpayer from a "lease" of retail space, and, therefore, exempt from B&O tax, where such amounts are paid by a third-party retailer for the use of a portion of Taxpayer's retail space and other related services?
2. Under RCW 82.04.480, WAC 458-20-159, and WAC 458-20-200, are amounts Taxpayer collected from sales of goods Taxpayer made on behalf of a third-party retailer exempt from B&O tax because Taxpayer was acting merely as the third-party retailer's collection agent?
3. Under RCW 82.04.480, WAC 458-20-159, and WAC 458-20-200, may Taxpayer opt to not remit retail sales tax collected on sales of goods Taxpayer made on behalf of a third-party retailer, and, instead, transfer the collected retail sales tax to that third-party retailer for remittance of such taxes?

FINDINGS OF FACT

. . . (Taxpayer A), and its wholly-owned subsidiary . . . (Taxpayer B) (collectively referred to as Taxpayers), both operate retail stores in Washington. Taxpayers' stores "are multi-department operations that sell name-brand merchandise . . . private label brand merchandise, and pharmacy and optical services."

On July 23, 1999, Taxpayers' affiliate . . . [Affiliate], contracted with an unaffiliated third-party . . . (Shoe Company), to occupy a designated space within Taxpayers' stores.² The contract between [Affiliate], and Shoe Company (Agreement) states that it also applies to all of [Affiliate's] "parents, subsidiaries and affiliates," which includes Taxpayers A and B.³ (Section 1.1.) Relevant terms of that Agreement are as follows:

- Taxpayers agreed to grant Shoe Company "the license and privilege to use" licensed space within Taxpayers' stores. (Section 2.2.)
- The "licensed space" at each store consists of a "selling area" and a "storage area." (Section 2.1.4.)
- The "selling area" means "the shoe department . . . within each [of Taxpayers' stores] which shall be used by [Shoe Company]" for certain "permitted uses." (Section 2.1.2.)
- The "storage area" means the area within the stock rooms of each of Taxpayers' stores where Shoe Company's "goods shall be stored, including the area used for processing deliveries." (Section 2.1.3.)

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

² In addition to its arrangement with Taxpayers, Shoe Company operates stand-alone retail stores, where it sells its own merchandise.

³ Thus, there is no agreement with Shoe Company in which Taxpayers A and B are specifically named; however, for the purpose of this determination, we treat Taxpayers A and B as contracting parties to the Agreement.

- The “permitted uses” of the selling area are defined as Shoe Company’s “sole and exclusive right to display and sell” certain types of footwear and the “non-exclusive right to sell” other merchandise. (Section 4.1.)
- Shoe Company agrees to pay Taxpayers an “annual license charge” equal to 13.5 percent of Shoe Company’s “net sales” of Shoe Company’s merchandise sold in Taxpayers’ stores.⁴ (Section 5.2.1.) This annual license charge was the only form of payment that Shoe Company paid to Taxpayers for all of the benefits Shoe Company received under the Agreement.
- Taxpayers reserve the right to “relocate” Shoe Company’s selling area or storage area in Taxpayers’ stores “at any time, or from time to time” so long as the new area is “of similar configuration . . . and approximately equal size.” (Section 2.4.)
- Shoe Company “shall, in its own name and at its own expense employ and staff” the licensed space.⁵ (Section 10.2.)
- The proceeds of sales of Shoe Company’s merchandise in Taxpayers’ stores shall “be paid by customers directly to [Taxpayers’] cashiers, and deposited by [Taxpayers] to [their] own account[s].” (Section 5.4.) Further, all sales of Shoe Company’s merchandise “shall be accounted for separately on [Taxpayers’] cash register or scanning system.” (Section 5.8.)
- Taxpayers agree to provide “security” for the licensed space, make their “loss prevention personnel reasonably available” to Shoe Company, and make “reasonable efforts” to work with Shoe Company to control “shrink” of Shoe Company’s merchandise in Taxpayers’ stores. (Section 5.10.)
- Taxpayers agree to furnish each licensed space “at no cost” various services, including heat, air conditioning, electricity, janitorial services, and telephone service. (Section 9.1.)
- All of Shoe Company’s merchandise located at Taxpayers’ stores “shall be at the sole risk and hazard of [Shoe Company].” (Section 13.3.) Further, “[t]itle to all of [Shoe Company’s] property shall remain with [Shoe Company] and shall not be subject to any liability of [Taxpayers].” (Section 23.1.)
- Taxpayers “shall have the right at reasonable times to inspect” the licensed space and to “make repairs.” (Section 20.2.) The Agreement is silent as to Taxpayers’ right to access the licensed spaces for other reasons.
- Shoe Company “is and shall be an independent contractor,” and the relationship between Taxpayers and Shoe Company is specifically “not one of joint venture, partnership, agency, employment, or landlord and tenant and nothing herein contained shall be construed as to create any such relationship between the parties.” (Section 23.1.) Further, nothing in the Agreement “shall permit either party to obligate the other party in any way.” *Id.*

