

Cite as Det. No. 88-219A, 10 WTD 264 (1990)

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

In The Matter of the Petition)	<u>F I N A L</u>
For Correction of Assessment)	<u>D E T E R M I N A T I O N</u>
Of)	
)	No. 88-219A
)	
...)	Registration No. ...
)	.. /Assessment No. ...
)	.. /Assessment No. ...

[1] **RULE 159:** PRINCIPAL AND AGENT--PURCHASING AGENT--RULE REQUIREMENTS. Where a taxpayer provides agreements showing that all inventory for resale purchased was as agent for specific subsidiaries, and where the books and records of the taxpayer show that at all times such relationships were maintained and documented, a taxpayer's claim of agency for such purchases will be granted. **Reverses Det. 88-219, 6 WTD 19 (1988), on this issue.**

[2] **RULE 159:** PRINCIPAL AND AGENT--PURCHASING AGENT--BULK PURCHASES. When taxpayer purchases supplies in bulk, maintains an inventory of such supplies, and fills orders for supplies as the subsidiaries request them, a claim of agency will not be recognized.

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 CONFERENCES: ...

...

NATURE OF ACTION:

Taxpayer protests the assessment of wholesaling taxes against it for inventory and supplies for its Washington subsidiaries.

FACTS AND ISSUES:

Hesselholt, Chief A.L.J. -- Taxpayer is [an out-of-state] corporation which is headquartered in [the Eastern United States]. Its books and records were audited for the period January 1, 1978 through March 31, 1985. As a result, the above-captioned assessments were issued, which taxpayer protested. Taxpayer was unregistered at the time of the audit.

Taxpayer is parent corporation to [many] subsidiary retail stores. The stores are organized under different names, and sell [consumer items]. All [items] are purchased from other vendors; the taxpayer does not manufacture any of them, although when it was first organized, it manufactured [some items]. The taxpayer employs district managers, some of whom are resident in Washington. These district managers function as teacher, motivator, counselor, controller, and administrator to the stores under their supervision. Additionally, taxpayer has field auditors that spend some time in Washington to perform internal audit functions.

During the audit period, taxpayer entered into an agreement with its subsidiaries which stated, in part:

- 1.The [subsidiary] hereby appoints [taxpayer] to act as supplier, purchasing agent, construction agent and business consultant for the [subsidiary], 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 [subsidiary] to establish and maintain its store and the merchandise requirements to be supplied by it to the [subsidiary] for operation of said store.
- 3.As construction agent for the [subsidiary], [taxpayer] shall perform or cause to be performed such construction and maintenance services as may be necessary or desirable to establish the store of the [subsidiary] and to maintain it in a condition suitable for the business of the [subsidiary].
- 4.Invoices to [taxpayer] for material and equipment purchased by [taxpayer] as purchasing agent for the [subsidiary], and statements for construction and maintenance services which [taxpayer], as construction agent of the [subsidiary], has performed or caused to be performed for the [subsidiary] shall be paid for by the [subsidiary] or by [taxpayer] out of funds furnished by the [subsidiary], and [taxpayer] shall act as disbursing agent in disbursing such funds. . .
- 5.[The taxpayer] shall supply the [subsidiary] with its requirements of apparel and other merchandise which shall be paid for by the [subsidiary] as follows . . .

The audit set up retailing B&O tax and retail sales tax on all sales of supplies and inventory to subsidiaries, as well as for construction costs and leasehold improvements.

Taxpayer has provided extensive documentation to show that when it orders inventory, the inventory is ordered specifically for each individual store, and that the documentation is complete through every step of the ordering process on its own records. The goods are ordered in pre-packaged arrays subdivided for distribution directly to each subsidiary. They are shipped by the vendors to Taxpayer's distribution centers in [other states], from which they are forwarded to the subs for which are purchased. Taxpayer pays the vendors for inventory from funds furnished by the subs. Each sub maintains a local bank account in which it deposits its daily cash receipts generated by sales. On the following banking day, all cash funds are wire-transferred from the sub's local account to one of Taxpayer's accounts via intercompany transfer. Taxpayer, in turn, uses these funds to pay for inventory it contracts for as purchasing agent for the subsidiary.

