

Cite as Det. No. 20-0171, 44 WTD 001 (2025)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition for Refund of ) Assessment of ) ) ) . . . ) )	) ) ) ) ) )	<u>D E T E R M I N A T I O N</u>  No. 20-0171  Registration No. . . .
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[1] RCW 82.04.067; [Former] RCW 82.04.067 (2016): B&O TAX – NEXUS – SUBCONTRACTORS. Taxpayer’s contracted service providers activities are significantly associated with Taxpayer’s ability to establish or maintain a market for its products and represent substantial nexus with Washington under both the constitutional and statutory nexus thresholds.

[2] RCW 82.08.050; RCW 82.04.250: RETAIL SALES TAX – WATER MITIGATION SERVICES. Water damage mitigation services are sales of services rendered in respect to the cleaning and repairing of existing buildings and structures classified as retail subject to retail sales tax.

[3] RCW 82.04.070; RCW 82.04.090; RCW 82.08.010: RETAIL SALES TAX – MEASURE. The measure of income from the sale of water mitigation services is the selling price or gross proceeds of sales, not merely the mark-up.

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.

Herkert, T.R.O. – A business that provides insurance companies with water mitigation services via local service providers (Taxpayer) petitions for correction of assessments on grounds that Taxpayer provides insurance claims management to out-of-state insurers rather than providing retail construction services through subcontracts to insureds and lacks nexus with Washington. Taxpayer also protests the measure of its gross income as total proceeds from payments made by an insurer rather than merely fees earned. We deny the petition.<sup>1</sup>

ISSUES

1. Under RCW 82.04.067, does Taxpayer have substantial nexus with Washington when it sells water mitigation services performed by Washington service providers?
2. Under RCW 82.08.050 and 82.04.250, is the sale of water mitigation services a retail sale?

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

3. Under RCW [82.04.070, RCW 82.04.090 and RCW 82.08.010(1),] what is the [taxable] measure of taxpayer's [income] for the purpose of imposing business and occupation (B&O) tax?

### FINDINGS OF FACT

. . . (Taxpayer) assists insurance companies in responding to claims by their insureds for water mitigation services. Taxpayer's headquarters are [out-of-state]. Water mitigation services refer to the process of properly cleaning, sanitizing, drying, repairing, and restoring a property to its pre-water damage condition. Taxpayer creates and maintains a referral network of local service providers capable of doing the required work, including providers in the State of Washington.

The Department of Revenue's (Department) Audit Division (Audit) examined Taxpayer's account for the period January 1, 2009, through December 31, 2013, and on July 28, 2017, assessed Taxpayer \$ . . . . The assessment is comprised of \$ . . . in retail sales tax, \$ . . . in retailing B&O tax, \$ . . . in service and other activities B&O tax, \$ . . . in a 29% delinquent penalty, \$ . . . in interest, \$ . . . in a 5% assessment penalty, and \$ . . . in a 5% unregistered business penalty. Audit also examined Taxpayer's account for the period January 1, 2014, through December 31, 2016, and on July 28, 2017, assessed Taxpayer \$ . . . . The assessment is comprised of \$ . . . in retail sales tax, \$ . . . in retailing B&O tax, \$ . . . in service and other activities B&O tax, \$ . . . in a 29% delinquent penalty, \$ . . . in interest, \$ . . . in a 5% assessment penalty, and \$ . . . in a 5% unregistered business penalty.

Audit reconciled Taxpayer's income using Taxpayer's Washington invoice detail. Audit classified amounts for Contents Inventory Services, Desk Review Mitigation, Fees, File Management, Inspection & Test, Lead, Trip or Dispatch, and Leak Detection, as subject to service and other activities B&O tax. Audit classified amounts for Asbestos, Mitigation, Mold Remediation, Flooring, Null, and CWOP, as subject to retailing B&O tax and retail sales tax. Audit adjusted the measure of retail sales tax with credits for tax paid at source by the service providers.

Taxpayer's customers are insurance companies. When a customer's insured files a claim and repair work is approved by the insurance company, the insured is connected with Taxpayer for assistance. Taxpayer arranges for water mitigation services by local independent service providers (some of which are members of Taxpayer's provider network), invoices the insurance company, and pays the local service providers, as evidenced by Form 1099s. Taxpayer's federal income tax returns lists expenses such as mitigation services, restoration trip charges, and salvage fees, as "other deductions."