⁴ The annual license fee was increased to fourteen percent of Shoe Company’s “net sales” through an amendment to the Agreement as of July 23, 2009.

⁵ Pursuant to an amendment to the Agreement dated October 1, 2000, Taxpayers and Shoe Company agreed that in certain stores “as mutually agreed upon in writing from time to time,” Taxpayers would provide in their “own name” and their “own expense” staff for Shoe Company’s licensed space in such stores. Additionally, in those cases where Taxpayers provided the staff for Shoe Company’s licensed spaces, the annual license charge was increased an additional twelve percent. The amendment to the Agreement references Exhibit A as identifying at which stores this arrangement would occur; however, the referenced exhibit is not included in the record. It is unclear if any stores in Washington were impacted by this amendment.

Under these Agreement terms, Shoe Company maintained a designated area in each of Taxpayers' stores. In each store, such area was not separated from the rest of the store by walls, gates, or other obstructions, although high shelves sometimes made a barrier of sorts on at least one side of the designated area. Based on the photographs in the record, the Shoe Company is identified by a sign hanging above the designated area, by signage attached to shelving walls, and by a large sign attached to the exterior of the store. Additionally, Taxpayers represent that the employees in the designated areas were employed by Shoe Company.

A customer who wished to purchase Shoe Company's merchandise at Taxpayers' stores did so through the following sequential general steps:

1. The customer went to Shoe Company's designated area of the store to shop for merchandise.
2. Shoe Company's employees assisted the customer, if necessary, in making merchandise choices.
3. Once the customer chose the merchandise for purchase, the customer took the merchandise from Shoe Company's designated area of the store, to Taxpayers' cashiers for purchase.
4. Taxpayers' cashiers charged the customer for the purchase and collected payment from the customer. Taxpayers' cashiers gave the customer a receipt that contained Taxpayers' trade name. Shoe Company's name is not identified on the transaction receipts.
5. The customer left Taxpayers' store with the purchased merchandise.

In 2012, the Department's Audit Division commenced a review of Taxpayers' books and records for the time period of January 1, 2009, through June 30, 2012. During the course of that review, the Audit Division made a number of findings, including (1) the income Taxpayers received from the annual license charges was not excludable from their reportable gross income and was, instead, subject to service and other activities business and occupation (B&O) tax; (2) Taxpayers should have reported retailing B&O tax on the proceeds of sales Taxpayers' stores collected on sales of Shoe Company's merchandise; and (3) in the future, Taxpayers could not remit the retail sales tax collected on sales of Shoe Company's merchandise to Shoe Company, but, instead, must remit such retail sales tax directly to the Department after collection.

On August 31, 2015, as a result of the Audit Division's review, the Department issued a tax assessment against Taxpayer A for a total of \$. . . , which included \$. . . in retailing B&O tax, \$. . . in service and other activities B&O tax, and \$. . . in interest.

Also on August 31, 2015, as a result of the Audit Division's review, the Department issued a tax assessment against Taxpayer B for a total of \$. . . , which included \$. . . in retailing B&O tax, \$. . . in service and other activities B&O tax, and \$. . . in interest.

Taxpayers subsequently sought review of the full amount of both tax assessments. Both tax assessments remain unpaid.

