Cite as 6 WTD 19 (1988)

This determination has been overruled in part by Det. No. 88-219A, 10 WTD 264 (1991).

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

In the Matter of the Petition For Correction of Assessment of)	D E T E R M I N A T I O N
)	No. 88-219
)	
. . .)	Registration No. . . .
)	Tax Assessment Nos. . . .
)	

[1] **RULE 159:** PRINCIPAL AND AGENT -- PURCHASING AGENT -- RULE REQUIREMENT. In order for a taxpayer to be recognized as an agent in making purchases for a principal, the requirements of Rule 159 must be met. There must be an agreement which clearly establishes a principal-agent relationship and certain record-keeping requirements must be met.

[2] **RULE 159:** PRINCIPAL AND AGENT -- FEDERAL INCOME TAX REPORTING. The fact that a taxpayer is considered an agent for federal income tax purposes does not establish agency under Rule 159. 2 WTD 391 (1987).

[3] **RULE 193B:** BUSINESS AND OCCUPATION TAX -- NEXUS -- PROMOTION OF RETAIL SALES BY WHOLESALER. Local activity by a wholesaler which consists of promoting retail sales of the wholesaler's goods creates sufficient nexus to subject sales by the wholesaler to the retailer to business and occupation tax. ETB 507.04.193B.

[4] **RULE 202:** BUSINESS AND OCCUPATION TAX -- DEDUCTION -- POOL PURCHASES. The requirements of Rule 202 must be met in order to gain the pool purchase deduction. There must be an agreement. There must be a joint purchase. The principal member must retain some of the goods for its own inventory.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

TAXPAYER REPRESENTED BY: . . .

DATE OF HEARING: May 28 and July 30, 1987

NATURE OF ACTION:

The taxpayer petitioned for a correction of assessments of tax issued as the result of an audit.

FACTS AND ISSUES:

Potegal, A.L.J. -- The taxpayer is [an out-of-state] corporation which has its headquarters in [another state]. The taxpayer has many subsidiary corporations each of which operates one retail store. These subsidiaries sell clothes and shoes to the public. The taxpayer has four divisions. The subsidiaries are organized into four corresponding groups. [A] stores sell men's clothes. [B] stores sell women's clothing. [C] and [D] stores sell shoes. All divisions except [C] have employees who engage in activity in Washington. Each subsidiary has a standard written agreement with the taxpayer. In part the agreement states:

> 1. The Corporation hereby appoints [taxpayer] to act as supplier, purchasing agent, construction agent and business consultant for the Corporation, and [taxpayer] hereby agrees to act in such capacities.
>
> 2. [Taxpayer] shall utilize its facilities and resources to purchase, at the best possible prices, the material and equipment required by the Corporation to establish and maintain its store and the merchandise requirements to be supplied by it to the Corporation for operation of said store.
>
> 3. As construction agent for the Corporation, [taxpayer] shall perform or cause to be performed such construction and maintenance services as may be necessary or desireable to establish the store of the Corporation and to maintain it in a condition suitable for the business of the Corporation.
>
> 4. Invoices to [taxpayer] for material and equipment purchased by [taxpayer] as purchasing agent for the Corporation, and statements for construction and maintenance services which [taxpayer], as construction agent of the Corporation, has performed or caused to be performed for the Corporation shall be paid for by the Corporation or by [taxpayer] out of funds furnished by

> the Corporation, and [taxpayer] shall act as disbursing agent in disbursing such funds. . . .
>
> 5. [Taxpayer] shall supply the Corporation with its requirements of apparel and other merchandise which shall be paid for by the Corporation as follows:

Tax was assessed on the basis that the taxpayer was not acting as an agent but as a seller of goods and services to the subsidiaries. Four types of transactions were taxed:

> 1. Construction Services. The auditor found that the taxpayer was the prime contractor for construction for subsidiaries which were opening new stores. Retailing business and occupation tax and retail sales tax were assessed against the taxpayer for construction costs. The taxpayer states that it merely was a construction agent which arranged for the construction. Furthermore, the subsidiaries either paid retail sales tax to contractors or reported use tax directly to the state.
>
> 2. Leasehold Improvements. The auditor found the taxpayer to be a seller of fixtures, furniture and equipment to subsidiaries opening new stores. Retailing business and occupation tax and retail sales tax were assessed against the taxpayer for these costs. The taxpayer states that it only was an agent. Also, the subsidiaries either paid retail sales tax to vendors or reported use tax to the state.
>
> 3. Supplies. Retailing business and occupation tax and retail sales tax were assessed against the taxpayer on sales of supplies such as paper, light bulbs and paper clips to subsidiaries. Again the taxpayer asserts that it acted as an agent and the subsidiaries paid either retail sales tax or use tax.
>
> 4. Inventory. Wholesaling business and occupation tax was assessed against the taxpayer on sales of inventory to subsidiaries. The taxpayer claims it was acting as an agent.

The taxpayer asserts that even if it was not an agent there is insufficient nexus to subject the sales to tax. With respect to inventory the taxpayer also claims that it is entitled to the pool purchase deduction provided by WAC 458-20-202 (Rule 202).

