Cite as Det. No. 17-0231, 37 WTD 088 (2018)

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

In the Matter of the Petition for Refund	)	D E T E R M I N A T I O N
	)	
	)	No. 17-0231
	)	
. . .	)	Registration No. . . .
	)	

[1] RCW 82.04.290(2)(a): B&O TAX – TAX CLASSIFICATION – NATURE OF BUSINESS ACTIVITY. B&O tax classification is determined by the nature of the business activity, not by labels or terms that a taxpayer may choose to employ in its business records. Contradictory labels or terms are not relevant if they do not accurately represent the actual nature of the business activity being taxed.

[2] RCW 82.04.290(2)(a): B&O TAX – SERVICE AND OTHER ACTIVITIES – COMMISSION INCOME. Income received by a taxpayer that is generated as a percentage of sales revenue is in the nature of ordinary commission. Commission income is not explicitly taxed in Chapter 82.04 RCW, and is defined as part of the gross income of a business. Income received by a taxpayer that is generated as a percentage of sales revenue is therefore subject to the service and other activities B&O tax classification.

[3 RCW 82.32A.020: TAXPAYER RIGHTS – ORAL ADVICE. Taxpayer is ineligible for waiver of tax based upon alleged oral advice from the Department because Washington law does not allow for waiver of tax when the alleged advice is oral, as the Department cannot confirm what facts Taxpayer presented to the Department and what instructions the Department provided to the Taxpayer.

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.

Davis, T.R.O. – A Washington couple acting as one single independent distributor (Taxpayers) selling nutritional supplements for an incorporated [out-of-state] direct seller organization seeks refund of taxes assessed when the Department of Revenue (Department) reclassified their reported gross income. Taxpayers dispute a decision by the Department to reclassify their income to the service and other activities Business and Occupation (B&O) tax classification resulting in additional tax liability. Taxpayers state they relied on oral instructions from the Department to report their income as wholesaling, and contend they properly reported their income under the

retailing, wholesaling, and royalties B&O tax classifications throughout the review period. We deny the petition.[1]

ISSUES

1. Is Taxpayers' income properly taxable under the service and other activities B&O tax classification according to RCW 82.04.290(2)(a)?

2. Are Taxpayers entitled to a waiver of tax under RCW 82.32A.020, where Taxpayers allege that a Department representative orally instructed Taxpayers to report their income under the wholesaling B&O tax classification, and issued Taxpayers a reseller permit?

FINDINGS OF FACT

. . . (Taxpayers) are a married Washington couple serving jointly as an independent distributor for . . . (the Business), [an out-of-state] nutritional supplement manufacturer using a multi-level marketing operating model to sell consumer nutritional supplement products. The Business operates as a Direct Seller Organization (DSO) under Washington law and has entered into a DSO tax collection agreement with the Department.

Distributors whose gross income from the Business equals or exceeds an amount eligible for the maximum small business B&O tax credit for the service and other activities B&O tax classification threshold must register and file taxes with the Department on their gross income.[2] Under the Agreement, the Business is required to submit a list to the Department annually containing the names of all distributors whose prior year income met this threshold amount.

Taxpayers' annual income from the Business exceeded the threshold amount during the entire relevant time period and they were required to independently register and file to report their income. Taxpayers registered as required and have filed quarterly combined excise tax returns. Taxpayers' names are also included in the Business's annual threshold lists.

As an independent distributor, Taxpayers receive payments from the Business based, generally, on the volume of sales generated by them and other sellers in their network, according to the operating model rules developed by the Business. Taxpayers receive a monthly paystub from the Business that categorizes payments with four labels: (1) "Retail Commission"; (2) "Wholesale Profit"; (3) "Royalty Override"; and (4) "Bonus Level Royalty Override." According to the Business's publicly-available handbook of rules and regulations (Handbook)[3] and Taxpayers' representations, the business activity associated with each of these four labels is as follows:

(1) "Retail Commission" – This category of income is not specifically defined by the Business; Taxpayers represented that "Retail Commission" refers to payments from the Business to a distributor such as Taxpayers of "a commission of 40%," or other percentage, of the sale price of products purchased through the distributor's Business website by customers.