ANALYSIS

1. Service and Other Activities B&O Tax

In Washington, “there is levied and collected from every person that has a substantial nexus with this state a tax for the act or privilege of engaging in business activities.” RCW 84.04.220. The B&O tax measure is “the application of rates against value of products, gross proceeds of sales, or gross income of the business, as the case may be.” *Id.* The rate used is determined by the type of activity in which a taxpayer engages. *See generally* Chapter 82.04 RCW. Income from any business activity that is not expressly classified in Chapter 82.04 RCW is taxed under the service and other activities B&O tax classification. RCW 82.04.290(2).

The B&O tax is a gross receipts tax, meaning that it applies to all value proceeding or accruing to the business, and not only to its profit margins. *Lamtec Corp. v. Dep’t of Revenue*, 170 Wn.2d 838, 843, 246 P.3d 788, 791 (2011). By enacting Washington’s B&O tax system, the legislature intended to impose the B&O tax on virtually all business activities carried on within the state. *Time Oil Co. v. State*, 79 Wn.2d 143, 146, 483 P.2d 628 (1971). Further, the B&O tax system was meant to “leave practically no business and commerce free of . . . tax.” *Budget Rent-A-Car of Washington-Oregon Inc. v. Dep’t of Revenue*, 81 Wn.2d 171, 175, 500 P.2d 764 (1972).

RCW 82.04.140 defines “business” broadly and includes “all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or another person or class, directly or indirectly.” Generally, all gross income of the business is subject to B&O tax, without any deductions for costs such as labor, materials, taxes, or any other expense. *See* RCW 82.04.080. This holds true unless the legislature has carved out a specific exclusion or deduction. Det. No. 15-0027, 34 WTD 577 (2015).

Here, Taxpayers received income from Shoe Company in the form of “annual license charges” for allowing Shoe Company to use a “licensed space” in Taxpayers’ stores, and for other services described in the Agreement. We conclude that these annual license charges are part of Taxpayers’ gross income of their business, and such charges are, therefore, properly included as part of the measure for determining Taxpayers’ B&O tax liability. We further conclude that because the income from such charges is not expressly classified elsewhere in Chapter 82.04 RCW, that the income from annual license charges are properly classified under the service and other activities B&O tax classification under RCW 82.04.290(2).

Taxpayers, however, argue that the annual license charges they received from Shoe Company during the audit period should not be included in the measure of its B&O tax liability under RCW 82.04.390, which states that the B&O tax “shall not apply to gross proceeds derived from the sale of real estate.”

WAC 458-20-118 (Rule 118), the Department’s administrative rule related to RCW 82.04.390, provides the following additional guidance:

- (1) Amounts derived from the sale and rental of real estate are exempt from taxation under the business and occupation tax. However, there is no exemption of amounts

derived from engaging in any business wherein a mere license to use or enjoy real property is granted. Amounts derived from the granting of a license to use real property are taxable under the service B&O tax classification

Thus, if the annual license charges here were paid by Shoe Company in exchange for a lease or rental of real property, there is no B&O tax liability. On the other hand, if the annual license charges were paid for a mere license, Taxpayers are liable for B&O tax on such income.

Rule 118 goes on to provide additional guidance on making the distinction between a lease and a license:

(2) **Lease or rental of real estate.** A lease or rental of real property conveys an estate or interest in a certain designated area of real property with an exclusive right in the lessee of continuous possession against the world, including the owner, and grants to the lessee the absolute right of control and occupancy during the term of the lease or rental agreement. An agreement will not be construed as a lease of real estate unless a relationship of “landlord and tenant” is created thereby

(3) **License to use real estate.** A license grants merely a right to use the real property of another but does not confer exclusive control or dominion over the same. Usually, where the grant conveys only a license to use, the owner controls such things as lighting, heating, cleaning, repairing, and opening and closing the premises.