DISCUSSION:

[1] WAC 458-20-159 (Rule 159) states in part:

> Any person who claims to be acting merely as agent or broker in promoting sales for a principal or in making purchases for a buyer, 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, or the actual buyer for whom the purchase was made.
>
> 2. The books and records show the amount of gross sales, the amount of commission and any other incidental income derived by the broker or agent from such sales.
> (Emphasis ours.)

With respect to Construction Services and Leasehold Improvements the taxpayer clearly demonstrated that it acted as an agent and met the requirements of Rule 159. The written agreement establishes an agency relationship for these activities. The books and records requirement of the rule has been met. In particular we note that purchase orders prepared by the taxpayer direct vendors to bill the subsidiary. Although vendors may have ignored these instructions and billed the taxpayer, the actual payment was from the subsidiaries direct to the vendors. The fact is that the taxpayer did not receive any money from the subsidiaries and did not pay the vendors.

With respect to Supplies the facts are different. The taxpayer orders and pays for supplies without the needs of any particular subsidiary in mind. The subsidiaries order supplies as needed from the taxpayer. Here the rule requirements have not been met. The principal-agent relationship has not been clearly established as to supplies. The books and records do not reflect that the taxpayer bought on behalf of a principal. Although the taxpayer is liable for business and occupation tax, if nexus is found, retail sales tax will be deleted from the assessment because the subsidiaries have paid use tax on the supplies purchased.

With respect to Inventory the requirements of the rule have not been met. The written agreement denotes the taxpayer as a supplier as well as a purchasing agent. The agreement speaks in terms of the taxpayer purchasing and paying for inventory. At

best, the agreement is equivocal with respect to the taxpayer acting as an agent in terms of purchasing inventory. The books and records show that the taxpayer purchased inventory for its own account with its own funds. The taxpayer put on extensive evidence demonstrating that it made its purchases of inventory based on the specific needs of each subsidiary. However, that does not necessarily mean that the taxpayer purchased as an agent. It could simply mean that the taxpayer knew in advance exactly what it was going to sell to each subsidiary. The paperwork between the taxpayer and the vendor in all respects reflects a sale to the taxpayer on its own account. Although the taxpayer asserted that the subsidiaries bore all risk of loss with respect to the purchase from the vendor, this appears to be true only because the taxpayer could force its wholly-owned subsidiaries to absorb any such loss and not because it was acting as an agent for the subsidiaries. The shipping documents specifically state that the risk of loss belonged to the taxpayer.

In support of its claim of agency the taxpayer asserts that the Internal Revenue Service treats it as an agent for federal income tax purposes with respect to the purchase of inventory. The taxpayer presented a copy of a closing agreement with the IRS. The agreement provides that services performed by the taxpayer for its subsidiaries should be allocated to subsidiaries with a profit element of 5%. The allocated income was to be allowed as an expense to each of the subsidiaries.

[2] For two reasons this argument is not persuasive. First, the manner of reporting income for federal tax purposes, in itself, does not prove that the requirements of Rule 159 have been met. 2 WTD 391 (1987). Second, the closing agreement does not disclose what particular services are involved or if those services are connected with the goods purchased by the subsidiaries. The agreement between the taxpayer and the subsidiaries provides that the taxpayer will act as business consultant to the subsidiaries. The closing agreement could concern itself with the allocation of income from the consulting activities of the taxpayer.

Having decided that the taxpayer is making sales of supplies and inventory to the subsidiaries, the next question is whether there is sufficient nexus with Washington to subject those sales to business and occupation tax. This issue is governed by WAC 458-20-193B (Rule 193B). That rule states in part:

BUSINESS AND OCCUPATION TAX

> RETAILING, WHOLESALING. Sales to persons in this state are taxable when the property is shipped from points

outside this state to the buyer in this state and the seller carries on or has carried on in this state any local activity which is significantly associated with the seller's ability to establish or maintain a market in this state for the sales. If a person carries on significant activity in this state and conducts no other business in this state except the business of making sales, this person has the distinct burden of establishing that the instate activities are not significantly associated in any way with the sales into this state. The characterization or nature of the activity performed in this state is immaterial so long as it is significantly associated in any way with the seller's ability to establish or maintain a market for its products in this state. The essential question is whether the instate services enable the seller to make the sales.

Applying the foregoing principles to sales of property shipped from a point outside this state to the purchaser in this state, the following activities are examples of sufficient local nexus for application of the business and occupation tax:

. . .

5. Where an out-of-state seller, either directly or by an agent or other representative, performs significant services in relation to establishment or maintenance of sales into the state, the business tax is applicable, even though (a) the seller may not have formal sales offices in Washington or (b) the agent or representative may not be formally characterized as a "salesman."

. . .

Under the foregoing principles, sales transactions in which the property is shipped directly from a point outside the state to the purchaser in this state are exempt only if there is and there has been no participation whatsoever in this state by the seller's branch office, local outlet, or other local place of business, or by an agent or other representative of the seller. A franchise or credit investigation of a prospective purchaser and/or recommendation or approval by a local office upon which subsequent transactions are based is such a utilization of the local office as to render such subsequent transactions taxable.