Taxpayer identifies water mitigation specialists with appropriate qualifications and licensing in Washington. Taxpayer provides insureds with the list of water mitigation specialists through referrals, from which insureds may choose to hire although they are not required to do so. Taxpayer argues that rather than selling water mitigation services that it purchases from independent contractors to insureds, it provides insurance management services for insurance companies. Taxpayer argues it does not have nexus for retailing B&O tax and retail sales tax because it did not have physical presence regardless of its relationship with the water mitigation businesses.

Taxpayer contends that those relationships do not create or maintain a market for Taxpayer's services in Washington.

In the alternative, Taxpayer argues that if it does have nexus with Washington, the measure of its income would be the difference between the amounts that the insurance company pays and the amount that is paid to the water mitigation business. Essentially, Taxpayer argues that based on the classification of its business activities, which Taxpayer contends are administrative services only, the measure of its income should not be the gross proceeds received from the insurance clients. Rather, it is only the "incidental" difference, positive or negative, between the amount the insurance carrier is willing to pay according to its estimation system and the amount ultimately paid to the local contractors actually performing the work.

Taxpayer focuses its argument with respect to the measure of income on the billing sequence. First, the billing sequence was described as Taxpayer receives an invoice from the local contractor, submits a marked up invoice to the insurance carrier that then pays Taxpayer before Taxpayer forwards payment to the local contractor. Subsequently, the billing sequence was described as Taxpayer receives an invoice from the local contractor, which is immediately paid. Then, Taxpayer invoices the insurance carrier for the amount allowed under its estimating system and receives payment on that basis regardless of the amount, greater or lesser, that Taxpayer paid to the local contractor.

Audit's petition response included a template of a Water Mitigation Services Agreement as evidence of Taxpayer's contracts with insurance companies. The agreement states as follows (in pertinent part):

### 1. RECITALS

WHEREAS, [Insurance Company] desires to outsource the administration, management, and auditing of water mitigation claims, including receiving initial service requests from insureds; the coordination, arrangement, and verification of the work performed by independent third-party contractors, whether those contractors are in the [Taxpayer's] network or not; the creation and maintenance of in-network documentation in accordance with IIRC S-500 ANSI Standards; and the auditing of out-of-network documentation to determine if ANSI-approved industry standards and local customary pricing guidelines are met; and

WHEREAS, [Taxpayer] has an infrastructure and network of independent contractors for the effective administration and management of water mitigation claims and desires to provide administration and management services for such claims for the [insurance company] . . . .

### 3. RESPONSIBILITIES OF [Taxpayer] . . .

**3.04 Management of Services Performed by Network Contractors.** . . . [Taxpayer] will receive and review invoices from Network Contractors to ensure that the Water Mitigation Services are billed in accordance with the estimating platform selected by the [insurance

company] in **Exhibit A**. Upon receipt of payment from the [insurance company] for Water Mitigation Services rendered in connection with a Request for Service, [Taxpayer] will pay the Network Contractor for said Services in accordance with the terms of their contract with [Taxpayer].

**3.05 Management of Services Performed by Non-Network Contractors.** [Taxpayer] will coordinate and manage water mitigation services provided by Non-Network Contractors. [Taxpayer] will verify that all such water mitigation services have been performed in accordance with IICRC S-500 ANSA Standards. [Taxpayer] will receive and review invoices from the Non-Network Contractors to ensure: i) that the services billed are appropriate and legitimate; and ii) that said services are billed in accordance with the estimating platform selected by the [insurance company] in Exhibit A[.] Upon receipt of payment from the [insurance company] . . . [Taxpayer] will pay the Non-Network Contractor for its services and manage the 1099 reporting at the end of the year as required by law. . . .

## **6. REQUEST FOR SERVICES**

**6.01 Initiation of a Request for Service.** Services under the Agreement are initiated by the [insurance company] or the [insured] contacting the Command Center and making a Request for Service. . . . Once a Request for Service had been made, neither the [insurance company] nor its agents or adjusters will contact the Network Contractor or a Managed Non-Network Contractor directly. . . .

## **12. WARRANTY**

**12.01** [Taxpayer] will, for a period of one year from completion of Water Mitigation Services performed by a Network Contractor under this Agreement, arrange for the repair or replacement of the work completed by the Network Contractor if such work does not meet the policyholder's satisfaction or is otherwise is [sic] deficient in workmanship or materials. All warranty claims shall be initiated by the [insurance company] or the insured through the Command Center. Upon receipt of a warranty claim, [Taxpayer] will dispatch a Network Contractor to evaluate and repair or replace the defective work or item.