Consistent with this language, [Washington courts have recognized that exclusivity is a key element in differentiating between a lease or rental of real estate and a license to use real estate. *See Barnett v. Lincoln*, 162 Wn. 613, 617-18, 299 P. 392 (1931) (“A lease is a contract for the exclusive possession of lands or tenements for some certain number of years or other determinate period, and a contract for such exclusive possession is a lease although there may be certain reservations or a restriction of the purpose for which the possession may be used, and although it may be described as a license.”); *McKennon v. Anderson*, 49 Wn.2d 55, 57-59, 298 P.2d 492 (1956) (exclusive possession of part of a barn); *Lamken v. Miller*, 181 Wn. 544, 44 P.2d 190 (1935); *City of Bellevue v. Jacke*, 96 Wn. App. 209, 212-13, 978 P.2d 1116 (1999); *City of Tacoma v. Smith*, 50 Wn. App. 717, 721-23, 750 P.2d 647 (1988) (a reassignable boat slip)] . . . ; *see also* [*Regan v. City of Seattle*, 76 Wn.2d 501, 504 (1969);] Det. No. 11-0080, 31 WTD 24 (2012) (“[T]he principal difference between a lease and a license is the right of exclusive possession and control over the premises, including against the owner.”). Further, “[i]n determining whether a written instrument constitutes a lease or a license [we] must consider it in its entirety, together with the circumstances under which it was made and determined and the intention of the parties.” *Conaway v. Time Oil. Co.*, 34 Wn.2d 884, 893, 210 P.2d 1012 (1949).

Based on this authority, we conclude that the annual license charges paid by Shoe Company were for a license to use the “licensed space” of Taxpayers’ stores as opposed to a lease of real property. First, the Agreement states that Taxpayers granted Shoe Company “the license and privilege to use” the licensed spaces in Taxpayers’ stores. There is no discussion of Shoe Company having “exclusive control” of those spaces, which is the primary distinction between a

lease and a license. Instead, the Agreement speaks in terms of mere “use” of the licensed spaces for “permitted” activities, which is consistent with a license under Rule 118(3).

Other terms of the Agreement demonstrate a lack of “exclusive control” by Shoe Company. For instance, Taxpayers reserved the right under the Agreement to relocate the licensed spaces “at any time” to other locations in the stores. Thus, Taxpayers retained the right to change the locations of Shoe Company’s licensed spaces under the Agreement. Also, Shoe Company was restricted from having keys to Taxpayers’ stores, and only had access to the licensed spaces “during business hours.” *See* Det. No. 01-015, 23 WTD 121 (2004) (holding that exclusive control was evident, in part, because “[t]he space is physically enclosed by walls and lockable doors” and the lessee was issued keys to the space.) More generally, there are simply no terms in the Agreement that restrict Taxpayers’ access of the licensed spaces in the stores.⁶ As such, Taxpayers imposed certain restrictions on Shoe Company’s access to the licensed spaces that are not indicative of “exclusive control.”

In addition, the Agreement identifies no specific licensed spaces, nor does the attached exhibit. Instead, the exhibit merely identifies the stores in which the licensed spaces will be designated. Under the terms of the Agreement, the initial licensed spaces were to “be determined by mutual agreement” between the parties, but no additional information is contained in the record indicating that specifically defined licensed spaces at those stores were part of the Agreement. In Determination No. 03-0118, 23 WTD 218 (2004), which was cited by Taxpayers, we specifically noted that designating a certain area of real property in the agreement at issue was a factor in determining that a lease had been created. *See also* Det. No. 96-173, 18 WTD 1 (1999) (holding that an agreement created a lease because, in part, the agreement identified the individual spaces “with a corresponding number” that each lessee was to lease). Here, no such specific designation of licensed spaces is included in the record.

Finally, as quoted earlier, under Rule 118(3), when an owner has control over such things as “lighting, heating, cleaning, repairing, and opening and closing the premises,” a mere license is apparent. Here, under the terms of the Agreement, Taxpayers provided all utilities for the licensed spaces, as well as “janitorial service.” Control over these aspects of the use of a space is indicative of a license. *See* Det. No. 99-345, 19 WTD 618 (2000); 13 WTD 108 (1993). Also, as previously mentioned, Shoe Company was not given keys to the stores to access their licensed spaces, and, therefore, was dependent on Taxpayers for opening and closing the premises, again, indicative of a license. *See* 13 WTD 108.

Taxpayers argue that many of these factors, alone, are not determinative of a lease or license. We do not disagree.⁷ However, given all of these factors, in their totality, we conclude that the

⁶ We note that Taxpayers specifically have the right to enter the licensed spaces to “make repairs.” We do not read this right as implying that Taxpayers are excluded from the licensed spaces for all other reasons. We further note that the record is unclear if any stores in Washington operated under the terms of the 2000 amendment, which allowed Taxpayers to employ staff to work in the licensed spaces in some stores. If so, that fact would be further evidence of a lack of exclusive control over the licensed spaces.

