Cite as Det. No. 08-0306ER, 36 WTD 001 (2017)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Reconsideration of Denial of Petition for Correction of Assessment	)	FINAL EXECUTIVE LEVEL RECONSIDERATION DETERMINATION
	)	No. 08-0306ER[1]
. . .	)	Registration No. . . .

[1] RCW 82.04.080; RCW 82.04.220: BUSINESS & OCCUPATION TAX -- GROSS INCOME – VALUE PROCEEDING OR ACCRUING – DEALER CASH AWARDS. Credit awarded by a vehicle manufacturer to a dealership for selling vehicles in compliance with terms set by the manufacturer ("dealer cash") is gross income of the dealership.

[2] RCW 82.04.290: BUSINESS & OCCUPATION TAX – SERVICE AND OTHER ACTIVITIES CLASSIFICATION – DEALER CASH AWARDS. Dealer cash is an incentive by the manufacturer to the dealer and subject to business and occupation tax under the catchall service and other activities tax classification.

[3] RCW 82.02.210: STREAMLINED SALES AND USE TAX AGREEMENT – DEALER CASH AWARDS. Treating dealer cash awards as gross income of the business is not inconsistent with the Streamlined Sales and Use Tax Agreement (SSUTA).

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.

Margolis, A.L.J. – An automobile dealership (Taxpayer) seeks executive level reconsideration of Determination 08-0306 in which we concluded that dealer cash incentive program awards (Dealer Cash)[2] are income to the business and subject to business and occupation (B&O) tax under the other business or service activities classification. We affirm our decision in Det. No. 08-0306 as Taxpayer has not proved that Dealer Cash qualifies as discounts to or reductions on the selling prices of the vehicles.[3]

[1] [This matter was subsequently litigated. *See Steven Klein, Inc. v. Dep't of Revenue*, 183 Wn.2d 889, 357 P.3d 59 (2015) (affirming imposition of tax).]
[2] We refer to the program as "dealer cash incentive program awards" or "Dealer Cash" because these are the words used by the manufacturer when it informs the dealer of the program in marketing bulletins. No actual cash changes hands.
[3] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

ISSUES

1. Whether a credit award, referred to as "dealer cash" and which automobile dealers receive from automobile manufacturers when specific vehicles are sold within specific time frames, is a reduction in the price paid by the dealer for the vehicle.

2. If "dealer cash" is not a reduction in the sales price, is it income subject to B&O tax under the other business or service activities classification of RCW 82.04.290, regardless that the dealer may not provide any services in exchange for the award?

3. Was the Department's treatment of "dealer cash" as additional income subject to B&O tax under the other business and service activities classification inconsistent with Streamlined Sales and Use Tax Agreement (SSUTA) provisions? [4]

FINDINGS OF FACT

On October 11, 2007, the Audit Division (Audit) assessed Taxpayer $ . . . in service and other business activities B&O tax on credit (Dealer Cash) the taxpayer received from the car manufacturer (Manufacturer) for certain vehicles it sold during a specific period of time. The assessment covered the audit period of January 1, 2003, through December 31, 2006. Taxpayer paid the assessment and timely petitioned for cancellation of the assessment claiming that the Dealer Cash constitutes discounts from the purchase price of the vehicles. We issued Det. No. 08-0306 and Taxpayer timely petitioned for Executive Level reconsideration, which request was granted.

Taxpayer is a car dealership, an independent franchisee of Manufacturer, with a car lot in Washington where it sells new and used vehicles, provides repair services, and sells automobile parts and accessories. It is required by contract with Manufacturer to maintain, in showroom-ready condition, a minimum inventory and representative mix of Manufacturer vehicle models for demonstration purposes, and effectively promote and sell Manufacturer's vehicles. If it or its employees present the vehicle invoice to a customer, it is required to present the invoice in its original and complete state. Invoices state that amounts may not reflect the dealer's ultimate vehicle cost given any rebates, allowances, collections, discounts, holdback, incentives, etc. Taxpayer has no obligation to sell any Manufacturer products at prices suggested by Manufacturer, and is the sole judge of the price at which it sells Manufacturer products (subject to local, state, and federal law.)

