

WAC 458-20-246 Sales to or through a direct seller's representative. (1) **Introduction.** The legislature passed chapter 23, Laws of 2010, (2ESSB 6143), which reaffirms and clarifies the legislature's intent in establishing the direct seller's exemption. The legislation also repeals the exemption provided by RCW 82.04.423 effective May 1, 2010.

Through April 30, 2010, RCW 82.04.423 provides an exemption from the business and occupation (B&O) tax on wholesale and retail sales by a person who does not own or lease real property in the state, is not incorporated in the state, does not regularly maintain inventory in this state, and makes sales in this state exclusively to or through a "direct seller's representative." This section explains the statutory elements that must be satisfied in order to be eligible to take this exemption.

(2) **Federal law background.** The statutory language describing the direct seller's representative is substantially the same language as contained in the federal Tax Equity and Fiscal Responsibility Act (TEFRA) of 1982, PL 97-248. See 26 U.S.C. 3508. The federal law designates types of statutory nonemployees for Social Security tax purposes. In the federal law, the "direct seller's representative," as used in this section and under RCW 82.04.423, is designated as the direct seller. The purpose of the direct seller provision in the federal tax law is to provide that a direct seller is not an employee of the direct selling company, thereby relieving the direct selling company of a tax duty. Under the federal law, the direct selling company is a business that sells consumer products using a direct seller who either purchases from the direct selling company and resells the consumer products or sells for or solicits sales of consumer products on behalf of the direct selling company. Retail sales are limited to those occurring in the home or in a temporary retail establishment, such as a vendor booth at a fair.

(3) **Washington's direct seller's exemption.** The 1983 Washington state legislature used the same criteria to delineate, for state tax purposes, the necessary relationship between a direct seller and a direct seller's representative. In this section "direct seller" refers to the selling company, and the "direct seller's representative" refers to the person who purchases consumer products from the direct seller and resells the products, or sells for or solicits sales on behalf of the direct seller.

The exemption provided by RCW 82.04.423 is limited to the B&O tax on wholesaling or retailing imposed in chapter 82.04 RCW (Business and occupation tax). A direct seller is subject to other Washington state tax obligations, including, but not limited to, the sales tax under chapter 82.08 RCW, the use tax under chapter 82.12 RCW, and the litter tax imposed by chapter 82.19 RCW.

(4) **Who may take the exemption.** The B&O tax exemption may be taken by a person (the direct seller) selling consumer products using the services of a representative who sells at retail or solicits the sales for retail of only consumer products as outlined in statute. There are ten elements in the statute that must be present in order for a person to qualify for the exemption for Washington sales. The person must satisfy each element to be eligible for the exemption. The taxpayer must retain sufficient records and documentation to substantiate that each of the ten required elements has been satisfied. RCW 82.32.070.

(a) The four statutory elements describing the direct seller. RCW 82.04.423 provides that a direct seller:

(i) Cannot own or lease real property within this state. For example, if the direct seller's representative is selling vitamins door to door for the direct seller, but the direct seller owns or leases a coffee roasting factory in the state, the direct seller is not eligible for this exemption; and

(ii) Cannot regularly maintain a stock of tangible personal property in this state for sale in the ordinary course of business. This provision does not, however, prohibit the direct seller from holding title to the consumer product in the state. For instance, the direct seller owns the consumer products sold by the direct seller's representative when the representative is making retail sales for the direct seller. However, the personal property must not be a stock of goods in the state that is for sale in the ordinary course of business. The phrase "sale in the ordinary course of business" means sales that are arm's length and that are routine and reasonably expected to occur from time to time; and

(iii) Is not a corporation incorporated under the laws of this state; and

(iv) Makes sales in this state exclusively to or through a direct seller's representative. This provision of the statute describes how sales by the direct seller may be made. To be eligible for the exemption, all sales by the direct seller in this state must be made to or through a direct seller's representative. The direct seller may not claim any B&O tax exemption under RCW 82.04.423 if it has made sales in this state using means other than a direct seller's representative. This requirement does not, however, limit the methods the direct seller's representative may use to sell these products. For example, the representative can use the mail or the internet, if all other conditions of the exemption are met. The direct seller's use of mail order or internet, separate from the representative's use, may or may not be found to be "sales in this state" depending on the facts of the situation. If the direct seller's use of methods other than to or through a direct seller's representative constitutes "sales in this state," the exemption is lost. Additionally, a direct seller does not become ineligible for the exemption due to action by the direct seller's representative that is in violation of the statute, such as selling a product to a permanent retail establishment, if the department of revenue (department) finds by a review of the facts that the ineligible sales are irregular, prohibited by the direct seller, and rare.

If a seller uses a direct seller's representative to sell "consumer products" in Washington, and also has a branch office, local outlet, or other local place of business, or is represented by any other type of selling employee, selling agent, or selling representative, no portion of the sales are exempt from B&O tax under RCW 82.04.423. For example, a person who uses representatives to sell consumer products door to door and who also sells consumer products through retail outlets is not eligible for the exemption. The phrase "sales exclusively to ... a direct seller's representative" describes wholesale sales made by the direct seller to a representative. The phrase "sales exclusively ... through a direct seller's representative" describes retail sales made by the direct seller to the consumer. The B&O tax exemption provided by RCW 82.04.423 is limited to these types of wholesale and retail sales.

(b) The six statutory elements describing the direct seller's representative. RCW 82.04.423 provides the following elements that relate to the direct seller's representative:

(i) How the sale is made. A direct seller's representative is "a person who buys only consumer products on a buy-sell basis or a deposit-commission basis for resale, by the buyer or any other person, in the home or otherwise than in a permanent retail establishment, or who sells at retail, or solicits the sale at retail of, only consumer products in the home or otherwise than in a permanent retail establishment." The direct seller sells the consumer product using the services of a representative in one of two ways, which are described by two clauses in the statute. The first clause ("a person who buys ... for resale" from the direct seller) describes a wholesale sale by the direct seller. The second clause (a person who "sells or solicits the sale" for the direct seller) describes a retail sale by the direct seller.

