Cite as Det. No. 16-0366, 37 WTD 021 (2018)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS 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. 16-0366
. . .	)	Registration No. . . .

RULE 111; RCW 82.04.080: B&O TAX – VALUE PROCEEDING OR ACCRUING – ADVANCES & REIMBURSEMENTS – REAL ESTATE REPAIR, MAINTENANCE, AND UTILITY EXPENSES. The fact that a bank pays repair and maintenance vendors directly does not prevent tax liability for a real estate broker who is required by the bank to arrange all necessary repairs and maintenance on foreclosed homes owned by the bank.

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.

Weaver, T.R.O. – A real estate broker, that is authorized to arrange third-party vendors to perform maintenance work on properties owned by a bank, appeals the assessment of retail sales tax and retailing B&O tax on the maintenance expenses paid to the third-party vendors directly by the bank. The petition for correction of assessment is denied.[1]

ISSUES

Whether, under RCW 82.04.080 and WAC 458-20-111, amounts paid directly from a broker's client to third-party vendors for utilities, repair, and maintenance of the client's real property are deductible from gross income as "advances" or "reimbursements."

FINDINGS OF FACT

. . . (Taxpayer), operates as a real estate broker for . . . (Bank). Bank requires its brokers to arrange all necessary repairs and maintenance, set up and pay for utilities, and make all other arrangements to get real estate owned (REO) homes[2] owned by Bank ready for sale.

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.
[2] "REO is a term used to describe a class of property owned by a lender – typically a bank, government agency, or government loan insurer – after an unsuccessful sale at a foreclosure auction." Real Estate Owned, Wikipedia, the Free Encyclopedia, <https://en.wikipedia.org/wiki/Real_estate_owned> (last visited November 14, 2016).

When it is determined that a task must be completed or an expense incurred by the Bank on an REO home, Taxpayer may either choose a vendor from a list of pre-approved vendors or apply to the Bank for the approval of a vendor. Once a vendor is approved, it joins the list of pre-approved vendors and Taxpayer is free to use it in the future without re-applying to the Bank. Taxpayer is not authorized to arrange any work on the REO homes without approval by the Bank.

All repair, maintenance, utilities, and other expenses are invoiced to Taxpayer, in Taxpayer's name, and are addressed to Taxpayer. If the invoices are for less than $500 or are for utilities, Taxpayer may pay the vendor directly and then request payment from Bank. Expenses of $500 or more are submitted to Bank, and the Bank then pays those vendors directly.

Other than the reimbursements for expenses under $500.00 that it pays, Taxpayer is not paid by the Bank until the properties are sold. Taxpayer earns a commission on the sale of the properties.

Taxpayer's books and records were examined by the Audit Division of the Department of Revenue (Department) for the period April 1, 2012, through December 31, 2014. The Audit Division assessed retailing business and occupation (B&O) tax and retail sales tax on payments made by the Bank directly to the vendors. The Audit Division's position is that because the vendor invoices were directed to Taxpayer, Taxpayer was liable for their payment, and, as such, the invoices were properly a part of Taxpayer's gross receipts. The Audit Division requested a copy of the contract between Taxpayer and the Bank from Taxpayer but it was not provided.

The Audit Division did not consider Taxpayer an agent of the Bank and, as such, treated Taxpayer as primarily or secondarily liable for the expenses under $500 that it paid directly. The Audit Division treated Taxpayer as a general contractor with respect to the vendor expenses paid directly by the Bank.

After reviewing Taxpayer's books and records, the Audit Division generated Workpaper A, titled "Service Expenses for which Agent Relationship Was Not Shown." *See* Workpaper A. Workpaper A listed service-taxable utility expenses from January 1, 2013, through December 15, 2014, on the properties that Taxpayer was contracted to service. Workpaper A listed the following totals:

Year 2013 - Service Expenses for which Agent Relationship was Not Shown

(Total) Amount	Less than $500	$500 and Greater
$ . . .	$ . . .	$ . . .

Year 2014 - Service Expenses for which Agent Relationship was Not Shown

(Total) Amount	Less than $500	$500 and Greater
$ . . .	$ . . .	$ . . .

The Audit Division also generated Workpaper B, titled "Retail Expenses for which Agent Relationship Was Not Shown." *See* Workpaper B. Workpaper B listed retail-taxable repair and maintenance expenses from January 1, 2013, through December 14, 2014, on the properties Taxpayer was contracted to service. Workpaper B listed the following totals:

Year 2013 - Retail Expenses for which Agent Relationship was Not Shown

(Total) Amount	Less than $500	$500 and Greater
$ . . .	$ . . .	$ . . .

Year 2014 - Retail Expenses for which Agent Relationship was Not Shown

(Total) Amount	Less than $500	$500 and Greater
$ . . .	$ . . .	$ . . .