⁷ Further, Taxpayers point out that some factors suggest a lease, such as the fact that notice is required for termination of the Agreement, and the term of the Agreement was for ten years. We do not disagree that these factors could be indicative of a lease; however, we have found [no] authority indicating that these two factors together make a lease where “exclusive control” is absent.

Agreement here was indicative of a license to use real property as opposed to a lease, and [the resulting income] is, therefore, subject to service and other activities B&O tax.

Taxpayers also claim that WAC 458-20-200 (Rule 200), entitled “Leased departments,” is applicable here. Rule 200(2)(a) provides the following guidance regarding B&O tax liability in leased department situations:

Where the lessor receives a flat monthly rental or a percentage of sales as rental for a leased department, such income is presumed to be from the rental of real estate and is not taxable. In a determination of whether an occupancy is a rental of real estate, all the facts and circumstances, including the actual relationship of the parties are to be considered (see: WAC 458-20-118). Written agreements, while not required, are preferred and are given considerable weight in deciding the nature of the occupancy. While the fact that the written agreement may identify the occupancy as a “lease” is not controlling, agreements which contain the following provisions support the presumption that the occupancy is a rental of real estate:

- i. The occupant is granted exclusive possession and control of the space.
- ii. The occupancy is for a time certain which is more than 30 days, i.e. month to month, yearly, etc.
- iii. The parties are required to notify each other in the event of termination of the occupancy.

We concluded earlier that under the Agreement, Shoe Company did not have “exclusive possession and control” of the licensed spaces. As such, the Agreement does not contain the provision described under Rule 200(2)(a)(i), which, in part, entitles Taxpayers to the presumption of a lease or rental, as opposed to a license.

Further, while Taxpayer suggests that the factors identified in Rule 200 control for determining whether the Agreement creates a lease or a license, we conclude that such determination must ultimately be made under Rule 118. Indeed, Rule 200 specifically incorporates Rule 118 by reference. Instead, the factors described in Rule 200 merely “support the presumption that occupancy is a rental of real estate.” We already concluded earlier that, under Rule 118, the arrangement between Taxpayers and Shoe Company was a license, as opposed to a lease or rental. Thus any presumption under Rule 200 is overcome by our consideration of the full Agreement under Rule 118. *See Conaway*, 34 Wn.2d at 893.

Even if Rule 200 were applicable here, Rule 200(2)(b) makes clear the following:

If the lessor provides any clerical, credit, accounting, janitorial, or other services to the lessee, the lessor must report the income from these services under the service B&O tax classification. The amounts for providing these services must be segregated from the amounts received from the rental of real estate. In the absence of a reasonable segregation, it will be presumed that the entire income is for providing these services.

Here, Taxpayers concede that they provided certain services to Shoe Company, including janitorial services, utilities, point-of-sale transaction services, and some accounting services related to such sales transaction. Since the price of Taxpayers' point-of-sale transaction services to Shoe Company are not segregated, Rule 200 would nevertheless require us to consider the entire amount of the annual license charges received by Taxpayers from Shoe Company as for such services, and fully subject to service and other activities B&O tax.⁸

2. Retailing B&O Tax

Retailing B&O tax is levied upon every person engaging in the business of making retail sales, a tax for the act or privilege of engaging in that business. RCW 82.04.220; RCW 82.04.250. There is no dispute that the sales of Shoe Company's merchandise constituted retail sales; however, Taxpayers argue that because they did not own the merchandise at issue, and merely acted as Shoe Company's agents, they should not be liable for retailing B&O tax on the sales of Shoe Company's merchandise.

This situation is addressed generally in RCW 82.04.480, "Sales in own name—Sales as agent," which states the following:

(1) Every consignee . . . having either actual or constructive possession of personal property . . . with power to sell such personal property in that person's own name and actually so selling, is deemed the seller of such personal property within the meaning of [the B&O tax]. Furthermore, the consignor . . . is deemed a seller of such property to the consignee

(2) The burden is on the taxpayer in every case to establish the fact that the taxpayer is not engaged in the business of making retail sales or wholesale sales 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 required by rule by the department.

