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BEFORE THE APPEALS DIVISION
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. 01-124
. . .	)	
	)	Registration No. . . .
	)	FY. . . /Audit No. . . .
	)	Docket No. . . .

[1] RULE 143: PRINTING AND PUBLISHING – REQUIREMENT TO PUBLISH. A prerequisite for applying Rule 143 to a taxpayer's activities is the publication of printed material. Publish means to distribute to the public. Thus, if a taxpayer does not publish printed material, Rule 143 does not apply to the taxpayer's activities.

[2] RULE 218: ADVERTISING AGENCY. A print advertising agency is subject to the business and occupation tax under the service and other activities classification.

[3] RULE 218: ADVERTISING AGENCY – MEASURE OF TAX. When an advertising agency charges its client a single fee for advertising services and amounts attributable to tangible personal property, the entire fee is subject to the service and other activities business and occupation tax classification.

[4] RULE 155: ADVERTISING AGENCY – ADVERTISING TEMPLATES – MEDIUM DELIVERED. When an advertising agency "burns" its advertising templates to a compact disc and transfers the compact disc to its client, the advertising agency is selling its advertising services not tangible personal property. The compact disc is just the medium through which the advertising agency delivers its services. Rule 155, concerning computer software, does not apply to transfer of the compact discs.

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.

NATURE OF ACTION:

An advertising design company protests the assessment of "printing and publishing" and "service and other activities" business and occupation tax on its gross receipts from sales of advertising materials.[1]

FACTS:

Coffman, A.L.J. -- The taxpayer's books and records were reviewed by the Department of Revenue's (Department) Audit Division for the period January 1, 1990 through December 31, 1993 ("First Audit"). The Audit Division found that the taxpayer had misreported its income under the wholesaling business and occupation (B&O) tax classification and reclassified the income to the "service and other activities"[2] classification. The taxpayer reported its income under the service B&O tax classification during the period January 1, 1996 through December 31, 1999. The Audit Division reviewed the taxpayer's books and records for the latter period and determined that the proper B&O tax classification was printing and publishing for a major portion of the taxpayer's activities.[3] The taxpayer filed a timely appeal of the resulting tax assessment.

The taxpayer has an arrangement with a furniture manufacturer (Manufacturer). The taxpayer creates templates for advertising circulars for the Manufacturer's products. The advertising circulars are designed for inclusion as advertising in a newspaper or use as a direct mailer. The Manufacturer provides the taxpayer with photos and descriptions of its products, which the taxpayer uses in creating the templates. The Manufacturer approves the templates before they are offered to retailers. The Manufacturer's sales representatives provide their customers with order forms for the advertising circulars.

The templates come in two sizes -- 4 pages and 8 pages. The templates include the pictures and product descriptions provided by the Manufacturer, banners (e.g., "President's Day Sale"), and spaces for prices and other variables. If a retailer of the Manufacturer's products orders advertising circulars, the taxpayer will add the retailer's logo, prices, times, dates, and location to the template. The customized template is then forwarded (as a computer file) to an out-of-state printer.[4] The printer prints the advertising circular and ships the completed circular to the newspaper for insertion in that publication. Sometimes copies are also shipped directly to the retailer.

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[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410. Nonprecedential portions of this determination have been deleted.

[2] During the period July 1, 1993 through June 30, 1998, some services [now classified as "service and other activities for B&O tax purposes] were classified as "selected business services." . . . [F]or the purposes of this determination, we will use the term "service B&O tax" to refer to both classifications, unless a distinction is necessary.

[3] The taxpayer has reported its income under printing and publishing according to the instructions included in the most recent audit report.

[4] The actual printer used depends on the location of the retailer.

While this arrangement has been in effect for a period of years, no compensation is exchanged between the taxpayer and the Manufacturer. The retailer pays the taxpayer, with the price dependent upon the quantity of circulars ordered. The printer bills the taxpayer for its printing services.