Manufacturer promotes the sales of its cars by offering various incentive programs to its dealers. These sorts of award programs are regularly employed by automobile manufacturers to stimulate the sales of certain models in response to changing economic conditions or other issues. For example, one incentive program Manufacturer offers is a volume discount program which provides "credits" to Taxpayer for each car sold. Under this program, Taxpayer must sell a specific number of a particular model. If Taxpayer sells the required number of vehicles, Manufacturer applies a

[4] RCW 82.02.210 provides that it is the intent of the legislature to bring Washington's sales and use tax system into compliance with the SSUTA.

specified credit to Taxpayer's account based on the number of cars sold. If Taxpayer exceeds the objective, the credit for every car sold under the program is increased retroactively.

Another incentive program Manufacturer offers is the Dealer Cash program, which is the subject of this appeal. This program is not based on volume sold but rather on sales of vehicles of a certain type and model in a specified period of time. It is motivated by Manufacturer's need to move vehicles from the manufacturing line to the end consumer. Manufacturer periodically offers the program to Taxpayer and other dealerships within the same geographic area. The program can be initiated at any time, and typically spans 10-30 days although it is sometimes extended when proven effective. The program provides Taxpayer with credits for selling specific vehicles that Taxpayer has purchased and are on Taxpayer's lot or in transit to Taxpayer. These credits or Dealer Cash amounts are applied against the price the dealer paid the manufacturer for the vehicle. The program is only valid during a specific time frame and is used to make a specific model more competitive and spur sales so that Manufacturer can maintain production levels and market share. The program is communicated by Manufacturer to Taxpayer via the Interactive Network, the manufacturer-dealer computer network, in a marketing bulletin. A sample bulletin reads as follows (in part):

> Name: "2007 [vehicle model name] Coupe $1,000 Dealer Cash" (Excludes CA)
> Dates: June [unreadable], 2007 – July 5, 2007
>
> . . .
>
> Other Offers: Eligible vehicles sold utilizing this incentive program will also qualify for . . . .
>
> Unless otherwise noted, the Dealership is the recipient of the awards and will be treated as such by [Manufacturer] for tax purposes. [Manufacturer] is not liable for any taxes applicable to program awards. For all tax purposes, the dealership is responsible for the accurate reporting of the receipt and allocation by the dealership of awards consistent with the above.

Taxpayer accounts for these Dealer Cash awards in its books and records as reductions in or discounts to the cost of vehicles, crediting its Incentive New Car Account and debiting its Incentive Receivable Account as required by Manufacturer. It does not report Federal income taxes or Washington State B&O taxes on these amounts.

Dealer Cash is not advertised or taken into consideration when ordering, nor is it reflected on vehicle invoices. No special advertising, best practices, or lot placement is required to receive the Dealer Cash award. The dealership need only sell the specified cars within the specified timeframe. Sales personnel behavior is not affected because only management is aware of the programs and sales commissions are unaffected. The only effect on sales activities occurs when the sales manager negotiates final pricing with the customer, or if the manager chooses to offer the customer a special discount.

When a vehicle that qualifies for Dealer Cash is sold, Taxpayer reports the vehicle identification number to Manufacturer and debits the Balance Forward Account to reflect the award amount. If

the vehicle is returned, the incentive payment is stopped and the adjustment is reversed. Audit assessed service and other business activities B&O tax on these amounts.

ANALYSIS

B&O tax is levied for the act or privilege of engaging in business activities. RCW 82.04.220. The term "business" includes "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. Activities not otherwise defined fall under the other business and service activities B&O tax classification and are taxed based on "gross income of the business." RCW 82.04.290, and .080. "Gross income of the business" is broadly defined as:

> 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.

In Det. No. 08-0306, we found that credits from the Dealer Cash program are "value proceeding or accruing by reason of the transaction" and are thus taxable unless there is authority for excluding or deducting those amounts from the gross income of the business. Taxpayer argued that the credits were not taxable because they were discounts from the wholesale purchase price and not part of the gross income of the business under RCW 82.04.4283 and WAC 458-20-108 (Rule 108). We held that Manufacturer had not given the taxpayer discounts from the purchase price, but instead had given its dealer incentive payments to encourage the dealer to sell cars within the defined timeframe. Since Taxpayer failed to establish any authority for excluding or deducting the amounts, we found that the credits are part of the taxpayer's gross income.

On reconsideration, Taxpayer argues that RCW 82.04.4283 and Rule 108 are not applicable, and instead asserts that the payments were not taxable income because they are not "gross income of the business" under RCW 82.04.080.[5] Taxpayer argues that there is one transaction in question, namely the sale of the subject vehicle by Manufacturer to Taxpayer where the gross proceeds the manufacturer actually derived from Taxpayer's purchase of the vehicle is determined by the transaction "as finally completed". Based on this characterization, Taxpayer contends that the cash back incentive award is simply a rebate that reduces the price Taxpayer paid the manufacturer and is in the nature of a refund. Thus, Taxpayer argues, the Dealer Cash award is not income derived from its business activities.

