Cite as Det. No. 98-192, 18 WTD 295 (1999)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Audit Instructions for	)	D E T E R M I N A T I O N
	)	No. 98-192
	)	Registration No. . . .
	)	Audit Letter

RULE 159, RULE 160: B&O TAX – FRUIT SALES – DEALER – BROKER – COMMISSION MERCHANT. The Washington receipts of a fruit wholesaler licensed as a dealer under the Commission Merchants' Law, who does not have any agreement establishing a principal-agent relationship, will be taxed under the wholesaling B&O tax classification.

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.

NATURE OF ACTION:

A fruit marketer protests Audit instructions reclassifying its income from the wholesaling to the service and other activities tax classification.[1]

FACTS:

M. Pree, A.L.J. -- . . . (taxpayer) is a Washington business corporation. The taxpayer sells Washington fruit to customers around the world. Following a 1989 audit, the taxpayer reported its receipts under the wholesaling business and occupation (B&O) tax classification with a deduction for fruit delivered out of Washington. In 1997, the Department of Revenue (Department) reviewed the taxpayer's records for the period from January 1, 1994 through September 30, 1997. The Department's Audit Division accepted the taxpayer's returns as filed, but instructed the taxpayer to report its income under the service and other activities B&O classification commencing February 1, 1998. The taxpayer requests to report its receipts under

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

the wholesaling classification, and a refund of any additional taxes paid as a result of the 1998 Audit instructions.

The Audit Division states two fruit packers formed the taxpayer in 1989 to sell their fruit, as well as the fruit of a third packer. The two fruit packers each own 25% shares of the taxpayer, while two individuals own the remaining 50%. The Audit Division states the taxpayer is the exclusive agent for the three packers. The taxpayer disputes the statement, contending that it is not an agent, and that it does not have an exclusive agreement with anyone. In fact, the taxpayer states each of the three packers sell fruit to others.

The taxpayer's financial reports identify the income[2] as "Commissions." The taxpayer reported only the net amount (sales price less cost) on its federal income tax returns.[3]

The taxpayer states it takes title to all the fruit. The taxpayer, not the packers, bears the risk of loss on shipments. The taxpayer pays common carriers to ship the fruit. The taxpayer is licensed as a dealer, not a commission merchant or broker.

Fruit buyers from around the world order fruit from the taxpayer. The taxpayer negotiates prices with the buyers. The taxpayer orders fruit from suppliers.

The taxpayer provided . . . documents, which it claims are representative of how it currently does business. The taxpayer prepares a sale order and mails it to its buyers. The taxpayer separately orders the fruit from its suppliers with instructions for shipment. The packer or other supplier invoices the taxpayer for the fruit shipped to the taxpayer's buyer. A typical invoice from a supplier names the taxpayer after the heading, "Sold to:". The invoice identifies the carrier, but not the taxpayer's customer.

The taxpayer is liable to the supplier for the invoiced amount. The taxpayer writes a check to the supplier for the cost of the fruit per the invoice, and the amount of the check is entered in the taxpayer's cash disbursement's journal.

Following shipment, the taxpayer invoices the buyer for the fruit. The bottom of each invoice contains the following statement:

> The perishable agricultural commodities listed on this invoice are sold subject to the statutory trust authorized by section 5(c) of the Perishable Agricultural Commodities Act, 1930 (7 U.S.C. 499e(c)). The seller of these commodities retains a trust claim over these commodities, all inventories of food or other products derived from these commodities,

[2] The Audit Division recognized some of the income as buy/sell where the taxpayer clearly took title to the fruit and resold it, but the instruction proposes classifying "all commission income received" under the service and other activities classification.

[3] The taxpayer states its federal income tax liability was the same as it would have been had the taxpayer reported the gross receipts from the fruit sales less the amount paid for fruit. It is unclear whether the taxpayer had inventory, which could have affected its liability by reducing its cost of goods sold.

> and any receivables or proceeds from the sale of these commodities until full payment is received.

While the invoice does not specifically state the seller is the taxpayer, the taxpayer's name is displayed prominently on the top of the invoice. A carrier is named, and of course the buyer to whom it is addressed. The supplier is not identified. Therefore, from the appearance of the invoice, the taxpayer was the seller.

The Audit Division recognized that the taxpayer had followed the instructions from the 1989 audit, and reported its receipts under the wholesaling classification. Based on those instructions, the Audit Division did not assess additional tax for the audit period. Rather the Audit Division instructed the taxpayer to report its receipts under the service and other activities classification prospectively.

