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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. 86-232 Registration No. . . .

[1] Rule 218; BUSINESS AND OCCUPATIONS; ADVERTISING SERVICE; RETAIL SALES; COMMERCIAL ART; RCW 82.04.050; ETB 308. Commercial artwork that is a finished product for outright sale to a consumer is subject to the retailing business tax and retail sales tax.

[2] ESTOPPEL; ETB 419; ORAL INSTRUCTIONS; PRIOR AUDIT. Doctrine of equitable estoppel applied where taxpayer relied on advice by Department employee when registering and by auditor in previous audit that taxpayer was to report his income under the Service category. Taxpayer relieved of obligation to pay retailing business tax and retail sales tax for period prior to most recent audit when he was correctly informed of his tax classification.

These 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: . . .

NATURE OF ACTION:

The taxpayer seeks correction of a tax assessment on grounds he had properly reported his income under the Service category, as he alleges he was previously advised by the Department. In the alternative, the taxpayer petitions for

prospective application of the decision to reclassify his income.

FACTS AND ISSUES:

Anne Frankel, Administrative Law Judge--The taxpayer registered his business in 1973 as a professional advertising service. The taxpayer alleges that he was advised by the Department at the time he registered that he should pay sales tax on his purchases and report his income under the Service and Other Activities category. His business includes constructing and selling signs, banners, directory boards, paintings and posters.

The taxpayer began reporting and paying B&O Service tax. In May of 1980, the Department issued a tax warrant to the taxpayer for the period of July 1979 through March 1980 for $384.44 in unpaid taxes, interest and penalties. The computation of liability was done by a compliance revenue officer using the figures submitted by the taxpayer on his excise tax returns. The taxpayer stated he assumed he was reporting his income properly under the Service category.

The taxpayer's records were examined in 1981. The taxpayer states that the auditor told him at that time he was reporting his income properly under the Service category. That investigation was the result of the Department receiving a letter from the Superintendent of Public Instruction indicating payment of sales tax on art work purchased from the taxpayer which he had not reported or submitted to the Department. The auditor's comment regarding the examination simply stated, "the subject claims this is the only sale and the records do not prove otherwise." The auditor reclassified the income from the sale to the school district, assessed retail sales tax on the transaction, and issued a Notice of Balance Due for $19.86 on Marchá26, 1981.

The audit at issue concerns an examination of the taxpayer's records for the period Januaryá1, 1981 through September 30, 1985. That auditor determined the taxpayer was engaged in the business of making retail sales and thus liable for retailing business tax and retail sales tax. The taxpayer was allowed credit for taxes he had paid under the Service category. He was also advised that he would receive a credit if he could properly document that the sales tax had already been paid or that he had made a wholesale sale instead of a retail sale.

Two issues are presented for review:

1. Whether the taxpayer's business activity falls within the definition of "advertising services" or whether the business is making retail sales; and

2. If the taxpayer is found to be in the business of making retail sales, whether the state should be estopped from collecting the retail sales tax and retailing business tax for the past periods.

DISCUSSION:

1. Business activity. In concluding that the taxpayer was engaged in the business of making retail sales and liable for retailing business tax and retail sales tax, the auditor relied on the following statutory provisions:

A. RCW 82.04.050 which defines a "Sale at retail" or "Retail sale" as including sales of tangible personal property to all persons irrespective of the nature of their business, including persons who "install, repair, clean, alter, improve, construct, or decorate real or personal property of or for consumers." The term includes the sale of or charge made for tangible personal property consumed and/or for labor and services rendered in respect to the imprinting or improving of tangible personal property.

B. RCW 82.08.010 which states the measure of the retail sales tax is the "selling price" without deduction of any costs or expenses paid or accrued; and

C. RCW 82.08.050 which states that the sales tax required to be collected by the seller shall be stated separately from the selling price.

The taxpayer, however, contends his business is primarily an advertising service and thus the business income is subject to the service tax. The taxpayer relies on WAC 458-20-218 (Rule 218) which states the gross income received for advertising services is taxable under the Service and Other Business Activities classification. Rule 218 states that amounts attributable to sales of tangible personal property, unless charges for such articles are separately stated in billings rendered to clients, are included in the Service classification. The taxpayer also relied on the fact he was advised by the Department when he registered to report his income under the Service category and that he was told he was reporting his income correctly when he was audited in 1981.

