

Cite as Det. No. 05-0142, 26 WTD 256 (2007)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition For Correction of )	<u>D E T E R M I N A T I O N</u>
Assessment of )	
)	No. 05-0142
)	
... )	Registration No. . . .
)	Document No. . . .
)	Docket No. . . .
)	

RULE 144, RULE 108, RULE 197, RULE 204; RCW 82.04.080, RCW 82.04.090: SERVICE B&O TAX -- ADVERTISING DISPLAY SERVICE -- BONA FIDE DISCOUNT -- NET CHARGE. Service B&O tax on advertising display service charges billed on a net basis is measured by the amount billed and legally due.

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.

STATEMENT OF CASE

M. Pree, A.L.J. – [An] advertising company protests a business and occupation (B&O) tax assessment on “commissions,” which the taxpayer contends were [advertising] agency “discounts” from the taxpayer’s normal rate of billing. The transactions reviewed involved bona fide discounts on sales through advertising agencies. The discounted rate was the proper measure of tax. We grant the petition subject to verification.<sup>1</sup>

ISSUE

Did [an advertising] company’s B&O tax measure include commissions or discounts provided to advertising agencies under WAC 458-20-108?

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

## FINDINGS OF FACT

[Taxpayer] provides advertising and production services . . . in Washington. The taxpayer's sales staff sells some services directly to customers, while advertising agencies for large customers bypass the sales staff and contact the taxpayer directly. If an [advertising] agency is involved, the taxpayer bills the [advertising] agency [a certain percentage] of its normal price for the advertising. While the [advertising] agency may bill its client the gross rate and retain a . . . commission or discount, the taxpayer is not involved with the compensation arrangement between the [advertising] agency and its customer. The taxpayer reported and paid business and occupation B&O tax on the net amount, which it received from the [advertising] agencies.

The Audit Division of the Department of Revenue (Department) reviewed the taxpayer's books and records for the calendar years 2000 - 2003. The Audit Division noted the taxpayer's invoice register listed gross invoice amounts and [advertising] agency commissions. . . . Another column listed the net amount reported by the taxpayer. The Audit Division assessed \$. . . other business or service activities B&O tax on the [advertising] agency commissions, which were not included in the net amounts reported by the taxpayer. The taxpayer paid the assessment, and petitioned for a refund including \$. . . interest and penalties added to the B&O tax.<sup>2</sup>

The taxpayer contends the [advertising] agency "commissions" were discounts, which the taxpayer never received or paid. While its contracts identified the customers, the contracts were signed by the [advertising] agency with a recognized . . .% agency discount. In other words, the [advertising] agencies were only obligated to pay the taxpayer [a certain percentage] of the normal price. Under these contracts, the taxpayer was only entitled to receive [a certain percentage] of the normal price, whether paid by the customer or the [advertising] agency.

The taxpayer used [a] form contract. Each contract [contained a statement that the buyer agreed to purchase certain services or space and pay a certain billing rate. A gross amount, which the Audit Division used to measure taxpayer's gross income, is noted. There is also a statement that the gross rate is subject to a . . .% advertising agency discount. An individual from the advertising agency signs the contract as accepting the discount and an employee of the taxpayer also signs].

The taxpayer provided the . . . invoices for . . . two contracts. Each invoice named the advertiser as well as the [advertising] agency, and was mailed to the [advertising] agency. The invoices identified the contracts, products, and listed the gross (amount used by the Audit Division), [the advertising] agency discount [amount], and [the] net [amount] (amount reported by the taxpayer). [The form notes a total amount due which corresponds to the net amount].

The taxpayer included copies of the two payment checks, both from the [advertising] agencies for the "total" amount due, (. . .% of the gross), equaling the net. . . .

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<sup>2</sup> Other taxes assessed and a pro rata portion of interest and penalties were paid, which were not disputed.

