Cite as Det. No. 05-0006E, 24 WTD 309 (2005)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment of	)	EXECUTIVE FINAL DETERMINATION
	)	
	)	No. 05-0006E
	)	
. . .	)	Registration No. . . .
	)	Document No. . . .
	)	Audit No. . . .
	)	Docket No. . . .

[1] RULE 185: TOBACCO PRODUCTS TAX – OUT-OF-STATE SALES – CREDIT FOR. A Washington-based internet tobacco products seller does not qualify for a credit against its tobacco products tax when its out-of-state sales are to consumers, as opposed to retailers.

[2] MISCELLANEOUS: TOBACCO PRODUCTS TAX -- INTERNET TAX FREEDOM ACT (ITFA) – APPLICABILITY OF. The tobacco products tax does not violate the ITFA because it is not a tax on internet access, nor does it impose a discriminatory burden on electronic commerce.

[3] MISCELLANEOUS – ESTOPPEL – WEBSITE – ORAL ADVICE. For a tax to be cancelled based on estoppel, the Department must have made a misrepresentation of a material fact upon which the taxpayer reasonably relied to its detriment. A taxpayer's reliance on a general statement on the Department's website does not provide a basis for estoppel. Unsupported, alleged conversations with departmental employees also do not provide a basis for estoppel.

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.

Dressel, A.L.J. – Internet [tobacco products] seller appeals the imposition of the tobacco products tax. Tax upheld. [1]

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

ISSUES:

1. Does a Washington [tobacco products] seller, selling via the internet to out-of-state customers, get a credit on such sales to offset the tobacco products tax?

2. Does the Internet Tax Freedom Act prohibit imposing the Washington tobacco products tax on the sale of [tobacco products] over the internet?

3. Is the Department stopped from collecting the tobacco products tax based on information contained on its website or based on oral information allegedly given by Department employees?

FACTS:

. . . (taxpayer) sells [tobacco products] on the internet. Its books and records were examined by the Department of Revenue (Department) for the period January 1, 1999 through December 31, 2002. As a result a tax assessment was issued for $ . . . . The taxpayer appeals the tobacco products tax, plus interest and penalties.

The taxpayer's president states that in 1998, when he first investigated his idea of getting into the internet [tobacco products] business, he visited the Department's website.[2] In an article about the tobacco products tax, he noticed, among other things that under the heading, "Exemptions, Deductions and Credits," was the phrase, "Credit for taxes paid on products that are subsequently shipped out of state." Following that, he spoke to Department employees . . . . He said that the employees with whom he spoke did not seem too knowledgeable about the tobacco products tax but did not disagree with his opinion that an out-of-state credit for that tax was available. He did not get the names of the employees or receive any advice in writing. From that point, the taxpayer concluded that he could take a deduction for the tobacco products tax on all sales wherein [tobacco products] were shipped by him to customers located outside Washington. He proceeded to do just that on the annual excise tax returns he filed with the Department.

When the Department audited the taxpayer's books, it disallowed the out-of-state deduction claimed for the tobacco products tax, and assessed the taxpayer $ . . . . The taxpayer states he was surprised. He had not built the tax into the charge he made to his out-of-state customers. The taxpayer claims the Department misled him to his great financial detriment. Besides the amount of the tax being excessive, he says that he quit a $ . . . a year job to get into this [tobacco products]-selling enterprise. Had he known that the 129 percent tobacco products tax was not deductible, he implies, he would not have left that previous position. He reasons that there is no way he could be competitive selling [tobacco products] over the internet when the tax on [tobacco products] asserted by other states is only about 18 percent.

[2] In that this business was, essentially, a one man operation, we will use the pronoun "he" when referring to both the taxpayer's president and the taxpayer LLC *per se*.

Some further background about the taxpayer's business is appropriate. He started it out of the basement of his home in 1998. He marketed his [tobacco products] primarily through yellow page advertising around the country. The taxpayer also had a website, ... Most customers ordered via the internet, although he had an 800 number, as well, through which he took telephone orders. The business did not make a profit until 2002. . . . . Over the years he has shipped [tobacco products] to about 40 countries and most of the American states. Orders were received at the taxpayer's home in . . . , Washington. He ordered the [tobacco products] from about 30 manufacturers and/or distributors, most of whom were located [outside Washington]. They shipped the [tobacco products] to the taxpayer in [Washington]. He repackaged them and then mailed them from his home base to customers around the world. Although he sold some product wholesale to a few small stores . . . , 98 percent of his sales were retail, *i.e.*, directly to consumers. Customers paid by credit card. Less than one percent of his [tobacco products] customers were from Washington. However, all [tobacco products] were first delivered to him in Washington.