We disagree. We find there are two separate transactions: Taxpayer's purchase of the vehicles from Manufacturer for resale; and, Manufacturer's payment in the form of "Dealer Cash" awards for Taxpayer's sales of the vehicles in compliance with terms set by Manufacturer. RCW

[5] Hearing Brief on Executive Review (Taxpayer's Brief), page 3.

82.04.080 defines gross income as value proceeding or accruing by reason of the transaction of the business engaged in, so Manufacturer's payment is gross income. Taxpayer's concept of "the transaction as finally completed" is found in Rule 108(1). Rule 108(1), however, applies when a sale is subject to cash or trade discount. We discussed Rule 108 in our original decision and concluded that the Dealer Cash awards that Taxpayer receives are neither cash nor trade discounts, stating that a cash discount is a discount for payment on or before a specified date, and a trade discount is a percentage deduction from the list price of goods. On reconsideration, Taxpayer concurs that Rule 108 is not applicable to the Dealer Cash award at issue here.

Taxpayer argues that our conclusion in Det. No. 08-0306 that Taxpayer is subject to B&O tax on the Dealer Cash it received (as a credit on its account) is inconsistent with Department precedent.[6] We disagree. Our finding does not conflict with the published determinations Taxpayer cited in support of its position, nor does it conflict with the Auto Dealers Industry Guide (January, 2006). In Det. No. 01-263, 11 WTD 263 (1991), for example, we relied upon Rule 108 and held that funds returned to dealerships under a Dealer Holdback Program (DHP) and Wholesale Floor Plan Protection Program (WFPP) provide a reduction in price and are not subject to taxation. Taxpayer, in its Brief at page 5, argues that we treated DHP and WFPP "as reductions in the dealer's purchase price because no services are required in exchange." We reviewed 11 WTD 263, and disagree with Taxpayer's claim. In that determination, the amount at issue was found to be an adjustment to the original purchase price, but in reaching that conclusion we noted that

> both parties are well aware that the 3% holdback will be returned to the dealer . . . it is clearly a revision to the original purchase price . . . contemplated by both parties at the time of the original sale.

11 WTD 263, 266. The return of the funds to the dealer therefore was not compensation to the dealer, but was a contemplated reduction in the purchase price at the time of purchase. Thus, as previously explained in Det No. 08-0306, the DHP and WFPP in that case are materially different from the Dealer Cash program at issue. In the instant matter, there was no contemplation of a reduction in purchase price at the time of the original sale. The amount at issue, the Dealer Cash, is an amount that is unknown when the dealer and the manufacturer contract for the purchase and sale of the vehicles; and, there is no evidence that either party contemplated a reduced price based on some possible future event.

In further support of its claim that Dealer Cash is a reduction in the dealer's purchase price, Taxpayer relies on Det. No. 98-172E, 18 WTD 387 (1999) and equates manufacturer's off-invoice purchase allowances and scan-down purchase allowances, which it asserts we recognized as non-taxable, with Dealer Cash incentives. However, the issue in 18 WTD 387 was whether grocers were subject to B&O tax on allowances, bill-backs, payments, or rebates from manufacturers where the grocers had purchased the manufacturer's products from a third-party distributor. It was not whether off-invoice purchase allowances or scan-down purchase allowances are reductions in price. We denied the taxpayer's petition and found that

[6] Taxpayer stated that the proposed executive level reconsideration mischaracterized some of the prior decisions of the Appeals Division. Although Taxpayer did not identify specific decisions and did not explain how we mischaracterized these decisions, we reviewed all prior decisions referenced in this determination. We do not agree that the determinations are mischaracterized.

> [t]he taxpayer's purchasing activity in exchange for providing a service constitutes engaging in business. Rebates, allowances, or bill-backs received from third parties are gross income from engaging in business. Unless an exclusion or deduction applies, receipts from purchasing are subject to tax under the service and other activities classification.

Regardless, Dealer Cash incentives are not off-invoice purchase allowances or scan down purchase allowances. We described off-invoice purchase allowances as occurring where the manufacturer reduced the price of the goods by allowing a discount off the invoice price, but Dealer Cash does not reduce the invoice price. We described scan-down purchase allowances as occurring where the manufacturer agreed to pay the grocer based on the volume of an item that runs across the grocer's scanner, and the grocer reduced its price for the item during that period. Taxpayer asserts that it need not reduce the price of vehicles based on Dealer Cash.

