

Cite as Det. No. 16-0285, 39 WTD 060 (2020)

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

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| In the Matter of the Petition of Correction of) | <u>D E T E R M I N A T I O N</u> |
| Assessment of) | |
|) | No. 16-0285 |
|) | |
| ...) | Registration No. . . . |
|) | |

[1] RCW 82.04.050(7); RETAIL SALES TAX - WARRANTIES. Taxpayer’s extended warranties were taxable as retail sales.

[2] RCW 82.08.010(2)(a), WAC 458-20-257(5)(b); OBLIGATION TO COLLECT. Taxpayer was a third party seller with an obligation to collect and remit retail sales tax on sales of extended warranties.

[3] RCW 82.32.100, WAC 458-20-254; RETAIL SALES TAX – RETAILING B&O TAX – ESTIMATING – STATISTICAL SAMPLE. A statistical sample discussed with taxpayer prior to use without objection is a reasonable method for estimating income.

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.

Gabriella Herkert, T.R.O. – Seller of vehicle extended warranty contracts protests assessment of Retailing Business and Occupation (“B&O”) Tax and Retail Sales Tax on sales of extended warranty service contracts by dealer directly to Washington consumers as part of a vehicle purchase transaction. Taxpayer also protests sampling methodology for estimated tax liability. Taxpayer’s petition is denied.¹

ISSUES

1. Are Taxpayer’s sales of extended warranties a retail sale under the provisions of RCW 82.04.050 or a wholesale sale under RCW 82.04.060?
2. Under RCW 82.08.010(2)(a) and WAC 458-20-257(5)(b) (Rule 257), is the warrantor of extended warranties obligated to collect and remit retail sales tax when the warranties are sold by third parties?

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

3. Under RCW 82.32.100, was sample methodology used to estimate tax liability appropriate?

FINDINGS OF FACT

. . . (Taxpayer) sells extended vehicle warranty service contracts to car dealers located in Washington. Taxpayer is headquartered in . . . , with offices in . . . , but no offices in Washington. Taxpayer hires independent contractors to visit Washington vehicle dealers (“Dealer”) and sign them to a contract program dealer agreement (“Dealer Contract”). The standard Dealer Contract includes the following provisions:

- II. B. COMPANY shall provide and maintain a contractual liability reimbursement insurance policy, performance bond, or appropriate insurance product, issued to the Obligor or Dealer, which shall provide coverage, subject to carrier’s underwriting rules as to eligible units and for coverage of valid and proper claims for COVERED REPAIRS submitted under the PROGRAM and other terms and condition of the coverage.
- II. F. COMPANY, upon proper cancellation of a CONTRACT, shall fulfill its obligations under the CONTRACT and provide refund(s) of its portion of the CONTRACT premium, less cancellation fees, if any.
- III. A. DEALER shall use its best efforts to solicit or provide CONTRACTS to CONTRACT HOLDERS, to be administered by COMPANY, and shall do so only on forms and through distribution channels which have been approved by COMPANY. Each approved CONTRACT shall be sold or provided only for a qualified unit and only in accordance with and subject to COMPANY’s programs, coverages, rules and fees indicated as the cost on COMPANY’s current rate care in effect at the time such CONTRACT is sold or provided. DEALER agrees it shall not make any representations altering, varying, or contrary to the express provisions contained in the contract. . . .
- III. F. DEALER’s relationship with COMPANY shall be that of independent contractor and nothing in this AGREEMENT or relationship shall be construed as creating the relationship of principal and agent, or employer and employee, or the relationship of partnership joint venture, or partnership. . . .

After the Dealer signs the Dealer Contract, Taxpayer provides the Dealer with vehicle service contracts (“Vehicle Contracts”) using standard terms and blank registration pages. The standard Vehicle Contract includes the following:

A. DEFINITIONS

Administrator/Service Contract Provider: means Protective Administrative Services, Inc.

. . . .

Contract Term: means the years or months and mileage of this Contract is in force, for the Coverage selected on the Registration Page, whichever period expires first and includes the time period and mileage, if any, covered by the manufacturer's warranty . . .

B. OUR RESPONSIBILITIES

Upon Your return of the Vehicle to the Dealer, the Administrator will authorize the repair or replacement of any Covered Part(s) that experiences (suffers) a Breakdown (subject to the Deductible and other provisions of this Contract)

Taxpayer provides rate charts setting rates ("Dealer Rates") owed to Taxpayer from Dealer for each Vehicle Contract sold to a purchaser. When Dealer sells a car, it offers a Vehicle Contract to purchaser. Dealer negotiates the selling price ("Purchaser Rates") directly with the purchaser. Purchaser remits the Purchaser Rate of the Vehicle Contract to Dealer. Dealer fills out the registration pages and forwards the information to Taxpayer with payment at the Dealer Rate. On some occasions, Dealer includes a Vehicle Contract as part of the purchase price of a used car. On those occasions, Dealer fills out the blank registration page with purchaser's information but does not charge purchaser separately. Dealer then pays Taxpayer the Dealer Rate itself.

