Cited as 1 WTD 9(1986)

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

In the Matter of the Petition For Correction of Assessment of	D E T E R M I N A T I O N
	No. 86-214
. . .	Registration No. . . .
	Tax Assessment No. . . .

[1] RULE 155 -- MANUFACTURING TAX -- OUT-OF-STATE SALES OF COMPUTER SOFTWARE -- ESTOPPEL.
Manufacturing tax sustained on out-of-state sales of computer software sold under licensing agreements. Taxpayer had listed its income from such sales under retailing taking a corresponding deduction for interstate and foreign sales.

Relief not warranted on grounds taxpayer had asked the Department to check its return when it first filed and error in reporting was not corrected or because of the Department's prior position that license to use agreements were professional services. Taxpayer had not relied on the previous position.

[2] RULE 228 -- INTEREST.
Department does not have authority to cancel interest because a taxpayer tried to determine its tax liability and report correctly.

TAXPAYER REPRESENTED BY: . . .

DATE OF HEARING: June 24, 1986

NATURE OF ACTION:

The taxpayer's records were examined for the period April 5, 1982 through March 31, 1985. The examination disclosed taxes and interest owing . . . $. . . . Tax Assessment No. 5847000 in that amount was issued on November 19, 1985.

FACTS AND ISSUES:

Anne Frankel, Administrative Law Judge -- The taxpayer objects to the assessment of manufacturing tax on the sales of standard

prewritten software packages to out-of-state customers. The taxpayer agrees that its sales fall under the manufacturing section, but contends the assessment should not apply to sales made prior to September 30, 1985, when the revised WAC 458-20-155 was filed.

In his petition, the president of the taxpayer corporation stated:

> We did our very best to research the proper tax rules and determine the correct tax to pay and we even changed the reporting method when the WAC section as filed in 1985. It seems to be grossly unfair to adjust our returns back to 1982 on a rule that was filed in 1985 and then on top of that, to charge interest. It makes it very difficult for a taxpayer to want to pay the correct tax when rules can be retroactively changed.

DISCUSSION:

The taxpayer registered its business in 1982, describing its services as computer design, sales, and consulting. The first excise tax return was filed in the third quarter of 1982. Attached to that return was a letter requesting that the Department review the return for "correctness." The letter indicated the return was based on one product sale to Australia, one sale to North Carolina and one on-site computer maintenance in Seattle. The income from the product sales was listed under retailing with a corresponding deduction for interstate and foreign sales. The maintenance income was listed under service and other activities. The taxpayer had also computed local convention and trade center tax. No amount was listed under line 18 for retail sales tax.

The return shows adjustments were made by the Department. The amount listed under retailing on line 17 was added to line 18 for retail sales tax with a corresponding deduction for interstate and foreign sales. The convention and trade center tax was deleted, as that tax only applies to hotels and motels. The taxpayer was given a credit for the tax it paid because its reported income was less than the minimum taxable amount.

In the audit at issue, the auditor assessed manufacturing tax on the sales made to out-of-state and foreign customers. The auditor relied on WAC 458-20-136 (Rule 136) and ETB 515.04.155, copies of which were provided to the taxpayer. Rule 136 provides in pertinent part that

> Persons who manufacture products in this state and sell the same in interstate or foreign commerce are taxable under the classification manufacturing upon the value of the products so sold, and are not taxable under retailing or wholesaling-all others in respect to such sales. (See also WAC 458-20-193.)

Part A of WAC 458-20-193 (Rule 193) deals with sales of goods originating in Washington to persons in other states and Part C deals with imports and exports. Rule 193 also states that persons who manufacture in Washington and who transfer or make delivery of articles produced to points outside this state are subject to business tax under the extracting or manufacturing classification.

When the taxpayer first filed its excise tax return, therefore, it incorrectly listed its income from the out-of-state sales under the retailing classification, taking a corresponding deduction. Although the taxpayer's name at that time, Digetec Software Design, Inc., indicated the taxpayer might have manufactured the software products, this was not clear from the return or its letter. The taxpayer was not informed by the Department that the income from the out-of-state sales was subject to the manufacturing tax.[1]

We do not have authority to grant relief because the error was not caught by the Department earlier. Where taxes are properly due, the state cannot be estopped to deprive it of the power to collect taxes, even in cases where an auditor failed to detect an error. See e.g. Kitsap-Mason Dairymen v. Tax Commission, 77 Wn.2d 812, 818 (1970). See also ETB 419.32.99.

Nor do we find relief is warranted because WAC 458-20-155 (Rule 155) was revised in 1985. The rule was revised to provide a distinction between sales and services. Prior to revision of the rule, the Department had informed some taxpayers that payments for licenses to use canned software programs were not subject to the retail sales or use tax. Transfers of computer software under license to use agreements were treated as professional services rather than retail sales. The Department reconsidered its position. In the revised Rule 155, all licenses to use standard pre-written software are sales of tangible personal property.

The taxpayer transfers its computer software out-of-state under license to use agreements. At no time, however, has the taxpayer shown it relied on the Department's former position. If it had, it would have been subject to the higher services tax. Instead, the taxpayer characterized its transfers as retail sales, but failed to recognize its business tax liability for interstate and foreign sales under the manufacturing classification. As the taxes are

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[1]The taxpayer also listed maintenance income on line 16, Services and Other Activities. Maintenance and repair charges, however, are "sales at retail." RCW 82.04.050. Rule 155 specifically adds that the retail sales tax also applies to all charges to users for the repair, maintenance, alteration, or modification of hardware, equipment, and/or standard, prewritten software or materials.

properly due, we have no authority to cancel the tax or the interest, even though the taxpayer's records indicate it has tried to pay the correct tax. RCW 82.32.050.

Interest is assessed upon money due the state which by reason of nonpayment has been at the use and disposal of the taxpayer. The only authority to cancel interest or penalties is found in RCW 82.32.105. That provision allows the Department to waive or cancel interest or penalties if the failure of a taxpayer to pay any tax on the due date was the result of circumstances beyond the control of the taxpayer. The same provision requires the Department to prescribe rules for the waiver or cancellation of interest or penalties.

The administrative rule which implements the above law is found in WAC 458-20-228 (Rule 228). Rule 228 lists only two situations under which cancellation of interest will be considered upon assessments pursuant to RCW 82.32.050:

1. The failure to pay the tax prior to issuance of the assessment was the direct result of written instructions given the taxpayer by the department.

2. Extension of the due date for payment of an assessment was not at the request of the taxpayer and was for the sole convenience of the department.

As neither of these situations are present, the assessment of interest is also affirmed.

DECISION AND DISPOSITION:

The taxpayer's petition for correction of Assessment No. . . . is denied.

DATED this 15th day of July 1986.