In addition to arguing detrimental reliance, the taxpayer contends that the tobacco products tax is "unfair, unjust and inequitable." He goes on to say:

> In fact, at 129% it is not a tax at all . . . it is a death knell for any internet business. It is well know (sic) that due to extreme competition of the internet the average sale mark up is around 15-to-30%. How could any such business exist with a 129% tax? Unfortunately it is a fatal device that eventually even robs the state of revenue, for it kills the "fatted" tax cow. The fire that fed the American Revolution was fueled in part by outrageous taxes like this one. Over reaching and unjust taxes such as this spawn contempt for the levying institution and eventually a housecleaning of the arrogance underlying the handing down of oppressive taxes. To lay a punitive tax on the [tobacco products] industry, as for the cigarette industry, demonstrates both unfairness and ineptness on the department's part. . . .

In addition, the taxpayer cites the "Internet Tax Ban," which, he says Congress passed in 1998. Regarding it, he states, "A key point of this bill is that states should not attempt to pass legislation that diminishes the protection afford[ed] the new internet industry by this bill." He enclosed a news item about the bill from the website of U.S. Representative Christopher Cox of Orange County, California.

There, it says H.R. 1552, the Internet Tax Non-Discrimination Act, was signed into law by President George W. Bush on November 28, 2001. The article states that "the new law extends through November 1, 2003 the moratorium on new, special, and discriminatory Internet taxes that was originally enacted in 1998 and also authored by Chairman Cox."

The tobacco products tax is infirm, as well, says the taxpayer because potentially more than one tax could be owed on the same [tobacco products]. He argues that not only would he have to pay tobacco products tax, but also out-of-state consumers would owe use tax on the [tobacco products] to their state taxing authorities. This would amount, he suggests, to unconstitutional

double taxation. The taxpayer contends, as well, that Initiative 773 (I-773) which caused the tobacco products tax rate to go up to 129 percent is unconstitutional.

Finally, related to estoppel and detrimental reliance, the taxpayer states that before the audit he filed annual tax returns for 1998, 1999, and 2000. Several times the Department wrote him back saying he owed small amounts, under $100. The Department, though, said nothing about the deduction he claimed on those returns for out-of-state sales. He says to not question the deductions then but to do so now is a form of *ex post facto* taxing by the Department.

ANALYSIS:

Initially, we will address the issue of whether the taxpayer's sales of [tobacco products] to out-of-state customers are exempt of the tobacco products tax. The authority for this tax is found at RCW 82.26.020, which reads, in part:

> **Tax imposed--Additional taxes for general fund, health services account.**
>
> (1) There is levied and there shall be collected a tax upon the sale, use, consumption, handling, or distribution of all tobacco products in this state at the rate of forty-five percent[3] of the wholesale sales price of such tobacco products.
>
> (2) Taxes under this section shall be imposed at the time the distributor (a) brings, or causes to be brought, into this state from without the state tobacco products for sale . . . .

[Footnote added.] Distributor" is defined at RCW 82.26.010(3), thusly:

> (3) "Distributor" means (a) any person engaged in the business of selling tobacco products in this state who brings, or causes to be brought, into this state from without the state any tobacco products for sale, (b) any person who makes, manufactures, or fabricates tobacco products in this state for sale in this state, (c) any person engaged in the business of selling tobacco products without this state who ships or transports tobacco products to retailers in this state, to be sold by those retailers, (d) any person engaged in the business of selling tobacco products in this state who handles for sale any tobacco products that are within this state but upon which tax has not been imposed . . . .

[1] The taxpayer is a person engaged in the business of selling tobacco products, [tobacco products], in this state who brings tobacco products from without Washington to Washington for sale.[4] The taxpayer is, thus, a distributor. The tobacco products tax is imposed at the time a distributor brings tobacco products into the state for sale. RCW 82.26.020(2). Whether they are delivered in-state or out-of-state, all [tobacco products] sold by the taxpayer are first brought to

[3] Various surcharges and statutory amendments have elevated the effective rate of this tax to its current level of 129 percent. [Senate Bill 6097, Chapter 180, Laws of 2005, lowers the OTP tax rate .]
[4] The [tobacco products] are shipped directly to him at his home office in Washington.

the taxpayer's place of business in Washington. The tobacco products tax, therefore, is owed on all [tobacco products] sold by the taxpayer.

There does exist a statutory credit that may be applied against the tobacco products tax in certain circumstances. It is found at RCW 82.26.110, which reads:

> **When credit may be obtained for tax paid.** Where tobacco products upon which the tax imposed by this chapter has been reported and paid, are shipped or transported by the distributor to *retailers without the state*, to be sold by those retailers, or are returned to the manufacturer by the distributor or destroyed by the distributor, credit of such tax may be made to the distributor in accordance with regulations prescribed by the department of revenue. (Italics ours.)