The Audit Division used the amounts in these Workpapers to generate Schedule 1, which listed the total taxes assessed against Taxpayer on unreported income transactions. The tax amounts due listed in Schedule 1 are identified, in pertinent part, as follows:

		2012	2013	Totals
Schedule 2A	Service B&O – Less than $500	. . .	. . .	. . .
Schedule 2B	Service B&O – More than $500	. . .	. . .	. . .
				. . .
Schedule 3A	Retailing B&O – Less than $500	. . .	. . .	. . .
Schedule 3B	Retailing B&O – More than $500	. . .	. . .	. . .
				. . .
Schedule 3C	Retail Sales Tax – Less than $500	. . .	. . .	. . .
Schedule 3D	Retail Sales Tax – Less than $500	. . .	. . .	. . .
Schedule 4	Adjustment – Tax Paid at Source	(. . .)	(. . .)	(. . .)
				. . .
Total Tax Adjustment		**. . .**	**. . .**	**. . .**

(excluding penalties and interest)

In Schedule 4, referenced in the chart above, the Audit Division did give Taxpayer a "tax paid at source" deduction for retail sales taxes paid directly to vendors.[3]

[3] The Audit Division referred to this as a "tax paid at source deduction," but it was, in fact, a credit for taxes paid by Taxpayer's customer, the Bank, directly to the vendors.

On November 3, 2015, the Audit Division issued Assessment No. . . . , totaling $ . . . , which included $ . . . in retail sales tax, $ . . . in retailing B&O tax, $ . . . in service and other activities B&O tax, $ . . . in interest, and a 5% assessment penalty of $ . . . . Taxpayer filed a timely appeal.

ANALYSIS

Washington imposes a B&O tax "for the act or privilege of engaging in business" in the State of Washington. RCW 82.04.220. The B&O tax measure and rate is determined by the type or nature of the business activity in which a person is engaged. "Business" is defined as including 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. The measure of the B&O tax is the application of rates against "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 is a gross receipts tax, meaning that it applies to all value proceeding or accruing to the company, and not only to its profit margins. *Lamtec Corp. v. Dep't of Revenue*, 170 Wn.2d 838, 843, 246 P.3d 788, 791 (2011). Within the statute, the term "business" includes "all activities engaged in with the object of gain, benefit, or advantage to the taxpayer or another person or class, directly or indirectly." RCW 82.04.140. The statute was written broadly because the legislature intended to impose the B&O tax on virtually all business activities carried on within the state. *Time Oil Co. v. State*, 79 Wn.2d 143, 146, 483 P.2d 628 (1971).

RCW 82.04.080 defines "gross income of the business" in the following manner:

> "Gross income of the business" means 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 (emphasis added). Under this broad definition, a service provider may not deduct from its gross income any of its own costs of doing business. *Rho Co. v. Dep't of Revenue*, 113 Wn.2d 561, 782 P.2d 986 (1989); *Pilcher v. Dep't of Revenue*, 112 Wn. App. 428, 436, 49 P.3d 947 (2002).

The term "value proceeding or accruing" is defined in RCW 82.04.090 as follows:

> Value proceeding or accruing" means the consideration, whether money, credits, rights, or other property expressed in terms of money, actually received or accrued . . . .

While generally a taxpayer may not deduct its costs of business from the measure of its business and occupation (B&O) tax, the Department has recognized by rule, WAC 458-20-111 (Rule 111), that amounts received for certain pass-through expenses should not be included in determining a

business' gross income for B&O tax purposes. Det. No. 00-206E, 21 WTD 66 (2002). Rule 111 reads, in pertinent part, as follows:

> The word "advance" as used herein, means money or credits received by a taxpayer from a customer or client with which the taxpayer is to pay costs or fees for the customer or client.
>
> The word "reimbursement" as used herein, means 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.
>
> *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.*
>
> There may be excluded from the measure of tax amounts representing money or credit received by a taxpayer as reimbursement of an advance in accordance with the regular and usual custom of his business or profession.

Rule 111 (emphasis added).

Taxpayer takes the position that the payments to the vendors made directly by the Bank should not be included in Taxpayer's gross income.[4] Specifically, Taxpayer takes the position that it was acting as an agent of Bank, because Taxpayer was not permitted to arrange any work be performed on the REO homes without the Bank's authorization. Taxpayer maintains that because it was acting as an agent of the Bank, it is not liable for tax on the payments made directly from Bank to the vendors. The Audit Division decided that Taxpayer was liable for both the utility and maintenance expenses on the properties, as Taxpayer was the named entity that was invoiced by the third-party utility and maintenance vendors. The Audit Division assessed tax on the utilities expenses at the service and other activities B&O tax rate, and assessed Taxpayer retail sales tax and retailing B&O tax on the maintenance charges, but allowed Taxpayer a "tax paid at source" deduction, which was a credit for retail sales taxes paid on the invoiced work by Taxpayer's customer, the Bank.