In general, service activities are those rendered to persons, rather than services rendered to personal property of persons. WAC 458-20-224. Rule 218 deals with the tax liability of advertising agencies. A commercial artist or sign painter is not necessarily in the advertising agency business because he or she produces work that is used to advertise a business. Advertising agencies primarily render professional services as advising customers of advertising strategies, preparing designs, logos, layouts for advertising circulars, and researching the effectiveness of advertising. It is the income from such activities that is taxed under the Service category.

Excise Tax Bulletin 308.04.224, issued Januaryá20, 1967, discusses the distinction between art work that is taxable under the Service classification from that constituting a retail sale. A distinction is made between the preparation of sketches, designs, layouts, drawings and other art work that is not a final product from that which is. Only the commercial art work that is a finished product for outright sale to a consumer is subject to the retailing business tax and the retail sales tax. See also WAC 458-20-144 and ETB 417.12.144. (If a printer produces articles to be used as an intermediate step in the production of a final printing job, the printer is engaging in a professional and/or artistic type of service. The printing of advertising circulars, posters, or other printed matter, however, is a retail sale if the customer either consumes or distributes such articles in the regular course of business.)

The taxpayer's attorney reviewed ETB 308.04.224 and concluded that the taxpayer's work, with the exception of Fine Art sold at retail, specifically to and for customers, was taxable under the Service classification. The attorney provided copies of the taxpayer's records in support of his position.

The records indicate that the taxpayer primarily produces paper signs. The taxpayer also produces such items as sand blasted signs, architectural renderings, awning and wall graphics, and fluorescent signs. On their face, all appear to be final products sold to a consumer. We find, therefore, that the auditor's present conclusion that the taxpayer is making sales rather than providing advertising services is correct.

In summary, the following are examples of business activities which constitute making sales:

1. painting letters or graphics on vehicles, awnings or other tangible personal property, notwithstanding that the information is for advertising purposes;

2. selling posters and signs used as final products;

3. preparing illustrative charts for an attorney or another professional to use in the professional's business; the professional is considered the "consumer" of the work even though the client is billed for the work done.

Commercial artwork for outright sale to customers is subject to wholesaling business tax if the work is for resale (see WAC 458-20-102 regarding requirement of seller to obtain resale certificate) and retailing tax if the work is sold directly to consumers.

The following are examples of business activities which constitute service activities:

1. producing articles used as an intermediate step in the production of a final printing or advertising job as sketches, layouts, proofs, plates or engravings:

2. advising about materials, design materials, and arranging for printing and marketing;

3. art instruction as an independent contractor, but not if hired as an employee.

If the taxpayer continues to believe his business activity constitutes a service rather than a sale, he should submit further evidence describing his business activity in more detail.

2. Estoppel--The taxpayer argues that a decision that the taxpayer's business activity is making retail or wholesale sales should be prospective only. The taxpayer contends the law is unclear as to the taxpayer's proper tax liability; therefore he acted responsibly in relying upon the Department's advice to report under the Service category. Furthermore, the taxpayer states payment of the assessment poses an extreme hardship as it would be impossible to collect the sales tax from the former customers to pay the past due sales tax.

The taxpayer alleges payment of the deficiency would result in a "manifest or grave injustice to the taxpayer." In support of this position, the taxpayer relies on State ex rel. Shannon v. Sponburgh, 66 Wn.2d 135 (1965); Conversions and Surveys, Inc., v. Department of Revenue, 11 Wn.App. 127 (1974) and Shafer v. State, 83 Wn.2d 618 (1974).

To create an estoppel, three elements must be present: (1) an admission, statement, or act inconsistent with the claim afterwards asserted, (2) action by the other party on the faith of such admission, statement, or act, and (3) injury to such other party resulting from allowing the first party to contradict or repudiate such admission, statement, or act. Harbor Air Service, Inc. v. Board of Tax Appeals, 88 Wn.2d 359, 366-67 (1977).