Thus, under RCW 82.04.480(1), if a "consignee" (1) has "power to sell" personal property, (2) in its "own name," and (3) actually sells such property, that consignee is the seller for B&O tax purposes and is liable for B&O tax on such sales. Correspondingly, under the last sentence of RCW 82.04.480(1), the "consignor" is treated as the seller of such property to the consignee and liable for B&O tax on the sale of the property to the consignee.

While RCW 82.04.480 does not define "consignee," WAC 458-20-159 (Rule 159), the Department's administrative rule implementing RCW 82.04.480, defines that term as follows:

A consignee, bailee, factor, agent or auctioneer, as used in this ruling, refers to one who has either actual or constructive possession of tangible personal property, the actual ownership of

⁸ While Taxpayers argued at hearing that these services were either provided for no compensation or, alternatively, were de minimis services, such arguments do not change the fact that Taxpayers provided certain services, which is all that is required to make Rule 200(2)(b) applicable.

such property being in another The term “constructive possession” means possession of the power to pass title to tangible personal property of others.

As such, a taxpayer is a “consignee” if it meets the following two requirements: (1) it has either actual or constructive possession of tangible personal property, and (2) the tangible personal property is owned by someone else. Because there is no dispute that the merchandise sold here was owned by Shoe Company, and not by Taxpayers, only the “possession” element is in dispute.

As Rule 159 states, constructive possession simply means possession of “the power to pass title to tangible personal property of others.” Here, the Agreement makes clear that the proceeds from the sales of Shoe Company’s merchandise “shall . . . be paid by customers directly to [Taxpayers’] cashiers, and deposited by [Taxpayers] to [their] own account.” Once the customers pay for the merchandise through Taxpayers’ cashiers, the customers have “title” to the merchandise. Thus, we conclude that Shoe Company has granted Taxpayers the power to pass title to the merchandise from Shoe Company to the customers when Taxpayers’ cashiers complete the sale transaction. As such, Taxpayers had constructive possession of the merchandise under Rule 159.

Taxpayers, however, argue that they never had any form of possession of the merchandise. According to Taxpayers, Shoe Company transferred actual possession of the merchandise directly to the customers when the customers physically took the merchandise out of Shoe Company’s area and eventually delivered such merchandise to Taxpayer’s cashiers for final purchase. Yet, at most, this argument addresses only actual possession. Neither RCW 82.04.480(1) nor Rule 159 restricts the consignee designation to only actual possession arrangements. Indeed, both of those authorities identify “constructive” possession arrangements as also qualifying forms of possession. Therefore, we conclude that Taxpayers meet the definition in Rule 159 of “consignee.” It naturally follows, then, that Shoe Company is a “consignor.”

As we have concluded that Taxpayers were “consignees,” we address the other elements of RCW 82.04.480(1), and specifically consider whether Taxpayers (1) had “power to sell” personal property, (2) in their “own name,” and (3) actually sold such property.

Regarding the first element, we have already concluded that Taxpayers had “power to pass title” to Shoe Company’s merchandise sold in Taxpayers’ stores. We conclude that such power is equivalent to “power to sell” Shoe Company’s merchandise. Regarding the second element, we conclude that Taxpayers were clearly authorized to sell the merchandise in their “own name” as the receipts produced from such sales only included Taxpayers’ common trade name and contained no reference at all to Shoe Company. Regarding the final element, there is no dispute that the merchandise was sold through Taxpayers’ cashiers, Taxpayers collected retail sales tax from customers on such sales, and Taxpayers documented such sales in their records; therefore, we conclude that Taxpayers “sold” the merchandise at issue.

Thus, Taxpayers meet all of the requirements of RCW 82.04.480(1), and are, therefore, the “seller” of the merchandise in question, and must generally report retailing B&O tax based on the total retail sales of such merchandise.⁹

However, under RCW 82.04.480(2), the consignee may avoid B&O tax liability on the sale of a consignor’s personal property if the consignee can prove that it is “acting merely as broker or agent” for the consignor and the consignee’s “accounting records are kept” in accordance with the Department’s rule. Therefore, unless Taxpayers prove that they were merely Shoe Company’s agents, Taxpayers are the sellers of the merchandise and liable for B&O tax on such sales. *See also* Det. No. 08-0301, 28 WTD 68 (2009) (“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.”). As such, we must determine whether Taxpayers have met their burden of proving that they were merely Shoe Company’s agents in order for Taxpayers to avoid B&O tax liability on the sales of Shoe Company’s merchandise.

