Cite as Det. No. 16-0295, 36 WTD 286 (2017)

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

In the Matter of the Correction of Assessment of )  )  )  )  )
 )  )  )  )  )
 )  )  )  )  )
 )  )  )  )  )
 )  )  )  )  )
 )  )  )  )  )
 )  )  )  )  )
 )  )  )  )  )

RULE 111: SERVICE B&O TAX - ADVANCES AND REIMBURSEMENTS.
Taxpayer may not exclude from taxable gross income the funds it receives for providing independently contracted natural health services to customers.

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.

Gabriella Herkert, T.R.O. – Naturopathic clinic (“Taxpayer”) protests assessment of service and other activities business and occupations (“B&O”) tax on amounts disallowed as deductions under independent contractor arrangements for provision of natural health services. Taxpayer’s petition is denied.¹

ISSUE
Under RCW 82.04.080 and WAC 458-20-111 (“Rule 111”), may Taxpayer exclude from its gross income of the business amounts it pays out to individual practitioners?

FINDINGS OF FACT
Taxpayer provides naturopathic medicine, colon hydrotherapy, massage, electric-lymphatic therapy, cranial sacral, and restorative yoga services. The taxpayer also sells supplements online and at a retail location within its location. Health care services are performed by licensed individuals (“Practitioners”) subject to a contract (“Contract”) between the Practitioner and Taxpayer.

Taxpayer provides supplies used during the services. Taxpayer schedules customers and an appropriate Practitioner. Practitioners are not given exclusive use of any space. In 2010, the Disclosure and Disclaimer FAQ page from Taxpayer’s website made reference to contractors without disclosing the nature of the relationship between Taxpayer and Practitioner. Taxpayer runs amounts remitted through a single point of sale system. Taxpayer remits to the Practitioner

¹ Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.
the amount paid by the customer minus a percentage for “rent” of the space. Taxpayer reported the amount of “rent” as rental income on its federal income tax return.

Practitioners provide the services listed on Taxpayer’s website. Practitioners use Taxpayer’s products or provide their own and keep the area clean. Sometimes, Practitioners schedule customers, answer phones, or provide minimal administrative support to Taxpayer. Practitioners offer discounts. Amounts retained by Taxpayer as “rent” are unaffected by discounts offered by Practitioners. In the event a customer does not pay, Practitioner receives nothing.

Taxpayer was audited by the Department of Revenue’s Audit Division (“Audit”) for the period of January 1, 2011, through September 30, 2013, resulting in an assessment of $....

Audit disallowed exclusions from service and other activities B&O tax of amounts paid to Practitioners for the provision of service reduced by cash and trade discounts. Audit reclassified rental income as service and other activities for B&O tax purposes, treating amounts Taxpayer called “rent” as licenses to use real estate, having concluded that Taxpayer merely granted Practitioners a right to use its real property without conferring exclusive control or dominion over the property. Taxpayer timely requested review of disallowed exclusions from income for amounts paid to Practitioners only. Taxpayer made no claim with respect to the reclassification of rental income.

**ANALYSIS**

Washington’s B&O tax is imposed on every person “for the act or privilege of engaging in business activities” and applies to the gross income of the business. RCW 82.04.220. “Business” for B&O tax purposes includes “all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or to another person or class, directly or indirectly.” RCW 82.04.140. “Gross income of the business” similarly is broadly defined as follows:

\[
\text{The value proceeding or accruing by reason of the transaction of the business engaged in and includes gross proceeds of sales, compensation for the rendition of services, gains realized from trading in stocks, bonds, or other evidences of indebtedness, interest, discount, rents, royalties, fees, commissions, dividends, and other emoluments however designated, all without any deduction on account of the cost of tangible property sold, the cost of materials used, labor costs, interest, discount, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.}
\]

RCW 82.04.080(1). The “value proceeding or accruing,” in turn, is defined as “the consideration, whether money, credits, rights, or other property expressed in terms of money, actually received or accrued.” RCW 82.04.090.

The Legislature “intended to impose the business and occupation tax upon virtually all business activities carried on within the state.” Simpson Inv. Co. v. Dep’t of Revenue, 141 Wn.2d 139, 149, 3 P.3d 741 (2000) (quoting Time Oil Co. v. State, 79 Wn.2d 143, 146, 483 P.2d 628 (1971)). Further, the B&O tax is not a tax on profit, net gain, capital gain, or sales “but a tax on the total

---

2 Document .... includes retail sales tax credit of $....; retailing B&O tax credit of $....; service and other activities B&O tax $....; use tax of $....; and interest of $.... No penalties were assessed.
money or money’s worth received in the course of doing business.” *Budget Rent-A-Car of Wash.-Oregon*, 81 Wn.2d 171, 172, 500 P.2d 764 (1972). In short, the B&O tax provisions “leave practically no business and commerce free of the business and occupation tax.” *Id.* at 175.

RCW 82.04.080(1) makes clear that there are no deductions from “gross income of the business” of expenses, including specifically, “labor costs.” *See also* Det. No. 99-223, 20 WTD 1 (2001). This is true regardless of whether the labor costs are being rendered by employees or independent contractors. *3* Washington taxes gross income of the business. Accordingly, Taxpayer cannot exclude any costs of doing business, unless there is some specific exclusion that is applicable.

We further note that Taxpayer has the burden of establishing its entitlement to any deduction or exemption from tax liability. *See Budget Rent-A-Car, Inc. v. Dep’t of Revenue*, 81 Wn.2d 171, 174-75, 500 P.2d 764 (1972) (“Exemptions to the tax law must be narrowly construed. Taxation is the rule and exemption is the exception. Anyone claiming a benefit or deduction from a taxable category has the burden of showing that he qualifies for it.”); *see also* Lacey Nursing *v. Dep’t of Revenue*, 128 Wn.2d 40, 905 P.2d 338 (1995); *Port of Seattle v. State*, 101 Wn. App. 106, 1 P.3d 607 (2000); Det. No. 13-0279, 33 WTD 75 (2014).