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.
[2] Throughout the relevant time period, this threshold was $28,000 per year based on a tax rate of 0.015.
[3] The Handbook, entitled ". . . ," is available at . . . (Aug. 10, 2016) (last visited September 6, 2017).

(2) "Wholesale Profit" – This category of income is defined by the Business and described by Taxpayers as a payment from the Business to a distributor such as Taxpayers of a percentage of the sale price of products purchased from the Business by others in the distributor's down-line network. The percentage paid is the difference between the up-line distributor's and down-line buyer's "purchase discount" rates. *See* Handbook § I. at 6; *Id.* § II. at 7.

(3) "Royalty Override" and "Bonus Level Royalty Override" – This category of income is defined by the Business and described by Taxpayers as a payment from the Business to certain distributors with more developed down-line networks of a percentage of some levels of this down-line network's total product sales volume. *See* Handbook § I. at 5, 6; *Id.* § II. at 7, 10.

During the relevant time period, Taxpayers completed their quarterly combined excise tax returns by reporting income in the three B&O tax classifications most closely matching their paystub labels. Thus, Taxpayers reported "Retail Commission" under the retailing B&O tax classification, "Wholesale Profit" under the wholesaling B&O tax classification, and "Royalty Override" and "Bonus Level Royalty Override" under the royalties B&O tax classification.

In 2016, the Department's Taxpayer Account Administration [Division] (TAA) reviewed the Business's annual threshold reporting list. During the review, TAA discovered that Taxpayers were reporting income under the retailing, wholesaling, and royalty B&O tax classifications and determined that this income should instead have been reported under the service and other activities B&O tax classification. TAA contacted Taxpayers on May 9, 2016, to notify them of the discovery, and began a separate review of Taxpayers' reporting for the period of April 1, 2013, through March 31, 2016 (Review Period).

On May 24, 2016, as a result of TAA's review, the Department recalculated Taxpayers' tax liability and issued a tax assessment against Taxpayers for $ . . . , which included tax liability of $ . . . , interest, and a five-percent assessment penalty. Taxpayers subsequently sought review of the full amount of the tax assessment. Taxpayers have paid the full amount of the tax assessment, and are, therefore, requesting a full refund.

On review, Taxpayers represented that when they first set up their business and registered with the Department, they spoke to a Department representative who told them they should report their income under the wholesaling B&O tax classification, and processed Taxpayers' application for a reseller permit, which was later issued under Reseller Permit No. . . . .

ANALYSIS

Washington imposes a B&O tax "for the act or privilege of engaging in business" in this state. RCW 82.04.220. 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)). "Business" is defined broadly to include "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; Det. No. 01-188, 21 WTD 289 (2002).

Depending on the nature of the business activity being conducted, the tax is levied upon the "value of products, gross proceeds of sales, or gross income of the business, as the case may be." RCW 82.04.220. The B&O tax rate varies based on the type of business activity the taxpayer engages in, and the statute provides numerous specific classifications of activities. *See generally* Chapter 82.04 RCW. Thus, the proper B&O tax classification is determined by the nature of the business activity, and not by any labels or terms that a taxpayer may choose to employ in its business records. If a taxpayer is engaged in a business activity "other than or in addition to an activity taxed explicitly" and listed under Chapter 82.04 RCW that activity is taxed under the service and other activities B&O tax classification at a rate of 1.5 percent of the gross income of the business. RCW 82.04.290(2); *see also* WAC 458-20-224; Det. No. 16-0045, 35 WTD 520 (2016). "Gross income of the business" means:

> [T]he value proceeding or accruing by reason of the transaction of the business engaged in and includes . . . compensation for the rendition of services, . . . commissions, . . . all without any deduction on account of . . . any other expense whatsoever paid or accrued . . . .