The Audit Division listed its difficulties in treating the income as wholesale sales:

1. Financial statements show the income as commissions.

2. Federal income tax returns are submitted showing [the taxpayer] as a commission broker.

3. The commissions are received on a price per box sold.

4. There are only oral marketing agreements with firms for whom the taxpayer is the exclusive marketing agent.

The taxpayer states its sales can be readily determined from its financial records. Its federal income tax liability was not affected by how the income was reported. It bought and sold the boxes at per box prices. There are no agreements, written or oral, that the taxpayer is acting as anyone's agent. Further, the taxpayer denies having exclusive arrangements with anyone.

The buyer pays the taxpayer. The taxpayer deposits the funds in its own bank account. The taxpayer arranges shipment. While the taxpayer may pay the supplier with those funds, there is no trust obligation to do so as may be required of an agent. The taxpayer then writes a check to its supplier. While in some instances the mark up or commission income could be computed on a per-box basis, the invoices always display gross sales prices and purchase prices.

ISSUE:

Was the taxpayer acting as the agent of the fruit companies, taxable on commission income; or did the taxpayer purchase and resell the fruit as a wholesaler?

DISCUSSION:

[1] B&O tax is imposed upon the Washington activities of engaging in business. See RCW 82.04.220. The measures and rates of tax vary depending upon the activity. A low rate applies to wholesalers, which is multiplied times their gross proceeds of Washington sales to determine the amount of tax. RCW 82.04.270.

A higher rate applies to persons selling the products of others on a commission basis. Such persons are taxable under the catchall service and other activities classification. See RCW 82.04.290, WAC 458-20-159 (Rule 159), and WAC 458-20-160 (Rule 160). That rate is multiplied times the gross income derived from business activities in Washington. RCW 82.04.290. Usually, the commissions constitute the gross income.

The taxpayer performs its activities in Washington. Therefore, if it is acting as a commission agent, all of its the commissions would be taxed here under the higher service and other activities rate. See WAC 458-20-194.

However, the taxpayer's customers usually take delivery of the fruit at locations outside of Washington. Washington State does not assess its taxes on sales of goods, which originate in Washington if receipt of the goods occurs outside Washington. WAC 458-20-193 (Rule 193). Therefore, if the taxpayer purchased and sold the fruit to its customers outside of Washington, no tax under the wholesaling classification would be due on the out-of-state sales.

We must determine whether the taxpayer acts as an agent of the fruit growers and fruit packers, or if the taxpayer purchases and sells the fruit as a dealer. If the taxpayer acts as an agent, it must pay tax measured by its gross income from commissions at the higher service and other activities rate as instructed by the Audit Division. If the taxpayer purchased and sold the fruit as a dealer, it would only be taxed on the gross receipts from fruit delivered in Washington at the lower wholesaling rate.

Rules 159 and 160 discuss distinctions between agents and dealers. Normally, because the measure of tax from sales of goods (gross receipts) is much higher than the measure of tax from commissions (gross income), taxpayers prefer to be taxed as agents to minimize their tax. The Department created presumptions in both rules that unless taxpayers complied with specific conditions, they would be deemed to be selling the products in their own name as dealers. The fact that as a dealer this taxpayer may pay less tax than as an agent does not reverse the presumptions.

Rule 159 requires "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". The taxpayer does not have any contract or agreement establishing a principle-agent relationship. The Audit Division's letter referred to an oral agreement. The taxpayer denies it has any such agreements. The Audit Division has been unable to provide any basis for making the statement that any such an agreement exists, much less the particulars clearly establishing an

agency relationship. Therefore, the underlying requirement of Rule 159 is not met. The taxpayer is not an agent.

Rule 160 provides a similar presumption:

> Any person whose business consists in selling agricultural products both as a dealer and upon a commission-consignment basis is presumed to be conducting business as a seller of tangible personal property either at wholesale or at retail, unless such person segregates upon his books and records between sales of products purchased and sold as a dealer and those handled strictly upon a commission basis.