In Sponburgh, the court found the liquor control board's actions were arbitrary and capricious in reversing a prior decision without legal justification. The court found the board had acted within its authority and with all material facts before it when if first acted. Likewise, in Shafer v. State, supra, the evidence indicated that state employees were also aware of the facts relating to the accident at issue. In the present case, the evidence is not as clear that all material facts were before the Department employees who allegedly advised the taxpayer to report his income under the Service category.

The Department's position is that oral instructions or interpretations by employees of the Department are not binding. See ETB 419.32.99. Ordinarily, the state may not be estopped from collecting taxes due it because of a mistake or oversight by one of its employees. See Kitsap-Mason Dairymen's Assoc. v. Tax Commission, 77 Wn.2d 812, 818 (1970).

Kitsap was not a case in which auditors changed their interpretation of a statute or a rule, but one in which they overlooked through "ignorance, neglect, or inadvertence," Kitsap's error in computing its tax liability. The fact that the oversight was not discovered earlier did not relieve Kitsap of its liability for the correct tax during the audit that was at issue. 77 Wn.2d at 818.

In the present case, it is not clear that the Department employees did not change their interpretation of Rule 218 and the applicable statutes relating to the taxpayer's tax obligation. The taxpayer's application for registration was

filled out by a Department employee. It is reasonable to assume that employee discussed the taxpayer's business activity and concluded his income was taxable as a professional advertising service--as he alleges was done. Also, when the auditor made a field investigation in 1981, it was specifically to determine if the taxpayer had made any retail sales other than the one to the school district. The auditor's statement that the taxpayer's records did not show that the taxpayer had made any other retail sales indicates the records were examined and discussed. We have no reason to doubt the taxpayer's statement that his business activity was the same then as it is today.

Furthermore, no evidence has been presented refuting the taxpayer's statement that he did not know he should be collecting retail sales tax. The evidence submitted to the Department in 1980 regarding the taxpayer's sale to the school district was a letter to the Department from the school facilities accountant which stated a contract had been entered into between the taxpayer and a named school district for a work of art. The letter indicated final payment had been made in May of 1980 and stated, "The following reflects all payments, including Washington State Sales Tax, made to the artist for the above mentioned art object:"

	Date of Payment	Amount For Art Work	WSST	Total
Single Payment	5/6/80	$452.38	$22.62	$475.00

One could conclude that letter suggests the contract was for $475 and the Superintendent's office broke the amount down into a purchase price and sales tax.

Also, there is evidence that the taxpayer sold some posters and signs and wrote "sales tax included" on the invoices. The taxpayer explained, however, that because he had been instructed to pay sales tax on the items he purchased and that he did not have to collect sales tax from his customers, he believed sales tax was "included" as part of the services he was providing.

If the facts are as alleged by the taxpayer, it is reasonable to conclude that he was led to believe by the Department that his income was subject to the service tax. He was entitled to rely upon statements made to him by responsible Department

officials, acting within the scope of their authority, which he did to his detriment.

In view of the cumulative effect of the information given to the taxpayer at the time of registration and of the previous field investigation of the taxpayer's business activity, we believe the taxpayer should be granted the benefit of any doubts which might possibly be raised under the rationale of Harbor Air Service, supra.

DECISION AND DISPOSITION:

The taxpayer's petition is granted. Assessment No. . . . shall be cancelled. The taxpayer's income from sales of paper signs and other finished products, as discussed herein, shall be subject to the retail or wholesaling business tax and retail sales tax as of Novemberá1, 1985.[1] The sales tax shall be separately stated from the purchase price, unless the taxpayer advertises the price as including the tax in the exact manner as provided in RCW 82.08.055.

DATED this 27th day of August 1986.

[1] Although we agree that the Department is estopped from collecting the retail business tax and retail sales tax from the taxpayer/seller for the periods prior to November 1, 1985, that does not preclude the Department from assessing deferred sales tax/use tax against the purchasers of the taxpayer's products. RCW 82.08.050. If the taxpayer has been able to collect any of the sales tax from the sales at issue, the tax should be remitted to the state. Those purchasers would not be liable for any additional sales or use tax on items on which the sales tax has been paid.