RCW 82.04.080(1). The service and other activities B&O tax classification is a "catch-all" provision of the B&O tax code, and includes certain . . . defined . . . services, but also includes all other business activity not specifically listed in other parts of Chapter 82.04 RCW. *See* RCW 82.04.290(2); WAC 458-20-224[; *Steven Klein, Inc. v. Dep't of Revenue*, 183 Wn.2d 889, 897, 357 P.3d 59 (2015)]. Therefore, it is not necessary for business activity to be in the nature of a "service" to fall within the service and other activities B&O tax classification.

Here, based on the limited information in the record, Taxpayers' income, regardless of how it was labeled on the paystubs, appears to be generated as a percentage of sales revenue, which is in the nature of ordinary commission. Ordinary commission income, although based on sales activity, is taxed under the "catch-all" service and other activity B&O classification pursuant to RCW 82.04.290(2)(a). *See* Det. No. 02-0213, 23 WTD 32 (2004); Det. 89-286, 8 WTD 7 (1989). This is consistent with RCW 82.04.080(1), which includes "commissions" in the definition of "gross income of the business," which is the measure for service and other activities B&O tax. Therefore, we conclude that Taxpayers' income is subject to the service and other activities B&O tax classification.[4]

Taxpayers, however, argue that various portions of their income are properly classified under the retailing, wholesaling, and royalties B&O tax classifications. We address each of these classifications herein.

[4] Taxpayers' direct seller representative relationship with the Business and the Business's collection agreement with the Department do not change Taxpayers' duty to directly report their own commissions to the Department under the service and other activities B&O tax classification, as the collection agreement indicates that representatives above a certain earning threshold, which Taxpayers here met, must report their own commissions directly to the Department.

1. Retailing B&O Tax

Taxpayers argue that the amounts labeled "Retail Commission" on their paystubs should be classified under the retailing B&O tax classification. RCW 82.04.250 states that retailing B&O tax is imposed "[u]pon every person engaging within this state in the business of making sales at retail." RCW 82.04.050, in turn, defines "sale at retail" to generally mean the sale of tangible personal property and retail services (not for resale) regardless of the nature of their business.

Here, the record is limited as to the nature of "Retail Commission." There is no specific definition provided in the Handbook to describe the source of the income assigned that paystub label. However, Taxpayers variously argued that they are "paid **commissions** and royalties on orders from customers and distributors" and that when a customer goes onto their website and orders products, Taxpayers "receive a **commission** of 40%" from the Business. (Emphasis added).

Although there is little information in the record to clearly identify the source of this income, we conclude that Taxpayers have not offered evidence that this income is anything other than what it appears to be – commission income. Receiving commission on a sale, which is subject to service and other activities B&O tax, is a distinct activity from actually making "sales at retail." Based on the information in the record, the income labeled "Retailing Commission" is not derived from anything included in the definition of "sale at retail" under RCW 82.04.050, and, therefore, cannot be subject to retailing B&O tax under RCW 82.04.250.

2. Wholesaling B&O Tax

Taxpayers next argue that the amounts labeled "Wholesale Profit" on their paystubs should be classified under the wholesaling B&O tax classification. RCW 82.04.270 states that wholesaling B&O tax is imposed "[u]pon every person engaging within this state in the business of making sales at wholesale." RCW 82.04.060, in turn, defines "sale at wholesale" generally as any sale, other than a sale at retail, of tangible personal property.

Here, the Handbook defines "Wholesale Profit" as the "profit" earned by all distributors, including Taxpayers, "from the Down-line sale" of products from the Business to other lower distributors within the first distributor's "organization." *See* Handbook § I. at 6; *Id.* § II. at 7. Taxpayers further represented the business activity from which "Wholesale Profit" was derived as follows: "This is when one of [Taxpayers'] distributors under them and their customers order product."

Here, the record makes clear that the income from "Wholesale Profit" is derived as a percentage of sales made by the Business to distributors that are below Taxpayers in the organization. In essence, this is another form of commission income. Therefore, "Wholesale Profit," despite the use of the word "wholesale" in the label, does not meet the statutory definition of a "sale at wholesale" under RCW 82.04.060, and, therefore, is not subject to wholesaling B&O tax under RCW 82.04.270.