However, taxpayer orders supplies in bulk, with no particular store in mind. Some of the supplies are manufactured by taxpayer and sold to the subsidiaries. The manufactured supplies are mostly sales slips with the store names imprinted on them. The subs do purchase some supplies from third parties, but the majority are purchased from Taxpayer. Taxpayer does not track supplies in the same manner as they do the inventory. Taxpayer charges the subs for the supplies that it provides to the sub at the rate of cost plus 5%. Taxpayer also charges the subs cost plus 5% for district managers, regional managers, and internal auditors who perform services for the subs within Washington.

Taxpayer's internal accounting and its federal tax reporting are both consistent with its claim as purchasing agent. Taxpayer does not claim a deduction for costs of goods sold for the inventory transfers, nor does it in any other way claim that the inventory has been purchased and resold for its own account. Taxpayer's internal accounting is reviewed, audited and approved by its independent accountants and auditors as being in accordance with Generally Accepted Accounting Principals.

In Det. 88-219, 6 WTD 19, the Department found that taxpayer was acting as agent for the construction activities and leasehold activities for its subs, but denied its claim of agency for inventory and supply purchases. The determination stated as follows:

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.

Taxpayer asserts that the only reason the agreement in effect during the audit period referred to itself as a "supplier" is because when the agreement was drawn up (in the 1950's), it was still manufacturing [a few items]. It has not manufactured [items] for many years, and all inventory is purchased from third-party vendors. Taxpayer also argues that it meets the requirements of WAC 458-20-159 for agent purchases.

DISCUSSION:

WAC 458-20-159 (Rule 159) provides, in part, as follows:

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 commissions and any other incidental income derived by the broker or agent from such sales.

[1] With respect to the inventory, we agree with the taxpayer. Taxpayer's agreements clearly provide that it is acting as a purchasing agent for inventory for its subsidiaries. Its books and records clearly show for which sub each purchase of inventory is made, and show the actual cost of such merchandise, as well as the amount charged by the taxpayer for its services in procuring the inventory. We believe that taxpayer has met its burden in showing that it has complied with the requirements of Rule 159 with respect to inventory purchases. Taxpayer's petition is sustained as to this issue.

[2] We disagree that taxpayer is acting as an agent with respect to the purchases of supplies. The supplies are purchased in bulk by the taxpayer and sold to the subs on an "as needed" basis. For such sales, taxpayer is acting as a retailer. However, all the subs have paid use tax on the supplies purchased from the taxpayer, so that part of the assessment will be deleted. The assessment of retailing B&O tax on the sales of supplies to taxpayer's Washington subsidiaries is sustained.

Persons engaging in business activities in this state taxable under the service and other classification of the B&O tax are entitled to apportion that portion of gross income to this state that is derived from services rendered within the state. RCW 82.04.460, WAC 458-20-194. Taxpayer provides

services to its subsidiaries within this state by providing management and other personnel. Taxpayer has presented three different methods of determining the taxable amount of services performed in Washington.

The first method, and taxpayer's preferred method, is based on what taxpayer calls separate accounting. This method divides supervisory costs by sales (by division), and then multiplies that percentage by Washington sales. Other calculations are performed to include markups, benefits and other costs. Based on that, the total amount taxable in Washington for the period 1978 - 1985 is \$ The second method is based on the actual costs incurred for the services in Washington, using actual payroll costs and other costs. Under that method, the total amount taxable in Washington for the period 1978 - 1985 is \$ The third method makes an analysis of all personnel who work in Washington and makes a determination of the amount of time each spends in Washington. The salary for each is then apportioned to Washington. Those amounts are totaled and then divided by the total amount of sales to derive a percentage number. That percentage is then applied to the gross sales for each year to determine the taxable amount for each year. The total amount taxable in Washington for the audit period under this method is \$

We prefer the second method. That method has the advantage of tracking the actual costs incurred in Washington, and we believe that it will be simpler, in the long run, for both the Audit Division and the taxpayer to administer. We will accept the second method of reporting for the audit periods at issue. This method is subject to audit evaluation, and may be changed if it is determined that the method is not an acceptable method of making the calculation. Any such change would be prospective only.

Det. 88-219, 6 WTD 19, also found that the taxpayer did not have nexus in Washington for its . . . division because it had no district manager in Washington. Taxpayer should be aware that if that situation changes or has changed, that its actions with respect to those stores may change.

DECISION AND DISPOSITION:

Taxpayer's petition is granted in part and denied in part.

DATED this 29th day of May 1991.