## **15. GENERAL CONTRACT PROVISIONS . . .**

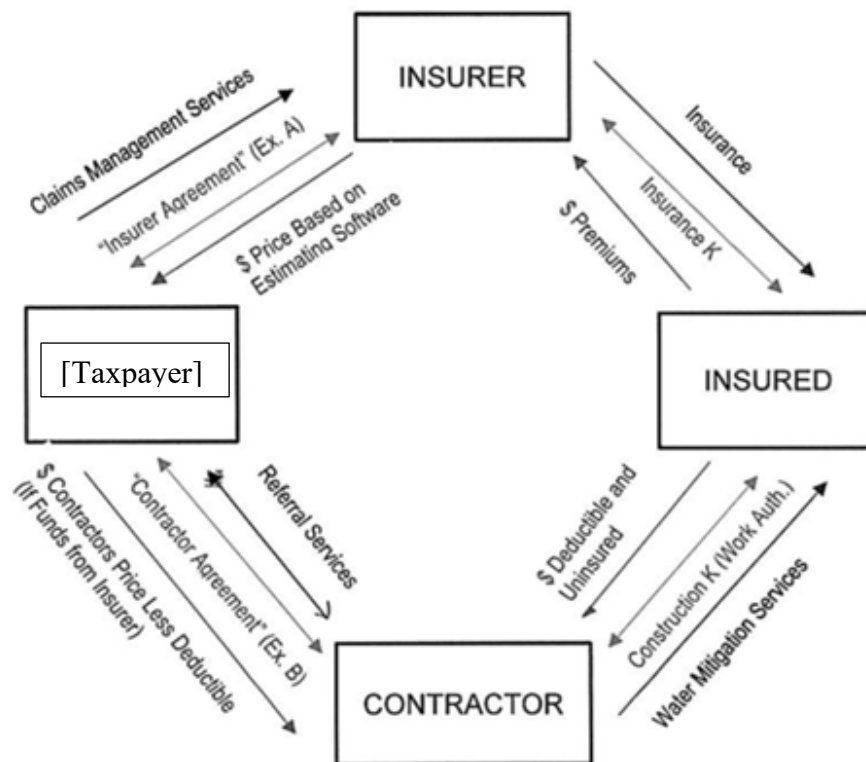
**15.03 Independent Contractor.** In the performance of this Agreement, it is mutually understood and agreed that [Taxpayer], Network Contractors, and Managed Network Contractors are, at all times, acting and performing as independent contractors with respect to the [insurance company].

Taxpayer provided sample mitigation invoices issued by a service provider and invoices issued to an insurance company on the same claim. The invoices list the same service line items, but with lower prices on the invoice issued to the service provider. For example, the invoice issued by the service provider shows 3 units of "Daily rental for low grain refrigerant dehumidifier rated at AHAM for 10-120 pints per day" for a price of \$ . . . , and the invoice issued to the insurance

company for the same item shows a price of \$ . . . . The total claim on the invoice issued by the service provider is \$ . . . . The claim total on the invoice issued to the insurance company is \$ . . . , and includes a “Base Service Charge – Affiliate” of \$ . . . , and a “Software License Fee – Affiliate” of \$ . . . , which are not listed on the invoice issued by the service provider. The invoice issued to the service provider states that the information is “personal and private” between Taxpayer and the service provider, and that the information “is not to be shared” with the insured or carrier without explicit authorization. Taxpayer also provided a template of a Master Services Agreement between Taxpayer and service providers. General Contract Provision 11.02 states that nothing in the agreement shall be construed to create an agency relationship between the parties.

Section 12.01 of the agreement establishes warranty responsibilities. Taxpayer provided further information with respect to the warranty during its hearing. Taxpayer stated that, in the event of defective or insufficient initial repair, Taxpayer contacted the original local contractor to fix the work. Taxpayer did not pay for the warranty mitigation. However, Taxpayer acknowledged that when the local contractor did not or could not bring the work up to an acceptable standard, Taxpayer engaged a different local contractor to meet its warranty obligations. Taxpayer stated it did not invoice the insurance company in that very unusual case simply to maintain good working relationships with its insurance company clients.

Taxpayer provided the following diagram it contends represents the multiple relationships between parties.



Taxpayer's diagram shows that no contractual agreement exists between the water mitigation service providers and its insurance company clients. This is consistent with the contractual language that specifically states Taxpayer is not the agent of the insurance company clients.

