BEFORE THE BOARD OF TAX APPEALS
STATE OF WASHINGTON

PROFESSIONAL PROMOTION SERVICES, INC.,	)	
Appellant,	)	Docket No. 36912
v.	)	Re: Excise Tax Appeal
STATE OF WASHINGTON DEPARTMENT OF REVENUE,	)	FINAL DECISION
Respondent.	)	

This matter came before the Board of Tax Appeals (Board) for an informal hearing on December 13, 1989, and December 28, 1989. The hearing follows the Department of Revenue's determination holding Appellant liable for business and occupation (B&O) tax and use tax arising out of its business operations. Robert Bisordi, President, represented Appellant, Professional Promotion Services, Inc. (PPS). Marguerite M. Bauer, Administrative Law Judge, represented Respondent, Department of Revenue (Department).

FINDINGS OF FACT

PPS is a small advertising agency which specializes in direct mail advertising promotions for automobile dealers nationwide. It designs, writes, and coordinates the printing and mailing of advertising circulars to be sent to potential customers of its clients. An auto dealer will contract with PPS to reach a defined type of potential customer by direct mail. PPS designs the advertising material and contracts with a printer to produce it. PPS then contracts with a mailing bureau to stuff and seal the material and deliver it to the U.S. Postal Service for mailing. The printing is done in Oregon; the mailing is done both in-state and out-of-state. PPS requires a down payment to cover the cost of postage before beginning work on the project. PPS bills the auto dealer for the remainder of the project after the materials have been mailed.

During the time period at issue (February 1, 1984, through September 30, 1987), PPS brought the printed material into this state for examination and proofreading before giving it to the mailing bureau. Before and after the audit

period, PPS sent a representative to Oregon to examine the printed material.

PPS adopted the practice of in-state examination of the printed materials after making a telephone inquiry to the Department. Mr. Bisordi asserts that he was told by a Department representative that PPS would not incur any use tax liability on advertising materials brought into Washington merely for examination and proofreading. Mr. Bisordi does not recall the name of the Department employee with whom he spoke. Mr. Bisordi also inquired about the B&O tax treatment of "advances" received from clients for postage. He asserts that a Department employee told him that these funds were exempt from the B&O tax pursuant to WAC 458-20-144 and 458-20-141, which exclude payments for postage from the measure of the B&O tax for printers and mailing bureaus, respectively. Again, Mr. Bisordi did not recall the name of the Department employee with whom he spoke.

The Department audited PPS for the period February 1, 1984, through September 30, 1987. It concluded that PPS was an advertising agency. It assessed use tax on the printed material brought into the state for examination by PPS prior to being mailed to out-of-state addresses.[1] It also assessed B&O tax under the "service and other" category (RCW 82.04.290) on the gross income received by PPS as payment for postage. The assessment was sustained by the Department's Interpretation and Appeals Division. This appeal followed.

ANALYSIS AND CONCLUSIONS

This appeal involves two issues:

(1) Is an advertising agency liable for B&O tax on funds received from clients, where the funds are intended to cover postage for mailing advertising materials to the public, the postage is separately stated on the billing invoice, and the agency charges no "markup" on the postage costs?

(2) Is the Department estopped from assessing tax when a taxpayer claims to have received oral advice from an unidentified Department employee, which alleged advice is later repudiated by the Department?

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[1] PPS reported and paid use tax on the printed material sent to in-state addresses.

Issue No. 1. Postage advances. As a general rule, gross income received by a person is subject to B&O taxation unless exempted or excluded by specific statutory exemption. No deductions are allowed on account of labor, materials, or any other expense of doing business. RCW 82.04.080. Historically, however, the Department has by rule excluded from the concept of "gross income" receipts which constitute advances or reimbursements of costs incurred by one person on behalf of another.

There is a fine distinction at the margin between an "advance" to cover costs and payment to recoup an "expense" (which is not deductible). For example, a law firm may exclude from its gross income amounts received from clients as reimbursement for the costs of a court reporter, because the client remains ultimately liable for these costs. Separate billing is not the determining factor for these costs. Walthew v. Department of Revenue, 103 Wn.2d 183, 691 P.2d 559 (1984). The distinction is sometimes referred to by the terms "pass-through" costs versus "overhead" costs. See Walthew, supra at 188-89.