BUSINESS AND OCCUPATION TAX

> RETAILING. Dealers are taxable under the retailing classification upon gross proceeds derived from retail sales. Persons selling upon a commission-consignment basis who do not segregate upon their books and records between sales made as a dealer and those handled upon a commission basis are taxable as sellers upon gross proceeds of all sales.
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> WHOLESALING. Dealers are taxable under the wholesaling classification upon gross proceeds derived from wholesale sales. Persons selling upon a commission-consignment basis who do not segregate upon their books and records between wholesale sales made as a dealer and those handled on a commission basis are taxable as sellers upon gross proceeds of all sales.
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> SERVICE AND OTHER BUSINESS ACTIVITIES. A person may be classified as engaging in service and other business activities **with respect to bona fide commission-consignment sales, even though such consigned sales are credited to the "sales" account, providing he has complied with the Commission Merchants' Law of the state of Washington** and has prepared and kept the following records supplementary to the regular books of account:
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> (1) Lot sheets, cards or similar subsidiary records upon which consigned sales are regularly recorded;
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> (2) An analysis sheet showing the date, lot number, gross proceeds of sales of consigned goods, remittances to consignor, advances, commissions, other charges and taxable amount with respect to consigned accounts. This sheet shall contain a complete analysis of all consigned sales showing the distribution made from lot sheets, cards or similar subsidiary records. Entries in the consigned sales analysis record shall be made as of the date that final distribution is made on lot sheet, card or similar record;
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> (3) A detailed record of deductions claimed with respect to sales
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> of products purchased. Such records shall show the date of sale, the lot number and the nature of the deductions claimed.

Emphasis supplied. Taxpayers must adhere to the stringent requirements of Rules 159 and 160 to be taxed as an agent. Det. No. 88-367, 6 WTD 409, 412 (1988).

The Audit Division states the taxpayer kept its books as a commission merchant. We find that while the taxpayer's federal income tax records and financial statements may appear to be those of a commissioned agent, the books alone do not control the taxability of receipts. The method of bookkeeping is only one of several requirements for the taxpayer's receipts to fall under the service and other activities classification. The taxpayer must also have bona-fide commission consignment sales and comply with the Commission Merchants' Law[4] of the State of Washington. Rule 160.

Commission merchants must file a schedule of commissions together with a list of charges with the Washington Department of Agriculture. RCW 20.01.080. The commission merchant must post a copy of the charges in a conspicuous place. The Audit Division has not mentioned such a list. Commission merchants have very specific record keeping requirements. See RCW 20.01.370; see also Rule 160. From the limited records provided it is not clear those requirements have been met. The taxpayer was not acting like a commission merchant.

The taxpayer is licensed as a dealer, not a broker or commissioned agent. Federal law (Perishable Agricultural Commodities Act, 1930 – or PACA) also differentiates between dealers, brokers, and commission merchants. See 7 U.S.C. 499a. License applicants must indicate the type of business (i.e. Wholesale, commission merchant, or broker). 7 CFR 46.4(b)(2).

Brokers must provide an itemized account to their principal showing the true gross selling price, all brokerage fees, and any other expenses. 7 CFR 46.28(b). The records provided for our review do not appear to meet the federal requirements of a broker. Under the Commission Merchants' Law, no broker may handle the proceeds of sale. RCW 20.010(9). The taxpayer deposits money from fruit sales in its bank account. The taxpayer was not a broker.

The taxpayer has a dealer's license, not a commission merchant's license or broker's license.[5] The taxpayer buys and sells fruit as a dealer. See RCW 20.01.010(7). The taxpayer does not meet the statutory requirements of a broker or commissioned merchant. The taxpayer is a dealer. Wholesale receipts of dealers are taxable under the wholesaling classification of business and occupation tax.

Finally, the Audit Division contends Det. No. 87-355, 4 WTD 383 (1987) controls. We disagree. In that advisory ruling, we held that the receipts of an agricultural marketing association organized under Chapter 24.32 RCW[6] were taxable under the service and other activities classification. We recognized that the very purpose of agricultural marketing associations was to sell the agricultural products **of its members**. We found that the agricultural marketing association was an agent by operation of law. 4 WTD 383, 387. That taxpayer derived its only income as a commissioned marketing entity, not as the seller of fruit in its own right. Id. Finally, we stated the intent of Chapter 24.32 RCW was to provide for well-defined, nonprofit business associations to serve the

[4] Title 20 RCW.
[5] The licensing records are public. RCW 20.01.110
[6] Chapter 24.32 RCW was repealed by 1989. Laws 1989, Ch. 307, Sec. 44.

interests of the members, **not to serve the interests of the associations themselves as distinct business entities.** Id. at 388 (Emphasis supplied).

The taxpayer was incorporated under the Washington Business Corporation Act, Title 23B RCW, to engage in any business activity (including the sale of fruit) as a distinct business entity. The taxpayer sells fruit in its own name for its own gain or profit. As discussed above, the taxpayer derives its receipts from the outright sales of the fruit as a dealer, not as a commissioned marketing entity. The taxpayer' s Washington gross receipts are taxable under the wholesaling classification of business and occupation tax.

DECISION AND DISPOSITION:

The taxpayer's petition is granted.

Dated this 12th day of November 1998.