Further, the Department's Auto Dealers Industry Guide (January, 2006) provides support for our conclusion in Det. No. 08-0306. It explains, in pertinent part:

> Payments that are bona fide cash discounts taken by the dealer or [that] represent an adjustment to the dealer's purchase price are not subject to tax. However, payments (whether credits against future purchases, checks, or cash) received for providing any services to the manufacturer are subject to B&O tax. . .

As we explained in Det. No. 08-0306, the Dealer Cash award is a payment to the Dealer for certain action: the sale of a particular car model within a specific timeframe. This award was not part of the negotiated price; in other words, it was not contemplated at the time the Dealer purchased the vehicle from the manufacturer. According to Taxpayer's description of how the Dealer Cash program works, Manufacturer determines that it wants certain specific vehicles that are in Taxpayer's inventory to be sold to end consumers within a certain timeframe and Manufacturer determines the amount it is willing to pay Taxpayer (by crediting its account) if Taxpayer meets the terms of the program. When Taxpayer meets the terms of Manufacturer's program, Taxpayer earns the awards. Thus, because Taxpayer contracts with Manufacturer to do something in exchange for credit against its account, the Dealer Cash is not a bona fide discount as described in the Department's Auto Dealers Industry Guide (January, 2006). Therefore, we again conclude that the Dealer Cash awards constitute "value proceeding or accruing by reason of the transaction of the business engaged in" and are gross income of the business under RCW 82.04.080.

On reconsideration, Taxpayer claims that we concluded the credits were rebates and that Taxpayer did not have to perform additional services to receive the "rebates". Taxpayer has misconstrued the determination. Det. No. 08-0306 did not conclude that the credits were rebates nor did we make any statement concluding that Taxpayer had not performed additional services on account of the Dealer Cash program. While performing additional services may not be required, the program is predicated on dealers taking action to earn the Dealer Cash incentive. An incentive is something (as hope of reward) that constitutes a motive or reason for doing something. *See* Webster's Third New International Dictionary, 1141, (1993). Taxpayer's and Manufacturer's description of the Dealer Cash as an incentive is consistent with our conclusion in Det. No. 08-0830 that the Dealer Cash program is predicated upon the dealership engaging in an activity (selling specific cars within a specific timeframe) to meet the Manufacturer's objective. The

Manufacturer offers the incentive to stimulate a business activity that, if successfully undertaken, results in a payment (in the form of credits) from Manufacturer to Taxpayer. These credits are incentives to dealers – not retail customers – as the amounts need not be passed to retail customers (who are not aware of the Dealer Cash program) and are thus subject to B&O tax because they constitute value proceeding or accruing by reason of the transaction.

On reconsideration, Taxpayer asserts that the Dealer Cash awards are either rebates or dealer discounts off the manufacturer's sales price. We disagree. In Det. No. 93-078, 12 WTD 559 (1993), we discussed rebates in the context of payments made by an electric power company to a builder for incorporating energy saving efficiencies into a building's construction. We said:

> The [payment] is really not a rebate. Generally, a rebate is thought of as "a deduction from an amount to be paid or a return of a part of an amount given in payment." William Morris, editor, American Heritage Dictionary, (Boston: Houghton Mifflin Company, 1980), p. 1086. In this instance, the electric utility, [client], makes a payment to the builder as an inducement to construct an energy efficient building. . .
>
> Under the very broad definitions of "Gross income of the business" and "Value proceeding or accruing" the income received whether it be in money, credits, or rights must be considered gross income of the business and subject to the B&O tax. Furthermore, the income is subject to the service B&O tax under the provisions of RCW 82.04.290.

In this matter, Manufacturer grants credits to Taxpayer as an inducement to sell specified cars within specified timeframes. We conclude that these payments are also not rebates and are also gross income of the business and subject to the B&O tax.

Further, the Dealer Cash awards, as they are not based on the quantity of items purchased and are not reductions in sales price, are not volume discounts. Rule 108(5). Nevertheless, Taxpayer argues that the incentives are like volume discounts because both are uncertain at the time of the original sale and both require sales to occur within a specified timeframe. Taxpayer relies on Det. No. 98-202, 19 WTD 771 (2000) for its contention that the Dealer Cash awards, like volume discounts, are deductions to the original purchase prices and are not taxable income. In 19 WTD 771, however, volume discounts are mentioned only in relation to Rule 108(5), as follows:

> . . . Volume discounts are reductions in the sales price of the article purchased based on the quantities of items actually purchased. The example in Rule 108(5)(c) allowing a one-cent per gallon rebate is one type of volume discount. Such discounts constitute a reduction in the original sales price and may be deducted from the gross proceeds of sale.