The Department of Revenue's ("Department") Audit Division ("Audit") performed a partial audit for the period of January 1, 2010, through June 30, 2014. After a review of Taxpayer's business activities, Audit determined that the independent contractors soliciting Dealers to enter into Dealer Contract's created nexus in the State of Washington for the entire audit period. Taxpayer does not dispute this.

Audit also determined that the dealers, by and large, collected and remitted retail sales tax on the gross proceeds measured by the Purchaser Rate. The dealers took a deduction under the Retailing B&O tax classification for the amount of gross proceeds, and reported the difference between the Purchaser Rate and the Dealer Rate as commission under the Service and Other Activities tax classification. The dealers did not provide reseller permits or exemption certificates to Taxpayer. The Vehicle Contracts showed Taxpayer or Taxpayer's dba at the top. Dealer's name was listed in the "Purchaser Information" section but did not designate Dealer as "seller."

On the basis of these facts, Audit concluded that Dealer behaved as a third-party seller and Taxpayer was the warrantor under the Vehicle Contracts. As warrantor, Audit determined that Taxpayer was liable for Retailing B&O and Retail Sales Tax on the total gross proceeds of the Vehicle Contracts. Audit made two adjustments for the audit period, one covering unreported Retailing B&O taxes due on all sales to Washington consumers and another on unreported Retail Sales taxes due on sales where Audit determined that Dealer had not collected retail sales tax on Washington sales. Unreported Retail Sales taxes were calculated based on a stratified statistical sample the parameters of which were conveyed via email to the Taxpayer on January 26, 2015, without objection. Audit applied the sample error rate across the audit period for Retail Sales Tax due and gave Taxpayer credit for amounts known to have been remitted by Dealer as Retail Sales Tax. As a result, Audit assessed \$² Taxpayer timely requested review.

² Document . . . includes \$. . . retail sales tax; \$. . . retailing B&O tax; \$. . . delinquent penalty; \$. . . interest and \$. . . 5% assessment penalty.

ANALYSIS

Washington levies a B&O tax for the “act or privilege of engaging in business in Washington.” RCW 82.04.220(1). The tax is measured by applying an applicable tax rate based on the taxpayer’s business classification against the gross proceeds of sales or gross income of the business. *Id.* Persons making retail sales are subject to Retailing B&O tax measured by gross proceeds of sales under RCW 82.04.250. Persons making wholesale sales are subject to the Wholesaling B&O tax measured by gross proceeds of sales under RCW 82.04.270. The term “retail sale” includes the sale of or charge made for an extended warranty. RCW 82.04.050(7).

1. Retail or Wholesale

The definition of “retail sale” contained at RCW 82.04.050 includes extended warranties. Specifically, RCW 82.04.050(7) explains:

For purposes of this subsection, "extended warranty" means an agreement for a specified duration to perform the replacement or repair of tangible personal property at no additional charge or a reduced charge for tangible personal property, labor, or both, or to provide indemnification for the replacement or repair of tangible personal property, based on the occurrence of specified events. The term "extended warranty" does not include an agreement, otherwise meeting the definition of extended warranty in this subsection, if no separate charge is made for the agreement and the value of the agreement is included in the sales price of the tangible personal property covered by the agreement. For purposes of this subsection, "sales price" has the same meaning as in RCW 82.08.010.

The Vehicle Contracts are agreements for a specified duration³ to perform the replacement or repair of tangible personal property at no additional charge.⁴ Sale of Vehicle Contracts are retail sales under RCW 82.04.050(7).

WAC 458-20-257 (Rule 257) addresses the tax classification for amounts paid for warranties not included in the retail-selling price of the article being sold. Income from agreements sold with or without tangible personal property to consumers is subject to the retailing B&O tax and retail sales tax, unless a specific exemption applies. Rule 257(4)(a). Sellers of agreements and insurance riders to consumers are responsible for collecting the retail sales tax from the consumers, and remitting it and retailing B&O tax to the department of revenue (department). *Id.* If a seller is acting as agent or broker for another party, such as the actual warrantor, the seller is still liable for collecting the retail sales tax from the buyer and remitting it to the department. *Id.* In this case, the seller as an agent or broker of the warrantor normally receives a commission. *Id.* Commission income is taxable under the service and other business activities B&O tax classification. *Id.*

Rule 257(5) specifically addresses sales of extended warranties by third parties and reads as follows:

³ Vehicle Contract, A. Definitions.