Taxpayer timely requested review of the additional assessments. Taxpayer's petition for review was denied in Det. No. . . . , which set a new due date for payment as October 25, 2018. Taxpayer paid the assessments on March 28, 2019. Taxpayer requested refund of the assessments plus sales tax and B&O tax payments of \$ . . . for the post-audit period of January 1, 2017, through February 28, 2019, on the same issues.

## ANALYSIS

### 1. Nexus

Taxpayer claims that it lacks the requisite nexus with Washington. Nexus requirements flow from limits on a state's jurisdiction to tax found in the Commerce Clause and Due Process Clause provisions of the United States Constitution. The limitations are discussed in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977), and *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) (overruled by *South Dakota v. Wayfair*, 585 U.S. \_\_\_, 138 S. Ct. 2080 (2018)).

Under established dormant Commerce Clause case law, nexus can be established in many different ways. For example, nexus can be established by maintaining an office or other business facilities in this state, regardless of whether the in-state office has any direct relationship to the taxed activity. *National Geographic Soc. v. Bd. of Equalization*, 430 U.S. 560 (1977). Additionally, nexus may be established by sending employees into the state to meet with customers or prospective customers. *Lamtec Corp. v. Dep't of Revenue*, 170 Wn.2d 838, 246 P.3d 788 (2011). Nexus may also be established by third parties acting on behalf of the taxpayer where such activities are significantly associated with the seller's ability to establish and maintain a market. *Tyler Pipe Industries, Inc. v. Dep't of Revenue*, 483 U.S. 232, 250 (1987). And nexus sufficient to meet dormant Commerce Clause constraints may be established through "substantial virtual connections to the State." *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080 (2018). This is not an exhaustive list. The simple and overarching inquiry under the dormant Commerce Clause is whether the taxpayer has "avail[ed] itself of the substantial privilege of carrying on business" in the taxing jurisdiction. *Id.* at 2099 (quoting *Polar Tankers, Inc. v. City of Valdez*, 557 U.S. 1, 11 (2009)).

The nexus limitation imposed by the Due Process Clause is satisfied if "a foreign corporation purposefully avails itself of the benefits of an economic market in the forum state." *Quill Corp.*, 504 U.S. at 307.<sup>2</sup>

The determination of whether in-state activities create nexus looks to the entire collection of a taxpayer's different activities, the totality of which creates substantial nexus. *GMC v. City of*

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<sup>2</sup> In questioning the state's assertion of nexus in this case, Taxpayer does not differentiate between the nexus limitations pertaining to the Due Process Clause as opposed to the Commerce Clause. In light of the recent decision by the United States Supreme Court in *Wayfair*, there may be no material difference between these nexus requirements. However, that is not an issue directly before us in this administrative appeal.

*Seattle*, 107 Wn. App. 42, 25 P.3d 1022 (2001); *see also General Motors Corp. v Washington*, 377 U.S. 436 (1964), *overruled on other grounds*, *Tyler Pipe*, 483 U.S. at 250 (1987) (holding that it is the bundle of corporate activity that determines whether a taxpayer has nexus with a state); WAC 458-20-193. Thus, establishing taxing nexus requires consideration of the entire bundle of a taxpayer's in-state activities.

Furthermore, in addition to the nexus thresholds in the Due Process Clause and dormant Commerce Clause, RCW 82.04.067 provides a statutory substantial nexus standard. It states that a person making retail sales is deemed to have substantial nexus if the person has a physical presence in this state, which need only be demonstrably more than a slightest presence. RCW 82.04.067(6)(a). Further, physical presence can be established by third parties as follows:

A person is also physically present in this state for the purposes of this subsection if the person, either directly or through an agent or other representative, engages in activities in this state that are significantly associated with the person's ability to establish or maintain a market for its products in this state.

[Former] RCW 82.04.067(6)(c) (2016). *See also Tyler Pipe Industries, Inc. v. Dep't of Revenue*, 483 U.S. 232, 250 (1987); *see generally* WAC 458-20-193(102)(d) (stating that agents or representatives include independent contractors acting at the direction of another in the context of sales of tangible personal property.).