Rule 159 provides additional guidance on how to determine whether a person is acting merely as an agent for a consignor:

Any person who claims to be acting merely as agent or broker in promoting sales for a principal . . . will have such claim recognized only **when the 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
- (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.

(Emphasis added). Therefore, we must begin by looking to the Agreement to determine if that document “clearly establishes the relationship of principal and agent.” *See Rho Co. v. Dep’t of Revenue*, 113 Wn.2d 561, 573, n.6, 782 P.2d 986 (1989) (“Taxpayers who buy or sell tangible personal property on behalf of another will not be treated as agents unless they have a contract expressly creating an agency relationship . . .”).

Such an agency relationship “is a fiduciary relationship that arises when one person (a principal) manifests assent to another person (an agent) that the agent shall act on the principal’s behalf and subject to the principal’s control, and the agent manifests or otherwise consents so to act.” Restatement (Third) of the Law of Agency §1.01 (2006). The Washington Supreme Court has similarly stated that an agency relationship general arises when two parties consent that one shall act under the control of the other. *Rho Co.*, 113 Wn.2d at 570. Further, the requirement that the principal in such an agency relationship exercise control over the agent means that “there must

⁹ While Shoe Company is not a party to this appeal, we note that our conclusion that Taxpayers are liable for B&O tax on the sales of Shoe Company’s merchandise necessarily means that Shoe Company, the consignor, is deemed the “seller” of such merchandise to Taxpayers, according to the final sentence of RCW 82.04.480(1).

be facts or circumstances that ‘establish that one person is acting at the instance of and in some material degree under the direction and control of the other.’” *Washington Imaging Serv., LLC v. Dep’t of Revenue*, 171 Wn.2d 548, 562, 252 P.3d 885 (2011) (quoting *Matsumura v. Eilert*, 74 Wn.2d 362, 368-69, 444 P.2d 806 (1968)).

Guided by these authorities, we conclude that the Agreement does not “clearly establish the relationship of principal and agent” as required under Rule 159. The Agreement specifically states the following:

The relationship between [Taxpayers] and [Shoe Company] **is not one of . . . agency, employment, or landlord and tenant** and nothing herein contained shall be construed as to create any such relationship between the parties hereto. Nothing in this [Agreement] shall permit either party to obligate the other party in any way.

Thus, the Agreement does not “clearly establish” an agency relationship. Indeed, its language expressly states the precise opposite, that the Agreement “is not” one of agency.

Taxpayers, however, rely on the *Rho* decision to argue that we should disregard this express language in the Agreement because “agency can be implied from the actions of the parties and need not be directly expressed orally or in contract.” (Emphasis in original). While Taxpayer’s argument under *Rho* is correct in the case of general agency law, *Rho* specifically recognized the distinct analysis of agency required under Rule 159:

We note that Washington’s tax regulations have placed additional restrictions on the definition of “agent” at least for one category of taxpayers. Taxpayers who buy and sell tangible personal property on behalf of another will not be treated as agents unless they have a contract expressly creating an agency relationship and their records indicate that the transactions were entered into in the name of the principal. WAC 458-20-159.

Rho, 113 Wn.2d at 573, n.6. [Because *Rho* concerned personal service activities, not sales of tangible personal property, the Washington Supreme Court found Rule 159 to be inapplicable to that case. *Id.* But Rule 159 does apply here, and it requires that a person claiming an agency relationship substantiate the claim through express language in the written contracts.] Because the Agreement here contains no such express language, and actually expressly declares the opposite, we conclude Taxpayers have failed to prove the existence of an agency relationship between them and Shoe Company as required under RCW 82.04.480(2) and Rule 159.