⁴ Vehicle Contract, C.

Sales by third parties. Consideration received by a third party as a commission, for selling an agreement for the actual warrantor, is generally subject to tax under the service and other activities tax classification. In this situation, the third-party seller never takes possession of the agreement, and the warrantor maintains liability for the provisions of the agreement.

Taxpayer is the administrator/service contract provider under the Vehicle Contract.⁵ Taxpayer is responsible for performing, authorizing, and paying for repairs under the Vehicle Contract.⁶ Taxpayer is the actual warrantor under the Vehicle Contract because it maintains liability for the provisions of the agreement. Dealers never take possession of the agreement, and Taxpayer maintains liability for the provisions of the Vehicle Contracts. Dealer sells the Vehicle Contracts as a third party under Rule 257(5).

Taxpayer relies on two key facts in support of its argument that Dealers are not third-party sellers of Vehicle Contracts but rather resellers. First, Dealer Contract unambiguously states that Dealer is not the agent of Taxpayer.⁷ Second, Taxpayer argues that differences between the Dealer rates, charged to Dealer, and the Purchase Rates, set by Dealer, are not commissions paid to an agent, but rather a reseller's markup.

Taxpayer asserts that the Dealer is not an agent of Taxpayer and selling for Taxpayer; rather, Dealer is buying the extended warranties from Taxpayer on its own behalf. As such, Dealer has purchased or acquired the warranties for resale in its ordinary course of business and fails to meet the definition of consumer under RCW 82.04.190(2)(e), and the sales by Taxpayer are not sales by third parties. Taxpayer contends that Dealer's right to negotiate Purchaser Rates supports its argument that Dealer has acquired the warranties for resale and the amount of markup is not a commission subject to Service B&O tax, but rather retailing income for Dealer.

Agency is a legal concept that depends on the manifest conduct of the parties; it "does not depend upon the intent of the parties to create it, nor their belief that they have done so. [A]n agency exists although the parties did not call it agency and did not intend the legal consequences of the relation to follow." Restatement 2nd of Agency §1, comment b (1958), *quoted in Busk v. Hoard*, 65 Wash.2d at 129, 396 P.2d 171. Agency can be implied, if the facts warrant, not only if the contract is silent but even if the parties execute contracts specifically disavowing agency. *See Rho Co., Inc. v. Dep't of Revenue*, 113 Wash.2d 561 (1989); *Fernandez v. Thigpen*, 278 S.C. 140, 143, 293 S.E.2d 424 (1982).

Excise Tax Advisory No. 3100.2009 (ETA 3100.2009) addresses agency as follows:

The existence of an agency relationship is not controlled by the labels the parties use to describe themselves in their contract documents. Rather, standard common law agency principles are used in analyzing whether an agency relationship exists. The essential elements of common law agency are mutual consent to the relationship between a principal and an agent, and the right of control over the agent by the principal. If these elements are not satisfied, there is no agency relationship

⁵ Vehicle Contract, A. Definitions.

⁶ Vehicle Contract, C.

⁷ Dealer Contract, III.F.

In this case, the Dealer Contracts executed by both parties require Dealer to use its best efforts to solicit Vehicle Contracts, to be administered by Taxpayer. Dealer is required to do so only on forms and through distribution channels which have been approved by Taxpayer. Each approved Vehicle Contract is sold only in accordance with and subject to Taxpayer's programs, coverages, rules, and fees. Dealer agrees not to make any representations altering, varying, or contrary to the express provisions contained in the contract. Dealer never takes possession of the agreements, and Taxpayer remains responsible as contracting party after Dealer sells to an end user. Mutual consent to agency and Taxpayer's control over Dealer is established in the Dealer Contract. Dealer is not reselling. Dealer is making sales as a third party under Rule 257(5).

The warrantor is subject to retailing B&O tax on the gross sales price received from the sales of agreements by third parties. Rule 257(5)(a). No deduction is allowed for commissions paid to third parties. *Id.* Taxpayer is subject to retailing B&O tax on the gross sales price received from the sale of Vehicle Contracts to third parties.

2. Seller Liability for Tax

Under RCW 82.08.050, retail sales tax must be paid by the buyer to the seller and each seller must collect from the buyer the full amount of the tax payable in respect to each taxable sale. RCW 82.08.010(2)(a) defines seller as "every person, including the state and its departments and institutions, making sales at retail or retail sales to a buyer, purchaser, or consumer, whether as agent, broker, or principal..." See also Rule 257(3)(d). Rule 257(5) specifically imposes collection and remission responsibility for retail sales tax on third-party sellers of extended warranties. Rule 257(5)(b). Dealer is a third-party seller of extended warranties and must collect and remit retail sales tax on its sales of extended warranties under Rule 257(3)(d).