Taxpayer contracts with Washington water mitigation service providers and refers those providers to insureds making claims. Taxpayer contends that the existence of its referral network does not create a market for its products in Washington. We disagree. Without the referral network, regardless of how frequently an insured chooses a different provider, Taxpayer's insurer customers could not effectively respond to insureds claims for water mitigation services. Taxpayer needs those referral providers available in Washington in order to provide its services of managing water mitigation claims to its clients. The existence of the referral network, created and maintained by Taxpayer, allows it to have a market for its products in Washington. Taxpayer is selling water mitigation services in Washington, and the fact that these services are ultimately performed by independent contractors does not insulate Taxpayer from substantial nexus with Washington. *See Scripto, Inc. v. Carson*, 362 U.S. 207, 211 (1960) (holding that nexus was established by a seller's in-state solicitation performed through independent contractors despite the lack of a physical presence on the part of the taxpayer). Because the service providers' activities in Washington are significantly associated with Taxpayer's ability to establish or maintain a market for its products in this state, we conclude that Taxpayer has substantial nexus with Washington under both the constitutional and statutory nexus thresholds.

## 2. Retail Sales Tax

RCW 82.08.020 imposes a retail sales tax on each retail sale in this state. The term "sale at retail" or "retail sale" includes the sale of or charge made for labor and services rendered in respect to the cleaning or repairing of existing buildings or structures for consumers. RCW 82.04.050(2)(b). Water mitigation services refers to the process of properly cleaning, sanitizing, drying, repairing, and restoring a property to its pre-water damage condition. Because sales of water damage

mitigation services are sales of services rendered in respect to the cleaning and repairing of existing buildings and structures, the services are subject to retail sales tax. RCW 82.08.020, 82.04.050(2)(d).

The seller must collect retail sales tax from the buyer, and then remit the collected tax to the Department. RCW 82.08.050. If the seller fails to do so, then it is personally liable for the amount of tax unless the seller maintains proper records of exempt transactions and provides them to the Department when requested. *Id.* Thus, a seller is liable for the retail sales tax due on any retail sale unless it has documentation to show that the sale was exempt or otherwise not subject to retail sales tax. *Id.*; see also Det. No. 01-193, 21 WTD 264 (2002).

Here, Taxpayer does not argue that the water damage mitigation services are exempt from retail sales tax. Instead, it argues that the service provider, rather than Taxpayer, is the seller of retail services, and Taxpayer is not responsible for retail sales tax on amounts invoiced to insurance companies.

The provided Water Mitigation Services agreement template and invoices do not support Taxpayer's argument. The agreement states that the insurance company desires to outsource the arrangement of work performed by third party contractors without creating a direct relationship with the water mitigation service providers. The sample invoice issued to an insurance company consistently includes a gross amount of the claim. It therefore includes both the services being provided by the water mitigation specialist and the markup charged by Taxpayer.

Similarly, Taxpayer received invoices from the water mitigation service providers showing only the amount of those services. Taxpayer resold those services to its insurance agent clients. Therefore, we conclude that Taxpayer is reselling the service provider's services to the insurance company.

RCW 82.08.010(2)(a) defines the term "seller" as "every person, including the state and its departments and institutions, making sales at retail or retail sales to a buyer, purchaser, or consumer, whether as agent, broker, or principal, . . . ." RCW 82.04.040 states that the term "sale" includes any activity classified as "sale at retail" or "retail sale" under RCW 82.04.050. Since sales of water mitigation services are retail sales, Taxpayer is a "seller" pursuant to RCW 82.08.010(2)(a), regardless of whether Taxpayer subcontracts this work to the service providers. As a "seller," Taxpayer is responsible to collect and remit retail sales tax from customers on the sale of water mitigation services. RCW 82.08.050. Since it failed to do so, Taxpayer is now liable for the retail sales tax it failed to collect. *Id.*

### 3. Measure of B&O tax

Washington imposes a B&O tax "for the act or privilege of engaging in business" in this state. RCW 82.04.220. The tax rate varies based on the type of business activity the taxpayer engages in and the statute provides numerous classifications of activities. The tax is measured by applying particular rates against the value of products, gross proceeds of sale, or gross income of the business as the case may be. Taxpayers engaging in service businesses that are not otherwise classified are subject to the Service and Other Activities B&O tax. RCW 82.04.290. The B&O tax



is “‘extensive and is intended to impose . . . tax upon virtually all business activities carried on in the State.’” *Analytical Methods, Inc. v. Dep’t of Revenue*, 84 Wn. App. 236, 241, 928 P.2d 1123 (1996) (quoting *Palmer v. Dep’t of Revenue*, 82 Wn. App. 367, 371, 917 P.2d 1120 (1996)).