The Department's rule excluding true advances and reimbursements from the measure of the B&O tax, WAC 458-20-111 (Rule 111) provides in pertinent part:

> The word "advance" as used herein, means money or credits received by a taxpayer from a customer or client with which the taxpayer is to pay costs or fees for the customer or client.
> The word "reimbursement" as used herein, means money or credits received from a customer or client to repay the taxpayer for money or credits expended by the taxpayer in payment of costs or fees for the client.
> The words "advance" and "reimbursement" apply only when the customer or client alone is liable for the payment of the fees or costs and when the taxpayer making the payment has no personal liability therefor, either primarily or second-arily, other than as agent for the customer or client.
> There may be excluded from the measure of tax amounts representing money or credit received by a taxpayer as reimbursement of an advance in accordance with the regular and usual custom of his business or profession.
> The foregoing is limited to cases wherein the taxpayer, as an incident to the business, undertakes, on behalf of the customer, guest or client, the payment of money, either upon an obligation

> owing by the customer, guest or client to a third person, or in procuring a service for the customer, guest or client which the taxpayer does not or cannot render and for which no liability attaches to the taxpayer. It does not apply to cases where the customer, guest or client makes advances to the taxpayer upon services to be rendered by the taxpayer or upon goods to be purchased by the taxpayer in carrying on the business in which the taxpayer engages.

(Emphasis added.)

Thus, for there to be an "advance" or "reimbursement" excludable from the measure of the tax, the payments received by the taxpayer must (1) be made as part of the regular and usual custom of the taxpayer's business or profession, (2) must be services to the customer which the taxpayer does not or cannot render, and (3) the taxpayer must not be personally liable for paying the customer's fees or costs, either primarily or secondarily, except as agent for its customer. Rho Company v. Department of Revenue, 113 Wn.2d 561, 567-68 __P.2d__ (1989), and cases cited therein.

The Department concedes that PPS meets the first two prongs of the three-prong test, above. We therefore focus our attention on the third prong -- liability only as agent of the client. PPS argues:

(1) Its clients clearly understood from the face of the invoice that they were responsible for paying postage on their own mailings;

(2) The payments from the clients were a straight "pass-through" from which PPS derived no benefit, such as by "marking up" the postage; and

(3) PPS's payment of the postage was a mere convenience to its clients.

The evidence indicates that PPS usually obtained payment for postage prior to commencing work on a project. The invoice always identified the payment as an advance for postage. Thus, there is no doubt that its clients knew that the payment was to cover the cost of postage. Knowledge of the client is not the test, however. The test is whether the provider of the service (in this case, the U.S. Postal Service) knew that the client was solely liable for the postage, and that PPS had no liability, either primarily or secondarily, other than as agent for the client.

The evidence presented by PPS concerning the U.S. Postal Service's knowledge (or position) was scant. Apparently, the Postal Service on several occasions refused to accept an out-of-state client's check for postage, requiring instead that PPS tender a check on its own account. On other occasions, the Postal Service would accept an out-of-state client's check. For the most part, however, the issue did not arise because PPS paid the postage from its own accounts. In the absence of any showing by PPS that the Postal Service would not consider PPS personally liable for postage, we are constrained to find that PPS has a liability for postage greater than that of a mere agent for its clients.

The evidence concerning PPS's handling of the payments from clients shows that PPS never made a profit on postage. Indeed, PPS's practice was to refund (or credit) the client with amounts paid in excess of the ultimate postage charge. On occasions when the postage payment turned out to be insufficient, PPS would "make up the difference" from its own accounts. Thus, PPS treated the postage payment as a "pass-through" in the sense that it billed the customer only for the actual cost of the service. Again, however, that is not the test. Many businesses bill customers for only the actual cost of providing some segments of the service (e.g., a lawyer billing a client for the actual cost of the lawyer's airplane ticket to argue a case in the U.S. Supreme Court). If the test were whether the taxpayer made a profit on the service contracted for, the B&O tax would be converted into little more than a net income tax.

PPS also argues that because printers and mailing bureaus are able to exclude payments for postage from the measure of their gross income, it should be permitted to do so also. PPS points out that if it endorsed the client's check for postage over to the mailing bureau, for example, the mailing bureau would be able to exclude the amount from its gross income. WAC 458-20-141. PPS can see no distinction in either principle or logic between itself and a mailing bureau which would justify differing B&O tax treatment.

The Board recognizes that the Department's administrative regulations provide an exclusion from gross income for postage payments made to printers (WAC 458-20-144) and mailing bureaus (WAC 458-20-141). Although the origin of these rules is not clear, one major difference between advertising agencies on the one hand, and printers and mailing bureaus on the other, is that the services of the latter two businesses are subject to the retail sales tax,

whereas the services of advertising agencies generally are not. More importantly, however, PPS is an advertising agency, not a printer or mailing bureau. PPS has contracted with its clients to deliver advertising material into the hands of its client's potential customers. PPS is not "selling" the advertising material to its clients, who then are responsible for delivery to potential customers. Rather, PPS is purchasing postal services as part of the business in which it -- and not mailing bureaus or printers -- engages.