Having previously determined that Taxpayer is making retail sales of the extended warranties, Taxpayer meets the definition of seller under RCW 82.08.010(2)(a) and Rule 257(3)(d). Under RCW 82.08.050(3), Taxpayer as seller has a duty to collect the full amount payable for retail sales tax on each transaction. RCW 82.08.010(2)(a) makes "any seller" who fails to collect and remit the tax personally liable. Taxpayer is therefore personally liable for the retail sales tax owed on the sale of Vehicle Contracts.

There is nothing in the statutory framework and the applicable rules precluding the principal from being liable for retail sales tax if it is not collected and reported by its agent. Taxpayer has not presented any authority for a different outcome. We note that guidance provided to auto dealers states that warrantors can be responsible for collecting and remitting sales tax if not collected by their agents.⁸ Accordingly, we affirm the assessment of uncollected retail sales tax on the sale of warranties where the in-state third-party seller did not collect and remit the retail sales tax.

⁸ Washington State Auto Dealers Guide to Excise Taxes 38-2 (August 1993) reads in relevant part:

Q: How am I taxable on the sale of an extended warranty when I am the warrantor?

A: A separate charge for an extended warranty to a consumer by a warrantor is taxable under the retailing classification of the B&O tax. In addition, the warrantor (or the warrantor's in-state selling agent) must collect and remit the retail sales tax.

<http://dor.wa.gov/content/questionsandanswers/default.aspx?cnode=8w5b2q&pnodes=5s1m0v> (last visited August 31, 2016).

3. Sample Methodology

Pursuant to RCW 82.32.070(1), “[e]very person liable for any fee or tax imposed by chapters 82.04 through 82.27 RCW shall keep and preserve, for a period of five years, suitable records as may be necessary to determine the amount of tax for which he or she may be liable . . .” If a taxpayer does not keep and preserve such records, the Department may proceed to do its best to estimate tax due, based on the records provided. RCW 82.32.100(1).

The Department has previously addressed the use of sampling in determining the amount of deferred retail sales tax due. *See* Det. No. 04-0084, 24 WTD 365 (2005); Det. No. 02-0114, 22 WTD 174 (2003). Det. No. 02-0114 contains the following explanation for use of sampling to identify the amount of deferred retail sales or use tax due on business purchases:

The goal of a sales and use tax audit is to identify the total amount of underpaid or overpaid tax for the period under review. For many businesses, in particular businesses with large numbers of transactions, it is a costly and time-consuming process for both the taxpayer and the Department to review all records for the entire period under review. The Department recognizes that a sampling of documents, rather than a review of all the records for the entire period, and projecting the results over the entire period, is an accepted and commonly used auditing method to estimate the amount of tax underpaid or overpaid. 22 WTD at 177.

The Department has used statistical sampling, which uses a randomly selected sample and the probability theory to evaluate the sample results. The Department has increasingly relied on statistical sampling in deferred retail sales or use tax audits. 22 WTD at 177. As pointed out in Det. No. 02-0114, while statistical sampling potentially yields greater accuracy and efficiency than block sampling, it may also be more costly. *Id.*; *see also* Roger C. Pfaffenberger, *Use and Abuse of Sampling in Sales and Use Tax Audits*, 97 COST State Tax Report, Issue 6, pp. 209 (November 1997), reprinted in 13 State Tax Notes 1673 (December 29, 1997).

In this case, the Audit Division assessed tax based upon a stratified statistical sample. Statistical sampling is a widely used and accepted sampling method. Det. No. 04-0084, 24 WTD 365 (2005). The Department will not overturn the results of such a sample when the use of the statistical sampling method was discussed with the taxpayer prior to its use, no objection was raised until after the assessment was issued, and no factual error or legal authority was presented to overturn the results. 24 WTD at 369.

Taxpayer argues that it did not consent to the sample for the purposes of projecting error rates across the entire audit period but rather to establish that Dealers were routinely collecting and remitting retail sales tax because the transactions were wholesale. Audit sent Taxpayer an email on January 26, 2016, defining the sample methodology. Taxpayer has provided no evidence that it objected at the time of the sample. In fact, Taxpayer’s current objections are not about the results of the sample but rather the applicability of a correctly calculated error rate to Taxpayer’s audit period. Taxpayer has offered no factual or legal authority to overturn the results. Taxpayer’s petition is denied as to this issue.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 2nd day of September 2016.