Additionally, the taxpayer will customize the template for a retailer and then "burn" the final product to a compact disc (CD). The CD is sold for a fixed price. The retailer then takes the CD directly to a newspaper to print the advertising circulars. During the audit period, the taxpayer contracted with a third party to "burn" the CDs. Also, the taxpayer acquired a CD burner during the audit period and "burned" a few CDs (less than a dozen) for sale using its own CD burner.

Most of the retailers are located outside of the state of Washington.

ISSUES:

1. What is the proper B&O tax classification for the taxpayer's services related to the advertising circular templates?
2. What is the proper B&O tax classification of the sale of CDs?
3. If the sale of the CDs is a retail activity, is the taxpayer a manufacturer and does the CD burner qualify for the manufacturing equipment exemption from the use tax?

POSITIONS OF THE DEPARTMENT AND THE TAXPAYER:

The Audit Division argues the taxpayer is engaged in printing and publishing as defined in RCW 82.04.280(1) and WAC 458-20-143 (Rule 143) and -144 (Rule 144) when it sells advertising circulars to retailers. The taxpayer claims the sales are retail sales and, to the extent that the advertising circulars are delivered to newspapers and retailers outside of the state, the sales are exempt from the B&O tax. See, WAC 458-20-193.

The Audit Division argues that the sale of CDs is an advertising service subject to the B&O tax under the Service classification. Further, the Audit Division argues that because the taxpayer uses the CDs in accomplishing its Service activities, the taxpayer owes use tax on the value of the CDs. The taxpayer argues that CDs are comparable to "canned software" and therefore the sales are retail sales. Further, the taxpayer argues because the CDs are manufactured, the taxpayer should have reported the income from the sale of the CDs under the manufacturing B&O tax classification. Thus the taxpayer claims it is a manufacturer and, therefore, the CD burner is exempt from retail sales tax and use tax under RCW 82.08.02565 and 82.12.02565.

DISCUSSION:

1. Advertising Circulars.

RCW 82.04.280(1) states: "Upon every person engaging in this state in the business of: (1) Printing, and of publishing newspapers, periodicals, or magazines: . . . the amount of tax on such business shall be equal to the gross income of the business multiplied by the rate of 0.484 percent." Both the taxpayer and the Audit Division rely on Rule 143, which addresses the printing and publishing B&O tax classification and states:

> Publishers of newspapers, magazines and periodicals are taxable under the printing and publishing classification upon the gross income derived from the publishing business.
>
> Persons who both print and publish books, music, circulars, etc., or any other item, are likewise taxable under the printing and publishing classification. However, persons, other than publishers of newspapers, magazines or periodicals, who publish such things and do not print the same, are taxable under either the wholesaling or retailing classification, measured by gross sales, and taxable under the service classification, measured by the gross income received from advertising.

The taxpayer is not a publisher of a newspaper, magazine, or periodical. But the Audit Division argues the taxpayer engages in activities "much like the newspaper industry."[5] The Audit Division then argues because newspapers are subject to the B&O tax under printing and publishing, the taxpayer is similarly taxable.

The taxpayer relies on Rule 143's statement: "However, persons, other than publishers of newspapers, magazines or periodicals, who publish such things and do not print the same, are taxable under either the wholesaling or retailing classification, measured by gross sales, and taxable under the service classification, measured by the gross income received from advertising."

[1] Both the taxpayer and the Audit Division misconstrue Rule 143. Rule 143 only applies to persons who publish items. Therefore, a prerequisite for applying Rule 143 is the publication of the advertising circular. The term "publish" means "To distribute copies (of a work) to the public." Black's Law Dictionary 1246 (7th ed. 1999). The taxpayer [is not responsible for publishing or distributing] anything. The newspapers publish the advertising circular at the request of the retailer.