In that case, a travel agency sought to deduct credits that were determined by the number of reservations the travel agency booked using the seller's computer system and terminals, which the travel agency leased. The more reservations made the more credits the travel agency received from the seller. The credits were applied as a reduction against the monthly lease charges the agency paid the seller. The travel agency considered the reduction in lease payments to be a "productivity" discount that offset the monthly charges it paid for leasing the computer terminals. Unlike the "volume" discount provided in the Rule 108(5) example, 19 WTD 771 found that "…

Taxpayer's productivity discount is not computed based on the volume of products or services purchased (since the number of leased computer units remains fixed) but instead is computed based on the amount of business generated by each leased terminal. In this respect," 19 WTD 771 concluded, "the productivity discount is similar to a commission for services rendered and not a true discount." That determination concluded that "[d]eductions for bona fide discounts are not available where a purchaser is required to provide any significant service to the seller in return for the reduction."

Thus, while 19 WTD 771 recognizes that volume discounts may be deducted from the gross proceeds of sale, it does not conclude that discounts contemplated after the articles were purchased, as would be the case with Dealer Cash incentives if they were discounts, constituted volume discounts under Rule 108. Like the Taxpayer in this matter, the travel agency received a future credit against a pre-existing purchase based on increasing the number of sales. The increased number of sales benefitted the seller and the travel agency was rewarded for its efforts (increased sales) by receiving from the seller credits. The credits were used to pay the amount the travel agency owed on its lease payments. The credits, however, did not reduce the original amount owed. 19 WTD 771 did not find these to be volume discounts exempt from use and retail sales tax, and provides no support to Taxpayer's argument that Dealer Cash incentives should be treated like volume discounts.[7]

Taxpayer also argues that as rebates or discounts, the Dealer Cash amounts cannot be taxed under the other business and service activities B&O tax classification as to do so would conflict with Streamlined Sales and Use Tax Agreement (SSUTA) provisions. *See* RCW 82.02.210. In support of this contention, Taxpayer provided an SSUTA issue paper titled "BUYDOWNS, MANUFACTURERS' COUPONS, STORE COUPONS" which includes an example of volume discounts where a rebate to the seller is based on the number of sales. The sales price is reduced to induce more customers to purchase. The example reads as follows:

> . . . A seller purchases appliances from a manufacturer for $1,000 each and resells them to customers at $1,500. If the seller sells more than 100 appliances in a month, the manufacturer will provide a rebate of $100 per item sold. In-store advertising indicates that "sales prices are slashed due to manufacturer's incentives." The amount of the rebate is not shown on the purchaser's invoice and all purchasers receive the reduced price. Accordingly, the rebate amount is not included in the sales price.

Taxpayer argues that this example supports its claim that Det. No. 08-0306 erred in concluding that the Dealer Cash Taxpayer receives from the Manufacturer is subject to the service B&O tax. Taxpayer states:

> The Appeals Division's analysis would render the SSUTA provisions regarding rebates superfluous and result in lower sales tax collections. If the Department is too quick to find that normal sales activities are sufficient to constitute services, such that sales incentives are service income, then it will fail to consider whether sales incentives are third party payments subject to retail sales and B&O.

[7] 19 WTD 771 found that these credits were commission income that could not be deducted from Taxpayer's monthly lease charges.

> The SSUTA recognizes that, when a manufacturer's payment reduces the selling price to the consumer by the amount of the payment, the retailer has not actually reduced the selling price but merely gotten the price from two different entities. . .

Hearing Brief on Executive Review (Taxpayer's Brief), page 6.

Taxpayer's reliance on the SSUTA volume discount example is misplaced. Taxpayer asserts that these volume discounts are similar to Dealer Cash incentives, and that both are not taxable. However, Dealer Cash incentives are not volume discounts. As we stated above, Dealer Cash incentives are "value proceeding or accruing by reason of the transaction," and as such must be reported as gross income of the business, subject to B&O tax under the other business or service activities classification in accordance with RCW 82.04.220, and .290.

DECISION AND DISPOSITION

Taxpayer's petition on reconsideration is denied.

Dated this 19th day of August, 2010.