Based on the fact that the Agreement does not “clearly establish” an agency relationship between Taxpayers and Shoe Company, we must conclude that Taxpayers have failed to meet their burden of proving that they are entitled to avoid B&O tax liability under RCW 82.04.480(2) and Rule 159.¹⁰ We, therefore, conclude that the Audit Division properly assessed retailing B&O tax on Taxpayers’ sales of Shoe Company’s merchandise.¹¹

¹⁰ Because we conclude here that the Agreement does not clearly establish an agency relationship, as required under Rule 159, we need not address the additional requirements related to the books and records necessary to establish an agency relationship. Nevertheless, we note that the absence of Shoe Company’s name on the sales receipts calls into

3. Retail Sales Tax

While the Audit Division did not assess Taxpayers for retail sales tax during the audit period, it included future reporting instructions to Taxpayers to remit the retail sales tax they collect on sales of Shoe Company's merchandise in Taxpayers' stores. It is these future reporting instructions that Taxpayers now challenge.

Generally, retail sales tax is imposed upon all retail sales. RCW 82.08.020. When a seller makes a retail sale, it is obligated to collect retail sales tax. RCW 82.08.050. When a seller fails to collect the retail sales tax, the seller becomes liable for the tax. RCW 82.08.050.

RCW 82.08.040 provides the following specific instructions for consignees regarding the collection of retail sales tax:

(1) Every consignee . . . selling . . . personal property belonging to another, is deemed the seller of such personal property within the meaning of [the retail sales tax]

(2)(a) Except as provided in (b) of this subsection (2), every consignee . . . must collect and remit [retail sales tax] with respect to sales made . . . by that seller.

(b) If the owner of the property sold is engaged in the business of making sales at retail in this state, the [retail sales tax] may be remitted by such owner under such rules as the department may adopt.

See also Rule 159. As such, in general, a consignee must collect and remit retail sales tax on the sales it makes for the owner. However, the Department is authorized to adopt rules for allowing an alternative arrangement for remitting retail sales tax when the owner is engaged in making retail sales also. Rule 159, the Department's administrative rule implementing RCW 82.08.040, provides the following:

It shall be the duty of every consignee . . . to collect and remit the retail sales tax directly to the department with respect to all retail sales made . . . by them; provided, however, that if the owner of the property sold is engaged in the business of selling tangible property and the sale by the consignee . . . has been made in the owner's name and owner continues to engage in business, the owner may report and pay the tax collected directly to the department.

question whether Taxpayers could prove that its "books and records . . . show the transactions were made in the name and for the account of" Shoe Company, as provided in Rule 159.

¹¹ We note that had Taxpayers proven they had an agency relationship with Shoe Company, the income that Taxpayers received in the form of annual license charges, discussed earlier, would necessarily be subject to service and other activities B&O tax under Rule 159, regardless of whether Shoe Company received a lease or license under Rule 118 and 200. This is because Rule 159 makes clear that "a consignee . . . who makes sales in the name of the actual owner, as agent of the actual owner . . . is taxable under the service and other business activities classification upon the gross income *derived from such business*. (Emphasis added). Because the annual license charges are a percentage of sales of Shoe Company's merchandise, such income is "derived" from the consignment sales.

Thus, Rule 159 allows a consignor to remit retail sales tax to the department if (1) the sales by the consignee were made in the consignor's name, and (2) the consignor is engaged in business. Otherwise, the consignee must remit directly to the Department the retail sales tax collected on sales on behalf of a consignor.

Here, we have already concluded that the sales at issue were not made in Shoe Company's name based on the nature of the receipts for such sale, which only state Taxpayers' trade name, and do not mention Shoe Company. Taxpayers argue that Shoe Company's signage that is present both inside and outside Taxpayers' stores shows that the sales were made in Shoe Company's name. We recognize that Taxpayers and Shoe Company have made certain efforts to advertise Shoe Company's distinct presence in Taxpayers' stores, and to distinguish Shoe Company's merchandise from that of Taxpayers. However, we conclude that the records of the sales – the receipts – must identify Shoe Company as the owner of the merchandise in order for Taxpayers to avoid the obligation to remit retail sales tax on the sales of Shoe Company's merchandise directly to the Department. Therefore, we conclude that the Audit Division's future reporting instructions were correct, and affirm.

DECISION AND DISPOSITION

Taxpayer A's petition is denied.

Taxpayer B's petition is denied.

Dated this 3rd day of August 2016.