3. Royalties B&O Tax

Taxpayers also argue that the amounts labeled "Royalty Override" and "Bonus Level Royalty Override" on their paystubs should be classified under the royalties B&O tax classification. RCW 82.04.2907 states the following:

> (1) Upon every person engaging within this state in the business of receiving income from royalties, the amount of tax with respect to the business is equal to the gross income from royalties multiplied by the rate provided in RCW 82.04.290(2)(a).
>
> (2) For the purposes of this section, "gross income from royalties" means compensation for the use of intangible property, including charges in the nature of royalties, regardless of where the intangible property will be used. For purposes of this subsection, "intangible property" includes copyrights, patents, licenses, franchises, trademarks, trade names, and similar items.

Here, both the Business's Handbook and Taxpayers make clear that the income labeled "Royalty Override" and "Bonus Level Royalty Override" is calculated as a percentage of product sales volume, which is, again, yet another form of commission income. *See* Handbook § I. at 5, 6; *Id.* § II. at 7, 10. These income categories, despite the inclusion of the term "royalty," have nothing to do with the use of intangible property as required under RCW 82.04.2907. Accordingly, the royalties B&O tax classification is inapplicable to Taxpayer's business activity of receiving commission income from product sales.

4. Reliance on Oral Advice

Taxpayers have alleged that when they registered their business, a Department representative told them they should report their income under the wholesaling B&O tax classification, and because of this advice, Taxpayers consistently reported income using the three classifications previously described above.[5] Therefore, Taxpayers argue that Department should waive the additional tax assessed on the tax assessment.

Because the Washington tax system is based largely on voluntary compliance, the Washington legislature has placed upon taxpayers the responsibility to know their tax reporting obligations, and to seek instructions from the Department when they are uncertain about those obligations. RCW 82.32A.030(2). We note that RCW 82.32A.020(2) gives taxpayers the right "to rely on specific, **official written advice and written tax reporting instructions** from the department of revenue to that taxpayer, and to have interest, penalties, and in some instances, tax deficiency assessments waived where the taxpayer has so relied to their proven detriment." (Emphasis added); *see also* RCW 82.32.105(3)(requiring cancellation of interest if failure to pay was direct result of written instructions). However, there is no statute that allows the Department to waive assessments of tax, interest, or penalties when the taxpayer relies on oral, as opposed to written, information provided by a Department employee.

[5] It is unclear how the alleged advice given to Taxpayers to report their income under the wholesaling B&O tax classification led Taxpayers to ultimately report their income under not just the wholesaling B&O tax classification, but also two additional tax classifications.

The Department addressed whether oral instructions are binding in Excise Tax Advisory (ETA) 3065.2009, [which] explains why the Department cannot waive taxes based on alleged oral advice:

> The Department gives consideration, to the extent of discretion vested in it by law, where it can be shown that failure of a taxpayer to report correctly was due to written instructions from the Department or any of its authorized agents. The Department cannot give consideration to claimed misinformation resulting from telephone conversations or personal consultations with a Department employee.
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> There are three reasons for this ruling:
>
> (1) There is no record of the facts which might have been presented to the employee for consideration.
>
> (2) There is no record of instructions or information imparted by the employee, which may have been erroneous or incomplete.
>
> (3) There is no evidence that such instructions were completely understood or followed by the taxpayer.

(Emphasis in original).

As explained in ETA 3065.2009, Washington law does not allow for waiver of tax when the alleged advice is oral. This is because, absent corroboration, we simply cannot confirm what facts were presented to the Department and what oral instructions the Department provided to Taxpayers.

In this case, Taxpayers offer no evidence that the Department gave written instructions to the Taxpayers to report income under the wholesaling B&O tax classification. Thus the law does not give the Department the authority to waive assessed tax, interest, or penalties, and we must deny Taxpayers' request.

DECISION AND DISPOSITION

Taxpayers' petition is denied.

Dated this 13th day of September 2017.