Cite as 11 WTD 5 (1983).

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petitions For Refund of	)	D E T E R M I N A T I O N
	)	No. 83-180
. . .	)	Registration No. . . .
	)	Tax Assessment No. . . .
	)	
. . .	)	Registration No. . . .
	)	Tax Assessment No. . . .
	)	

RULE 108: DISCOUNTS -- ADVERTISING ALLOWANCES. The deduction for a bona fide discount is not available if the purchase is required to provide any service to the seller in return for the reduction.

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.

TAXPAYER REPRESENTED BY: . . .
. . .

DATE AND PLACE OF CONFERENCE: March 23, 1983; Seattle, Washington

FACTS:

Faker, A.L.J. -- [The taxpayers are affiliated corporations.] The taxpayers protest the auditor's disallowance of certain claimed deductions from the measures of the taxpayers' Wholesaling Business tax. These are referred to by the taxpayers, and in their books of account as "advertising allowances," granted by [the parent taxpayer] to the [subsidiary taxpayer] and, in turn, by the sales company to

retail distributors of the taxpayers' products (. . .). The allowance granted by [the parent] to [the subsidiary] is designated "co-op advertising expense." The allowance granted by [the subsidiary] to retailers are simply called "advertising allowances." The taxpayers explain that, in substance, these allowances are precisely the same, for the same reasons (sharing the cost of advertising) though they are handled differently for billing purposes.

The taxpayers assert that the advertising allowances constitute bona fide discounts of the wholesale selling price of products and are thus deductible from the wholesale tax measures under WAC 458-20-108 (Rule 108). In support of this position the taxpayers submitted the following statement:

> As used by these taxpayers, the advertising allowance is an unconditional, "no-strings-attached" discount used in calculating the net selling price of their products. Contrary to the practice of some manufacturers, these taxpayers impose no requirement that the amount of the discount be actually used for advertising or any other limited purpose, nor is there any "co-op" advertising pool or program for their products. In fact, the allowance is given to dealers "up front" at the time of the invoice, by means of a credit memo attached to the invoice. The taxpayers' salesmen use the unconditional nature of [the parent's] discount (in contrast to their competitors' practices) as a selling point to give them a competitive advantage.
>
> These facts are evidenced by the attached examples of internal communications, announcements to national "major accounts," agreements with individual dealers, salesmen's price sheet, and invoices/credit memos.

The taxpayers start with an established wholesale list price and then allow various reductions, including the advertising allowances at issue here. This credit is a percentage of the wholesale price (typically three percent) which sometimes varies. The taxpayers submitted a sample wholesale invoice and the related credit memo which is a "trailing document." Also submitted were a copy of the written "program" providing for these allowances and a written actual example of how the program works for a major wholesale customer . . . .

The taxpayer, [the parent], actually receives, and is entitled to receive, only the net billing amount after the credit for advertising is deducted from the price originally billed. This system works at two levels. The [subsidiary] gets the advertising allowance on its total billings from [the parent] on a periodic or monthly basis for an entire grouping of sales invoices. The single credit is granted for the gross amount, with no trailing credit documents related to specific sales. The [subsidiary], in turn, grants the allowances to retailers on an isolated, sale by sale basis, with identifying credit documents for each sale. In substance, however, the effect is the same.

The taxpayers' most significant argument is that nothing is required of the two-level buyers in order to obtain the price reduction. They are not required to advertise anything or to incur any advertising expense whatever. Of course, the taxpayers encourage this advertising use of the funds represented by the price reduction, but it is not required. Thus, these reductions are bona fide price discounts, actually granted on each sale. It is immaterial how they are designated, whether "advertising allowances," "co-op advertising expense," or whatever. The point is, according to the taxpayers, these amounts do not represent the taxpayers' cost of doing business in any sense.

The auditor disallowed the advertising allowances as deductions from the tax measures because they were included with numerous other amounts which the taxpayers regularly deducted from their reported tax measures which were the taxpayers' own business costs. These other items included freight-out, dealer delivery, financing, inventory markdown avoidance, commissions, and functional allowances. It was some of these items, originally protested for taxation, which the taxpayers conceded to be their own costs of doing business at the hearing. The cumulative total of these amounts, including the advertising allowances, constituted 19.1 percent of gross sales income from Washington sales. The taxpayers routinely reduced their gross income reported this state by this 19.1 percent computation. In disallowing this deduction the auditor concluded that, among the other items, advertising allowances were simply the taxpayers' own advertising costs and were not deductible under RCW 82.04.070, "Gross proceeds of sales."

DISCUSSION:

The sole issue before us is whether the advertising allowances represented by credits granted against the wholesale selling prices constitute bona fide discounts under WAC 458-20-108. We find that they do not.

Rule 108, in pertinent parts, implements the provisions of RCW 82.04.160, RCW 82.08.010, and RCW 82.04.4283. The first statute defines the term "cash discount," the second defines "selling price," and the last provides a business and occupation tax deduction for cash discounts actually taken by the purchaser. The defining statute refers to a deduction from the seller's invoice price which is allowed if the bill is paid on time. In Rule 108, the Department has recognized that such bona fide discounts may be granted for reasons other than simply timely payment by the buyer. Thus, this rule provides,

> The selling price of a service or of an article of tangible personal property does not include the amount of bona fide discounts actually taken by the buyer and the amount of such discount may be deducted from gross proceeds of sales providing such amount has been included in the gross amount reported. (Emphasis ours.)

The Department has been uniform and consistent in its position that this deduction for bona fide discounts is never available if the purchaser is required to provide any service or benefit to the seller in return for the price reduction. In such cases the discount simply is not "bona fide." It has, to use the taxpayers' terminology in this case, "strings attached."

In the instant case we have carefully reviewed all of the documentation provided by the taxpayers in support of their position. We see that, without exception, every invoice, credit memo, "program," and sample transaction record refers to the price reduction as being for "advertising." Regardless of the taxpayers' assertion that there are "no strings attached" to the price reduction, their own books and records belie this position. It is clear that the 3 percent (or variable) credit extended to buyers is contemplated, programmed, intended, and encouraged to be used to pay or offset advertising costs. Such advertising, when done, directly benefits the wholesale sellers, [parent] and [subsidiary], at both levels. Such advertising costs are costs of the taxpayers themselves, however they may organize their sales programs to pay them. We also take administrative notice that most, if not all, of the taxpayers' customers

(retail stores) do advertise. Our ruling here, however, does not depend on that consideration. Rather, we find that the credits, payments, or invoiced versus list price differentials are predicated upon the undertaking of advertising by the retail store buyers. The fact that the taxpayers may not actually insist upon the expenditure of funds for advertising purposes does not alter their purpose. In our view, if the so-called discounts were not in return for advertising they would not be so called. We are convinced that this methodology serves the taxpayers' own commercial and possibly even Federal tax purposes. In any event, the amounts in question do not qualify as "bona fide discounts" under Rule 108 or "cash discounts" under statutory law.

Finally, though not critical to this finding, we note that the taxpayers did not include these amounts, "in the Gross Amount reported," as required by Rule 108. Rather, the taxpayers systematically reduced their tax measures reported by 19.1 percent of gross selling revenues, including advertising expenditures.

DECISION AND DISPOSITION:

The taxpayers' petitions are denied.

DATED this 28th day of July, 1983.