Previously, we concluded that Taxpayer was a “seller” of water mitigation services. As such, Taxpayer was responsible for the collection of retail sales tax on the sale of those services and, since it had not collected those amounts, personally liable for remitting the appropriate amount of retail sales tax on the value of those services regardless of whether those amounts were included in the measure of gross proceeds for the purpose of imposing B&O tax.

Taxpayer argues that it is only providing administrative services and that it should only be taxed on its mark-up. As we have previously concluded, Taxpayer’s services are not in the nature of administrative services, but services subject to retail sales tax and retailing B&O tax. Income from providing retail sales is subject to B&O tax on the “gross proceeds of sales” under RCW 82.04.070 and the “selling price” under RCW 82.08.010(1). RCW 82.04.250(1); RCW 82.08.020. RCW 82.04.070 defines “gross proceeds of sales” as:

‘the value proceeding or accruing from the sale of tangible personal property, digital goods, digital codes, digital automated services, and/or for other services rendered, without any deduction on account of the cost of property sold, the cost of materials used, labor costs, interest, discount paid, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.’

RCW 82.04.070. “‘Value proceeding or accruing’ means the consideration, whether money, credits, rights, or other property expressed in terms of money, actually received or accrued.’ RCW 82.04.090.

Because Taxpayer is subject to tax based on the selling price of its services, it cannot limit its liability to its mark-up. See *Budget Rent-A-Car of Wash-Or, Inc., v. Dep’t of Revenue*, 81 Wn.2d 171, 500 P.2d 764 (1972) (“Whether a profit is realized on the transactions is immaterial, for the tax is on the gross revenues received in the course of doing business.”); *Time Oil*, 79 Wn.2d at 147 (Court upheld B&O tax on exchanges of fuel where the parties only saved transportation and storage costs, but did not make a profit); *Young Men’s Christian Ass’n v. State*, 62 Wn.2d 504, 383 P.2d 497 (1963); *City of Seattle v. State*, 59 Wn.2d 150, 367 P.2d 123 (1961) This is because the plain meaning of the words used to define “business” in RCW 82.04.140, such as “gain,” “benefit,” and “advantage,” “convey a meaning wider in scope than does the word ‘profit.’” *City of Seattle*, 59 Wn.2d at 153. Taxpayer’s agreement with its insurance company clients specifically states that the agreement does not create agency between Taxpayer and that client.<sup>3</sup> Furthermore, Taxpayer retains warranty obligations after the water mitigation services are rendered. Taxpayer is not receiving payment of the water mitigation services from their clients as an agent of those clients. Plus, Taxpayer retains liability for the provision of those services as the warrantor. Consequently,

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<sup>3</sup> [While Taxpayer is not arguing, in this case, that receipts are excludible from its measure of tax as “advances” or “reimbursements” under WAC 458-20-111, we note parenthetically that without a requisite finding of agency, a taxpayer cannot exclude receipts from the measure of tax as an advance or reimbursement under WAC 458-20-111.]

the measure of Taxpayer's income is the selling price or gross proceeds of sales to the insurance company clients under RCW 82.04.070 and RCW 82.08.010(1).

Taxpayer argues that the measure of its income should be the difference between the amount received from the insurance carrier and the amount paid to local contractors to perform the work. Taxpayer's argument relies on its assertion that the business activity it is engaged in is merely administrative services. Having already addressed the business activities of Taxpayer and concluded that those activities are not merely administration but rather the provision of water mitigation services, the measure of Taxpayer's income is the gross amount received from the insurance companies as discussed above. Taxpayer provided no legal authority for its contention that the measure should be other than gross proceeds from the insurance company if the business activities were deemed water mitigation services. Taxpayer argues that the billing sequence, specifically that Taxpayer may be paying the local contractors prior to invoicing the insurance company, would change the measure of its income. We disagree. The measure is determined by the factual relationship between Taxpayer and its insurance company clients. Both billing sequences are consistent with the Taxpayer providing water mitigation services to its insurance company clients. While the billing sequence might also theoretically reflect a different relationship between Taxpayer and the insurance company, it does not change the actual contractual and factual relationship between Taxpayer and its insurance company clients. Taxpayer provides water mitigation services, not mere administrative services. The measure of gross income from water mitigation services is the gross proceeds received from the insurance companies. We sustain the Department's calculation of the measure of Taxpayer's income.

#### DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 19th day of June 2020.