The [A], [B] and [D] divisions each have employees conducting activities in Washington. The taxpayer's job description for these employees is set forth here in its entirety:

DISTRICT SALES MANAGER

JOB DESCRIPTION

The District Sales Manager's primary responsibility is to generate sales in the stores within his supervision. At the same time, the DSM must never lose sight of the fact that an equally important responsibility is the turning of a profit within these same stores.

In order to accomplish the two objectives mentioned above, the DSM must function simultaneously as:

1) Teacher - The DSM is first and foremost a teacher. He teaches selling techniques, proper operational procedures, display methods, etc. He is constantly teaching and reinforcing the skills necessary to generate sales and, in turn, profit.

2) Motivation - Once a certain level of proficiency has been achieved within his sales force, the DSM must motivate the help to want to put into practice their newly acquired skills. The best teacher will ultimately fail if that which is taught is never practiced. The motivation encourages the students to want to use the knowledge to strive towards the ultimate goal.

3) Counselor - The DSM, because he is dealing with people, must be sensitive to the needs of his staff. He must provide guidance, both professional and at times personal. He must direct the career paths of his people.

4) Controller - The DSM must be aware of expenses. Because he is also responsible, to a certain extent, for profits, he must be ever watchful and cost conscious. He must know when to spend and when to save. A total awareness of everything going on around him is essential.

5) Administration - The DSM must administer to the day-to-day needs of the stores within his supervision. He must be organized to follow through on multiple tasks at the same time. He must carry the message to the stores and then bring about the carrying out of the message by the stores.

6) Customer Service Specialist - Sales are generated by satisfying the needs of the customer. The DSM must be aware of the customer's wants and needs in his area. He must then coordinate all efforts towards providing the service necessary to satisfy these needs.

7) Merchant - The DSM must know his customer and merchandise. He must communicate his merchandise needs to the proper areas and then follow up to see that the necessary action is taken.

The term "Jack of All Trades, Master of None" can be modified slightly to describe the DSM. The new phrase "Jack of All Trades, Master of Selling" better depicts what is expected of a DSM.

The "S" in DSM stands for sales and selling, and although many things are expected of DSM's, the one function that will always remain uppermost in importance is selling. Without sales and selling all of the other duties and responsibilities become meaningless.

[3] The Department has long held that the promotion by a wholesaler of retail sales creates nexus for taxing the seller's wholesale sales. See ETB 507.04.193B, attached. The activities of the taxpayer's employees clearly are designed to generate retail sales. There is obviously a direct relationship between retail sales by the subsidiaries and wholesale sales by the taxpayer to the subsidiaries. We believe, therefore, that the activities of the taxpayer's employees in Washington are significantly associated with its sales into Washington. Under the rule such sales are subject to business and occupation tax.

However, there is no local activity connected with the [C] stores. The taxpayer's [C] operations are independent from the activities of the other divisions. The taxpayer's sales to the [C] subsidiaries are not associated with any local activity and are not subject to business and occupation tax under the rule.

The final issue is pool purchase deductions. This deduction is discussed in Rule 202 which states:

> The term "pool purchase" means the joint purchase by two or more persons, engaging in independent business activities, of commodities in carload or truck load quantities for the purpose of obtaining a purchase price or freight rate which is less than when purchased or delivered in smaller quantities.
>
> The term "principal member" means that member of the pool to whom the goods are charged by the vendor of the commodities purchased.
>
> In computing tax liability of the principal member under chapter 82.04 RCW, there may be deducted from gross proceeds of sales the amount received by him from other members of the pool of their proportionate share of the cost thereof of the commodities purchased.
>
> This deduction is allowed only when all of the following conditions are met:
>
> 1. The amount received is included in gross proceeds of sales.
>
> 2. The pool purchase agreement was entered into prior to the time of placing the order for the commodities purchased.
>
> 3. The pool purchase agreement provides that each member shall accept a specific portion of the shipment.
>
> 4. Division of the shipment is made prior to warehousing of the commodities by a member of the pool.
>
> In no event will a "pool purchase" deduction be allowed when an agreement relative to the amount of the share to be distributed to any member is made after the date of the purchase order, or where one member of a pool pays an amount for his portion in excess of the proportionate amount paid by another member.

The requirements of the rule have not been met. There is no evidence of a pool purchase agreement. The taxpayer was not participating in a joint purchase. Rather, it bought all goods for resale to the putative pool members. Furthermore, the rule contemplates that the principal member retain some of the commodities for its own inventory. That was not the case here.

DECISION AND DISPOSITION:

The taxpayer's petition is granted in part and denied in part. Business and occupation tax and sales tax assessed on construction services and leasehold improvements will be deleted from the assessments. Sales tax assessed on sales of supplies will be deleted from the assessments. Business and occupation tax on sales of supplies and inventory to the [C] subsidiaries will be deleted from the assessments. Business and occupation tax on sales of supplies and inventory to [A], [B] and [D] subsidiaries will not be deleted from the assessments. Amended assessments will be issued in due course.

DATED this 20th day of May 1988.