(A) A transaction is on a "buy-sell basis" if the direct seller's representative performing the selling or soliciting services is entitled to retain part or all of the difference between the price at which the direct seller's representative purchases the consumer product and the price at which the direct seller's representative sells the product. The part retained is remuneration from the direct seller for the selling or soliciting services performed by the representative. A transaction is on a "deposit-commission basis" if the direct seller's representative performing the selling or soliciting services is entitled to retain part or all of a purchase deposit paid in connection with the transaction. The part retained is remuneration from the direct seller for the selling or soliciting services performed by the representative.

(B) The location where the retail sale of the consumer product may take place is specifically delineated by the terms of the statute. The direct seller may take the exemption only if the retail sale of the consumer product takes place either in the home or otherwise than in a permanent retail establishment. The resale of the products sold by the direct seller at wholesale is restricted by the statute through the following language: "For resale, by the buyer or any other person, in the home or otherwise than in a permanent retail establishment." This restrictive phrase requires the product be sold at retail either in the home or in a nonpermanent retail establishment. Regardless of to whom the representative sells, the retail sale of the consumer product must take place either in the buyer's home or in a location that is not a permanent retail establishment. Examples of permanent retail establishments are grocery stores, hardware stores, newsstands, restaurants, department stores, and drug stores. Also considered as permanent retail establishments are amusement parks and sports arenas, as well as vendor areas and vendor carts in these facilities if the vendors are operating under an agreement to do business on a regular basis. Persons selling at temporary venues, such as a county fair or a trade show, are not considered to be selling at a permanent retail establishment.

(ii) What product the direct seller must be selling. The direct seller must be selling only a consumer product, the sale of which meets the definition of "sale at retail," used for personal, family, household, or other nonbusiness purposes. "Consumer product" includes, but is not limited to, cosmetics, cleaners and soaps, nutritional supplements and vitamins, food products, clothing, and household goods, purchased for use or consumption. The term does not include commercial equipment, industrial use products, and the like, including component parts. However, if a consumer product also has a business use, it remains a "consumer product," notwithstanding that the same type of

product might be distributed by other unrelated persons to be used for commercial, industrial, or manufacturing purposes. For example, desktop computers are used extensively in the home as well as in businesses, yet they are a consumer product when sold for nonbusiness purposes.

(iii) How the person is paid. The statute requires that "substantially all of the remuneration paid to such person, whether or not paid in cash, for the performance of services described in this subsection is directly related to sales or other output, including the performance of services, rather than the number of hours worked." The remuneration must be for the performance of sales and solicitation services and it must be based on measurable output. Remuneration based on hours does not qualify. A fixed salary or fixed compensation, without regard to the amount of services rendered, does not qualify.

Remuneration need not be in cash, and it may be the consumer product itself or other property, such as a car.

(iv) How the contract is memorialized. The services by the person must be performed pursuant to a written contract between the representative and the direct seller. The requirement that the contract be in writing is a specific statutory condition of RCW 82.04.423.

(v) What the contract must contain. The sale and solicitation services must be the subject of the contract. The contract must provide that the representative will not be treated as an employee of the direct seller for federal tax purposes.

(vi) The status of the representative. A person satisfying the requirements of the statute should also be a statutory nonemployee under federal law, since the requirements of RCW 82.04.423 and 26 U.S.C. 3508 are the same. The direct seller must maintain proof the representative is a statutory nonemployee.

(5) **Tax liability of the direct seller's representative.** The statute provides no tax exemption with regard to the "direct seller's representative." The direct seller's representative is subject to the service and other activities B&O tax on commission compensation earned for services described in RCW 82.04.423. Likewise, a direct seller's representative who buys consumer products for resale and does in fact resell the products is subject to either the wholesaling or retailing B&O tax upon the gross proceeds of these sales. Retail sales tax must be collected and remitted to the department on retail sales unless specifically exempt by law. For example, certain food products are statutorily exempt from retail sales tax (see WAC 458-20-244).

(a) Subject to the agreement of the representatives, the direct seller may elect to remit the B&O taxes of the representatives and collect and remit retail sales tax as agents of the representatives through an agreement with the department. The direct seller's representative should obtain a tax registration endorsement with the department unless otherwise exempt under RCW 82.32.045. (See also WAC 458-20-101 on tax registration.)

(b) Every person who engages in this state in the business of acting as a direct seller's representative for unregistered principals, and who receives compensation by reason of sales of consumer products of such principals for use in this state, is required to collect the use tax from purchasers, and remit the same to the department, in the manner and to the extent set forth in WAC 458-20-221, Collection of use tax by retailers and selling agents.

(6) **The retail sales and/or use tax reporting responsibilities of the direct seller.** A direct seller is required to collect and remit the tax imposed by chapter 82.08 RCW (Retail sales tax) or 82.12 RCW

(Use tax) if the seller regularly solicits or makes retail sales of "consumer products" in this state through a "direct seller's representative" even though the sales are exempt from B&O tax pursuant to RCW 82.04.423.

[Statutory Authority: RCW 82.32.300, 82.01.060(2), and 82.04.423. WSR 10-21-011, § 458-20-246, filed 10/7/10, effective 11/7/10. Statutory Authority: RCW 82.32.300. WSR 99-24-007, § 458-20-246, filed 11/19/99, effective 12/31/99; WSR 84-24-028 (Order 84-3), § 458-20-246, filed 11/30/84.]