The taxpayer had no direct agreements with the [advertising] agencies' clients (advertisers/ultimate customer). The [advertising] agencies acted as the advertiser's (ultimate customer's) agents in procuring the advertising. They did not perform services for the taxpayer. The [advertising] agencies had no "commission contract" with the taxpayer. They worked for the customers. Whether a customer paid its advertising agency the gross amount, net amount, or another amount did not affect the amount due the taxpayer for the transactions at issue. The taxpayer did not pay a commission to the [advertising] agencies for selling advertising or any other service. The taxpayer had its own sales representative named on each contract and accepted the contract by signing . . . , while the advertising agent was the authorized representative signing on behalf of the advertiser . . . .

We must determine the taxpayer's proper measure of B&O tax under the circumstances reflected from our limited sample of two transactions, which the taxpayer states is representative. We will address this situation only.<sup>3</sup> The extent these transactions are representative is subject to verification by the Audit Division.

#### ANALYSIS

The taxpayer renders an advertising service to others . . . . In addition, its business . . . constitutes an "advertising display service" under WAC 458-20-204 (Rule 204). Under Rule 204, these advertising services are subject to business and occupation (B&O) tax under the service and other business activities classification measured by the taxpayer's gross income.

RCW 82.04.080 and .090 provide, respectively, that a business' "gross income" means "the value proceeding or accruing by reason of the transaction of the business engaged in . . . ." The value proceeding or accruing is the amount "actually received or accrued." The Department's Rule 197 (WAC 458-20-197) addresses, "When tax liability arises" for accrual taxpayers in subsection (2):

- (a) When returns are made upon the accrual basis, value accrues to a taxpayer at the time:
  - (i) The taxpayer becomes legally entitled to receive the consideration, or,
  - (ii) In accord with the system of accounting regularly employed, enters as a charge against the purchaser, customer, or client the amount of the consideration agreed upon, whether payable immediately or at a definitely determined future time.

Under the contracts provided by the taxpayer with the agent and/or agent's customer, the taxpayer was not entitled to receive more than [a certain percentage] of the normal charge for its

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<sup>3</sup> This determination is limited to instances where the advertising agency was the customer's agent only and had no "commission" contract with the taxpayer (we are not aware of any). In addition, the income at issue does not include situations where anyone had an obligation to pay the taxpayer anything more than the reduced amount. Finally, we lack any evidence the [advertising] agencies were required to perform any services for the taxpayer in consideration for the reduced amount due. See e.g. Det. No. 83-180, 11 WTD 5 (1983); Det. No. 98-183, 18 WTD 220 (1999); Det. No. 98-202, 19 WTD 771, 774 (2000).

services. For a cash basis taxpayer, value proceeds to the taxpayer at the time the taxpayer receives payment. Rule 197(3). The disputed transactions involved situations where the contract price for the services rendered was [that certain percentage] of the taxpayer's standard billing rate. The taxpayer properly reported the amount it was entitled to receive – the total shown on the invoice or net amount.

WAC 458-20-108 (Rule 108) provides that the selling price of a service 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, provided that such amount has been included in the gross amount reported. The Department recognizes that "discounts" qualify as bona fide when they are merely "reduced prices," i.e., the seller's selling price was merely reduced before the sale is made and there is no requirement for the purchaser to do anything in return. Det. No. 88-208, 5 WTD 403 (1988). Any discount given with "strings attached" by the vendor is therefore deemed to be consideration given in exchange for a service, and, as such, is B&O taxable to the purchaser. Det. No. 98-183, 18 WTD 220 (1999); Det. No. 98-172E, 18 WTD 387 (1999). The taxpayer merely has a contract to sell its . . . advertising services for the net price or "total" shown on its invoices.

Under the facts presented, the [advertising] agencies were the customers' agents that purchased advertising services from the taxpayer on behalf of, and for, their customers. The [advertising] agencies performed no services for the taxpayer for which the taxpayer owed the [advertising] agencies anything. Whether paid by the agent or the customer, the taxpayer was entitled to receive only [a certain percentage] of the gross charge.

. . . Since the amount billed and legally due as well as the actual payment was only [a certain percentage] of the taxpayer's normal charge, this reduction represented a bona fide discount, with the value accruing or proceeding to the taxpayer subject to tax. We conclude this reduced amount constituted the taxpayer's gross income.

#### DECISION AND DISPOSITION

We grant the taxpayer's petition subject to verification and remand the case to the Audit Division for further document review and adjustment.

Dated this 30th day of June, 2005.