[2] We have reviewed the audit report for the First Audit. In that audit, the Audit Division correctly found the taxpayer was engaged in the business as a "print advertising agency." As such, the taxpayer's B&O tax obligation is under the service B&O tax classification. See WAC 458-20-218 (Rule 218). Rule 218 addresses the B&O tax obligations of advertising agencies and provides:

[5] Informal Conference -- March 15, 2000 -- Field Audit Manager's Comments.

> The gross income received for advertising services, including commissions or discounts received upon articles purchased as agents in behalf of clients, is taxable under the service and other business activities classification. (See WAC 458-20-144 for discounts or commissions allowed by printers.) Included in this classification are amounts attributable to sales of tangible personal property, unless charges for such articles are separately stated in billings rendered to clients.
>
> The retailing or wholesaling classification applies to articles of tangible personal property sold to persons for whom no advertising service is rendered and also to charges to clients for such articles if separately stated from charges for advertising services in billings rendered.
>
> The manufacturing classification applies to articles manufactured for sale or commercial or industrial use (see WAC 458-20-134), and also to interstate sales of manufactured articles separately stated from advertising services. (General principles covering sales or services to persons in other states are contained in WAC 458-20-193.)

(Emphasis added.)

[3] The taxpayer charges the retailers a single fee for its advertising services and the advertising circulars. While the charge for the tangible personal property is included in the single charge, the taxpayer has not separately stated the charge for the tangible personal property (advertising circulars). In order to separately state the charge for tangible personal property, the taxpayer must separately state the charge for its other services. Therefore, the entire fee is subject to service B&O tax.

However, the Auditor's Detail of Differences and Instructions to Taxpayers from the First Audit states:

> In the course of the audit it was determined that [the taxpayer] is acting as an agent for its clients in contracting with printers. These costs can be deducted from your gross income as advancements and reimbursements [WAC 458-20-111], before determining your business and occupation tax liability.

(Bracketed material added.) The taxpayer's activities and method of doing business has not changed since this instruction was given. Taxpayers have "the right to rely on specific, official written advice and written tax reporting instructions from the department of revenue to that taxpayer." RCW 82.32A.020(2). The taxpayer relied on this instruction from the Department and now is faced with an additional tax assessment. Thus, we find the taxpayer detrimentally relied on the instruction and the appropriate remedy is to allow the audit period, the reporting directed by the First Audit report.

[Generally, advertising agencies are not entitled to the WAC 458-20-111 (Rule 111, ...) exclusion for advances and reimbursements. See Rule 218. The taxpayer is specifically instructed that, effective October 1, 2001, it may not continue to rely on the First Audit to claim

entitlement to the Rule 111 exclusion. Any future entitlement to the Rule 111 exclusion must be based on Rule 111 and the taxpayer's activities.]

2. CDs.

During the audit period the taxpayer reported its income from the sale of CDs under the service B&O tax classification. The taxpayer took a deduction for the amount it paid its supplier for "burning" the CDs. The Audit Division treated the income as correctly reported, but denied the deduction. The taxpayer now claims the sales are retail sales and to the extent that the CDs are delivered to out of state retailers, the taxpayer is entitled to the interstate sales deduction from the measure of the tax. The taxpayer claims that the CDs it provides to retailers are comparable to "canned software." See WAC 458-20-155, RCW 82.04.215. Additionally, the taxpayer cites Rule 218 and ETA 308.04.224.

[4] The taxpayer's reliance on the canned software analogy is misplaced. The taxpayer is not manufacturing and selling computer programs. When the taxpayer delivers a CD to a retailer, it is providing the same advertising services it provides through the delivery of advertising circulars. The only difference is the medium through which it is delivered. Therefore, the taxpayer properly reported the income from the "sales of CDs" under the service B&O tax classification. . . .

Because the "sale of the CDs" is actually a service activity, the taxpayer is liable for the use tax on the blank CDs. See RCW 82.04.190(2)(a).

. . .

DECISION AND DISPOSITION:

The taxpayer's petition is granted in part and the file is remanded to the Audit Division for recalculation consistent with this determination.

Dated this 28th day of August, 2001.