For these reasons, we conclude that PPS is liable for B&O tax in respect to funds received from clients, even though the funds are intended to cover the cost of postage, are separately stated on the invoice, and no markup is charged.[2]

Issue No. 2. Estoppel. Estoppel consists of three elements: (1) a statement inconsistent with a claim later asserted, (2) action by the other party in reliance on such statement, and (3) injury to such other party resulting from allowing the first party to repudiate the statement. Harbor Air Service, Inc. v. Board of Tax Appeals, 88 Wn.2d 359, 560 P.2d 1145 (1977); Department of Revenue v. Martin Air Conditioning, 35 Wn. App. 678, 668 P.2d 1286 (1983). Estoppel will not lightly be invoked against the state to deprive it of the power to collect taxes. Wasem's, Inc. v. State, 63 Wn.2d 67, 385 P.2d 530 (1963).

Mr. Bisordi, the president of PPS, testified that he inquired by telephone of the Department whether PPS could bring printed advertising materials into this state for examination prior to mailing to out-of-state customers. When told he could do so without incurring use tax liability, he changed his practice of going to Oregon to examine the materials. PPS argues that the Department is now estopped from repudiating its earlier advice.

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[2] We take notice of the minority opinion concerning the Department's policy ruling that printers and mailing bureaus act solely in an agent capacity when dealing with the U.S. Postal Service. There may be convincing evidence that the Postal Service would not consider those businesses personally liable for postage. The question of whether the Postal Service considers the clients of those businesses liable was not argued before this Board. We must review the taxpayer's procedures in light of the evidence presented here, existing statutes, and judicial precedents. Having done so, we find, as noted above, that PPS is liable for B&O tax.

The Department argues that it cannot be estopped where the claimed misinformation resulted from telephone consultations or personal consultations with Department employees. Only where the Department gives written instructions will it consider itself to be bound. The Department's reasoning is set forth in Excise Tax Bulletin 419.32.99 (ETB 419) as follows:

> (1) There is no record of the facts which might have been presented to the agent for his consideration.
> (2) There is no record of instructions or information imparted by the agent, which may have been erroneous or incomplete.
> (3) There is no evidence that such instruc-tions were completely understood or followed by the taxpayer.

The Department's position focuses on the standard of proof which must be met before estoppel will be applied. In effect, the Department argues that the first element of estoppel -- a statement inconsistent with a claim later asserted -- must be proven by evidence greater than the testimony of the allegedly wronged taxpayer as to his or her recollection of a conversation with a Department employee. We agree. Estoppel is not lightly invoked against the tax administration agency to prevent it from collecting revenues and carrying out legislative policy. Wasem's, Inc., supra. This caution counsels a higher quality of evidence than mere unsupported assertions. The factors listed in ETB 419, above, are important considerations in administering the tax system fairly and efficiently. Without some objective evidence of actual statements, the Department, this Board, and the courts have no way of evaluating the claim of inconsistent statements or inaccurate and misleading information being imparted to a taxpayer. Questions of tax liability are frequently complicated and often turn on nuances of fact or law not immediately apparent to the taxpayer or the Department. For these reasons, this Board has uniformly refused to apply estoppel where the alleged misinformation was imparted in oral conversations between the taxpayer and a Department employee. See, e.g., Poldervart v. Department of Revenue, BTA Docket No. 844 (1970); Walsh Construction Co. v. Department of Revenue, BTA Docket No. 83-22 (1984).

In this case, Mr. Bisordi could not recall the exact conversation, nor could he recall the name of the Department employee he talked with in 1984. PPS did call as a witness Mr. Richard Dittrich, a veteran Department employee specializing in providing taxpayer information. Mr. Dittrich was

unable to recall a conversation Mr. Bisordi claimed he had with him in 1987, concerning advice on the issue of postage. Mr. Dittrich did confirm, however, that Mr. Bisordi had made a written inquiry to the Department during the course of the audit which is the subject of this appeal. That inquiry was referred to the employees conducting the audit, pursuant to long-standing Department policy. Ultimately, Mr. Dittrich was not helpful in proving that Mr. Bisordi, more likely than not, received inaccurate information in 1984.

For the foregoing reasons, we conclude that PPS has failed to prove that the Department provided it with inaccurate advice after being made aware of all facts and circumstances bearing upon its tax liability. Therefore, PPS's claim of estoppel must be denied.

DECISION

Determination No. 89-171, issued by the Department of Revenue on March 24, 1989, is affirmed. The taxpayer's appeal is denied.

DATED this _____ day of _____, 1990.

BOARD OF TAX APPEALS

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LUCILLE CARLSON, Chair

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RICHARD A. VIRANT, Vice Chair

See Partial Dissenting Opinion
MATTHEW J. COYLE, Member

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A timely Petition for Reconsideration may be filed to this Final Decision within ten days pursuant to WAC 456-10-755, a copy of which was provided to you earlier either on form BTA300, Your Right To An Appeal, or form BTA305, Answering The Assessor's Notice Of Appeal.