While a taxpayer generally may not deduct its costs of business from the measure of its B&O tax, Rule 111 permits an exclusion from gross income for certain “advances” and “reimbursements” that a taxpayer receives solely in its capacity as an agent. Rule 111 provides, in part:

The words "advance" and "reimbursement" apply only when the customer or client alone is *liable for the payment* of the fees or costs and when the taxpayer making the payment has no personal liability therefor, either primarily or secondarily, other than as agent for the customer or client.

The foregoing is limited to cases wherein the taxpayer, as an incident to the business, undertakes, *on behalf of* the customer, guest or client, the payment of money, either upon an obligation owing by the customer, guest or client to a third person, or in procuring a service for the customer, guest or client which the taxpayer does not or cannot render and for which no liability attaches to the taxpayer. It does not apply to cases where the customer, guest or client makes advances to the taxpayer upon services to be rendered by the taxpayer or upon goods to be purchased by the taxpayer in carrying on the business in which the taxpayer engages.

(Emphasis added.)

Rule 111 defines “advance” as “money or credits received by a taxpayer from a customer or client with whom the taxpayer is to pay costs or fees for the customer or client.” (Emphasis added).

---

*3* Taxpayer stated that he sought advice from both the Department of Labor & Industries and the Employment Security Division in establishing Practitioners as independent contractors. While their status as independent contractors alters Taxpayer’s responsibilities with respect to Practitioners’ workers compensation coverage (L&I) and unemployment insurance (ESD), the distinction is irrelevant for B&O tax purposes.
Similarly, Rule 111 defines “reimbursement” as “money or credits received from a customer or client to repay the taxpayer for money or credits expended by the taxpayer in payment of costs or fees for the client.” (Emphasis added). The clear language of both definitions requires that, for Rule 111 to apply, Taxpayer must be a client’s or customer’s agent for the purpose of payment to third parties; the only difference in Rule 111 between an “advance” and a “reimbursement” is the timing of the money received from the client for such payment.

Here, Taxpayer asserts that it acted as a collection agent for Practitioners and that the funds collected were money owed to Practitioners for services they performed. Under such a creditor/debtor theory, the taxpayer must be an agent for Practitioners, the patients must expressly agree to purchase the services from Practitioners and not from Taxpayer, and Taxpayer must not be liable to Practitioners for the collected funds other than as an agent.

Rule 111 requires the existence of a true agency relationship between the client and the taxpayer. Washington Imaging Services, LLC v. Dep’t of Revenue, 171 Wn.2d 548, 252 P.3d 885 (2011). Agency requires a factual determination that both parties consented to the agency relationship and that the principal exercised control over the agent. Id.; see also Nordstrom Credit, Inc. v. Dep’t of Revenue, 120 Wn.2d 935, 941, 835 P.2d 1331 (1993); Det. No. 05-0206E, 25 WTD 72 (2006); Det. No. 03-0128, 24 WTD 168 (2005). The Washington Imaging court emphasized that “The proper focus is on the facts and whether they show a true agency relationship that requires payment to a third party on behalf of the recipient (e.g., client or patient) paying for the goods or services.” Washington Imaging, 171 Wn.2d at 565.

The basic requirements for a collecting agent were discussed in Washington Imaging, 171 Wn.2d at 548, 252 P.3d at 889, where the court commented:

The agreement also declares that Washington Imaging acts as a collection agent for Overlake. Washington Imaging contends that because it acted only as a collection agent, the amounts it received from patients that were paid to Overlake do not constitute its own income, but rather Overlake’s income.

For Washington Imaging to prevail on the argument that it acted only as a collection agent of Overlake, it must have collected money owed to Overlake. But the patients contracted solely with Washington Imaging to pay for medical imaging services and have no separate obligation to Overlake. The patient registration form, Washington Imaging’s contracts with patients’ insurers, and the bills that Washington Imaging sent to patients all establish that patients owed payment only to Washington Imaging, not Overlake. Therefore, regardless of what the contract between Washington Imaging and Overlake states, for purposes of its B & O tax liability, Washington Imaging was not acting as an agent of Overlake collecting payments owed by the patients to Overlake. There is no evidence at all that the patients owed money to Overlake or that Washington Imaging collected money owed to Overlake. Therefore, based on the undisputed facts we reject Washington Imaging’s argument that it acted only as a collection agency and the amounts paid by patients were not its own income.

(Emphasis added.)
Here, as in *Washington Imaging*, the Agreements between Taxpayer and Practitioners do not describe a collecting agent relationship. Rather, they indicate that a Practitioner is an independent contractor that provides some health care services. Although taxpayer alleges that clients knew services were to be performed by Practitioners as independent contractors and, therefore, understood that Taxpayer was acting as an agent. We disagree. [The fact that a business hires independent contractors to provide services for customers of the business does not make the business an agent of the contractors. In addition, . . .] [t]here is no proof in the record supporting Taxpayer’s assertion. In fact, the Disclosure and Disclaimer FAQ page from Taxpayer’s website available in June 2010 makes only an oblique reference to contractors without providing adequate information for customers to infer much less understand that Taxpayer was acting solely as an agent and was not contracting with clients directly. Accordingly, the evidence does not support a deduction for funds received by Taxpayer as a collecting agent.

Taxpayer’s petition is, therefore, denied.

DECISION AND DISPOSITION

Taxpayer’s petition is denied.

Dated this 13th day of September 2016.