The sole issue in this case is whether Taxpayer can deduct the expenses from its gross income, as an agent of the Bank.

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[4] [In its petition for review, Taxpayer does not argue that the vendor costs directly paid by the Bank are not its "gross income" because they are directly paid to the vendors by the Bank without being first paid to Taxpayer. Under the broad definition of "gross income of the business" in RCW 82.04.080, a service provider may not deduct from its gross income any of its own costs of doing business. *See* RCW 82.04.080. Because the costs of the work performed by the vendors are Taxpayer's expenses and not the Bank's, those costs are properly included as Taxpayer's own costs of doing business, whether paid directly by Taxpayer or by the Bank. Because the vendor's work is included in Taxpayer's costs of doing business, those costs are correctly considered "gross income" to Taxpayer. Having established that the vendor costs are "gross income" to Taxpayer, we now turn to Taxpayer's agency arguments under Rule 111.]

Taxpayer has failed to provide any evidence that the vendor costs paid by the Bank were the Bank's expenses, rather than Taxpayer's own expenses. In this case, Taxpayer contracted to perform certain services for the Bank. Specifically, Taxpayer was hired by the Bank to maintain upkeep on REO homes for eventual sale. Taxpayer was listed as the customer on all vendor invoices for maintenance on the REO homes. The fact that Taxpayer forwarded the vendor invoices to the Bank for actual payment does not change the nature of the expenses. The expenses for the upkeep of the REO homes were incurred by Taxpayer. RCW 82.04.080 does not permit a deduction for expenses accrued from the "gross income of the business."

Taxpayer argues it should not be liable for the assessed taxes because the amounts paid to the vendors by the Bank are qualified reimbursements under Rule 111. Generally speaking, all receipts of a company are subject to B&O tax, without any deductions for costs such as labor, materials, taxes, or any other expense. RCW 82.04.080. However, Rule 111 "excludes from the definition of 'gross income' certain 'advances' and 'reimbursements' for which the taxpayer assumes solely agent liability." *Washington Imaging Servs. LLC v. Dep't of Revenue*, 171 Wn.2d 548, 561, 558, 252 P.3d 885, 891 (2011) (citing *Rho*, 113 Wn.2d at 567, 782 P.2d 986.).

> Specifically, for the rule to apply, three conditions must be met: '(1) the payments are "customary reimbursement for advances made to procure a service for the client"; (2) the payments "involve services that the taxpayer did not or could not render"; and (3) the taxpayer "is not liable for paying the associate firms except as agent of the client."

Washington Imaging, 171 Wn.2d at 561-62, 252 P.3d at 892 (citing *Rho*, 113 Wn.2d at 567-68, 782 P.2d 986 (quoting *Christensen, O'Connor, Garrison & Havelka v. Dep't of Revenue*, 97 Wn.2d 764, 769, 649 P.2d 839 (1982)). Thus, advances or reimbursements transferred by a taxpayer can be deducted from its gross income for B&O tax purposes where the liability of the taxpayer is solely that of an agent. *City of Tacoma v. William Rogers Company, Inc.*, 148 Wn.2d 169, 175, 60 P.3d 79 (2002).

We address the third condition first. In this case, Taxpayer contracted directly with vendors to perform maintenance and upkeep on the REO homes and utility providers to keep the REO homes in livable condition. However, Taxpayer has failed to meet its burden of showing that its liability was "solely agent liability." *Washington Imaging*, 171 Wn.2d at 561, 252 P.3d at 891.

The fact that the Bank paid the vendors directly does not alter Taxpayer's liability for the charge. Taxpayer has presented nothing to indicate that Taxpayer's liability was "solely as an agent" of the Bank.[5] On the evidence presented, as the party that contracted with the vendors to perform maintenance on the REO homes, we find that Taxpayer was, itself, liable for the expenses incurred by those vendors. As such, Taxpayer's liability was not "solely agent liability." *Id.* Therefore, Taxpayer does not meet the third criteria of Rule 111 to deduct the expenses as qualified advances or reimbursements.

[5] If, on reconsideration, Taxpayer can show that the vendors and utility companies knew that Taxpayer was acting as an agent of the Bank, our analysis may be different. *See e.g.*, Det. No. 88-7, 4 WTD 423 (1987) ("it is a third party vendor's knowledge and acceptance that it is dealing with an agent, and not just the existence of the agency relationship itself, which finally relieves the agent from liability.")

The assessment is affirmed.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 17th day of November 2016.