Partial Dissenting Opinion:

I concur in the Board's resolution of the estoppel issue. It is in accordance with well established legal precedent. I cannot concur, however, with the Board's resolution of the postage advance issue. If the Department permits printers and mailing bureaus to exclude postage advances from their gross income, direct mail advertising agencies should be allowed to do so also.

The Board correctly focuses on the language of Rule 111 as the starting point of its analysis. The exclusion of "advances" and "reimbursements" has historically been permitted by Department regulation. Only recently, in Walthew v. Department of Revenue, 103 Wn.2d 183, 691 P.2d 559 (1984), has the State Supreme Court considered and articulated a statutory basis for the exclusion. That statutory basis is found in the language of RCW 82.04.080 and .090, which, according to the court, evidences a legislative "intent to tax only gross income which is `compensation for the rendition of services' (RCW 82.04.080) or `consideration . . . actually received or accrued' (RCW 82.04.090)." Walthew, supra at 188.

Rule 111 excludes advances and reimbursements which constitute mere "pass-throughs"; that is, where the taxpayer's liability to the third party provider is solely as agent of the taxpayer's client. The Rule provides:

> The words "advance" and "reimbursement" apply only when the customer or client alone is liable for the payment of the fees or costs and when the taxpayer making the payment has no personal liability therefor, either primarily or second-arily, other than as agent for the customer or client.

By focusing on the nature of the taxpayer's liability to the third party provider of services, Rule 111 attempts to establish a "bright-line" test for distinguishing between true advances and reimbursements on the one hand, and ordinary business expenses of the taxpayer on the other. However, the line is not always easily determined. Pure agency liability is sometimes an amorphous concept. For example, in Walthew, supra, the court had no trouble in labeling as "advances and reimbursements" payments made by a law firm to court reporters and expert witnesses for litigation support services. The court found that because the Disciplinary Rules of the Code of Professional Responsibility

(now the Rules of Professional Conduct) prohibit a lawyer from advancing the costs of litigation unless a client remains ultimately liable for those costs, the law firm's liability to third party litigation service providers was solely that of its client's agent. That is to say that the law firm had no liability to the litigation service providers, either primarily or secondarily. In a very recent case, however, the Court of Appeals found that it was the custom of law firms in King County to guarantee payment of an expert witness' fees, and that expert witnesses customarily look to attorneys for payment of their fees. Copp v. Breskin, 56 Wn. App. 229, __P.2d__ (1989). Under those circumstances, and in light of the fact that the law firm actually advanced the expert witness a part of his fees, the court held that the law firm was personally liable -- along with the client -- to the expert witness.

Similarly, in this appeal, the "bright line" is not easily determined. The Board properly casts the burden of proof on PPS to show that it is liable only as an agent of its client for payment of postage. In other words, if for some reason the U.S. Postal Service performed its mailing services prior to being paid, would or could the Postal Service look to PPS for payment of postage in the event PPS's client failed to pay its bill? PPS failed to demonstrate that its liability was solely that of an agent. This is not surprising, given that the Postal Service normally does not do business "on account".

However, I submit that the Department has already ruled as a matter of policy -- if not law -- that persons in PPS's position act solely in an agency capacity when dealing with the U.S. Postal Service. This conclusion stems directly from the Department's Rules 141 (WAC 458-20-141) and 144 (WAC 458-20-144), which exempt postage advances or reimbursements paid to mailing bureaus and printers, respectively.

Why does the Department consider postage payments to be excludable from the gross income of printers and mailing bureaus? It can only be because the Department considers such payments to be advances or reimbursements.[3] If they

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[3]F The Department's representatives were unable to articulate a valid reason for the treatment of postage in the case of printers and mailing bureaus. The one reason advanced -- that printers' and mailing bureaus' services are subject to retail sales tax -- does not seem to be a valid reason for the Department to exclude, sua sponte, such payments from the

are advances or reimbursements for printers and mailing bureaus, they should be advances and reimbursements for advertising agencies as well. Fairness, equity, and principled administration of this state's tax system demand such a result.

The failure of PPS to demonstrate that it is acting solely in an agency capacity when handling postage advances should not doom its claim of exemption. I can understand the Department's reluctance to "open the door" to claims of "pass-through" deductions by a legion of businesses. But the door has already been opened -- at least as to postage -- by the Department. I can see no logical reason for closing it in PPS's face. Accordingly, I respectfully dissent.

MATTHEW J. COYLE, Member

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measure of the B&O tax. (cf. WAC 458-20-247, which excludes the value of a trade-in from the measure of the retail sales tax, but not from the measure of the retailing B&O tax.) The Department's representatives conceded that one logical explanation for the tax treatment of printers and mailing bureaus could be that the Department considers such payments to be advances or reimbursements. In the absence of any other explanation, I conclude that such is actually the case.