The Department's regulation on tobacco products, WAC 458-20-185 (Rule 185), refers to this credit, where it states:

> (8) **Interstate sales and sales to U.S.**
>
> (a) The tax does not apply to tobacco products sold to federal government agencies, nor to deliveries to retailers outside the state for resale by such retailers, and a credit may be taken for the amount of tobacco products tax previously paid on such products. RCW 82.26.110. *The credit is not available for sales made for delivery outside this state other than sales for resale to retailers. For example, no credit may be taken for a sale of tobacco products delivered to a consumer outside the state.* (Italics ours.)

The taxpayer ships the great majority of his [tobacco products] out-of-state, but to consumers, not retailers. This credit and certainly the one referenced on the Department's website is for out-of-state sales by a distributor to a *retailer*. Because the taxpayer's customers, for the most part, were not retailers, the taxpayer is not eligible for the credit.[5]

On the first issue, the availability of the out-of-state credit, the taxpayer's petition is denied.

We will address some additional points raised by the taxpayer. Regarding his criticism of the rate of the tobacco products tax at 129 percent, we must remind the taxpayer of our role, which is to interpret the law, not to make it. If the taxpayer thinks the tobacco products tax rate is excessive, he should pursue any desired changes through the legislative process. That is the arm of government that makes the law. As an administrative agency and part of the executive branch of state government, we are only empowered to enforce the law, which includes the tobacco products tax.

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[5] For the few sales the taxpayer made to stores [outside Washington], we assume the credit of RCW 82.26.110 was allowed. If not, the taxpayer should contact the Department's Audit Division (Audit) with records of those sales. If they are adequate, Audit will adjust the [assessment].

The taxpayer contends that the Department is prohibited from assessing this tax by the "Internet Tax Ban," enacted by Congress as H.R. 1552. We believe the taxpayer is referring to the Internet Tax Freedom Act (ITFA), Pub.L. No. 105-277, § 1100, et. al., 112 Stat. 2681 (1998) (reproduced at note to 47 U.S.C. § 151 (e) (1998)). Section 1101 of the ITFA reads, in part:

> **"§ 1101. Moratorium**
>
> **"(a) Moratorium.**--No State or political subdivision thereof shall impose any of the following taxes during the period beginning on October 1, 1998, and ending on November 1, 2003--
>
> **"(1)** taxes on Internet access, unless such tax was generally imposed and actually enforced prior to October 1, 1998; and
>
> **"(2)** multiple or discriminatory taxes on electronic commerce.
>
> **"(b) Preservation of state and local taxing authority.**--Except as provided in this section, nothing in this title [this note] shall be construed to modify, impair, or supersede, or authorize the modification, impairment, or superseding of, any State or local law pertaining to taxation that is otherwise permissible by or under the Constitution of the United States or other Federal law and in effect on the date of enactment of this Act [Oct. 21, 1998].

[2] The Washington tobacco products tax is not a tax on internet access. Therefore, it is not a violation of ITFA § 1101 (a)(1). Neither is it a violation of § 1101 (a)(2), because it does not impose multiple or discriminatory taxes on electronic commerce. The trigger for this tax is the handling, in Washington, by a distributor, of tobacco products. The tax in the same amount applies whether the tobacco products are sold locally, whether they are sold to an in-state or out-of-state customer over the telephone, or whether they are sold to an in-state or out-of-state customer via the internet. Thus, there is no multiple or discriminatory tax on electronic commerce.

Without giving specifics, the taxpayer contends I-773 is unconstitutional and that the tobacco products tax is, as well, because it creates the risk of double taxation. We note that an administrative agency, of which we are a part, is not empowered to pass on the constitutionality of the law it administers. Only the courts have that power. *Bare v. Gorton*, 84 Wn.2d 380, 383, 526 P.2d 379 (1974). With respect to double taxation, its possibility is *not* prohibited by the due process clause of the U.S. Constitution. *Cohn v. Graves*, 300 U.S. 308, 314 (1937). In addition, there is no constitutional prohibition either of this state or the United States against double taxation as applied to excise taxes. *Klickitat County v. Jenner*, 15 Wn.2d 373, 383, 130 P.2d 880 (1942).

[3] Taxpayers are charged with the responsibility of knowing their tax reporting obligations and, when they are uncertain about them, to seek instructions from the Department. RCW 82.32A.030(2). According to his testimony, the taxpayer in the instant case did that. He did not, however, receive definitive, written instructions from the Department. A taxpayer has 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).

Besides the alleged reliance on the general information on the website, the taxpayer allegedly relied on oral information he received from Department employees. In essence, the taxpayer's claim is one of estoppel. Equitable estoppel is a doctrine in law that "rests upon the principle that, where a person wrongfully or negligently by his acts or representations causes another who has a right to rely upon such acts or representations to change his condition, to his detriment or prejudice, the person performing such acts or making such representations is precluded from pleading the falsity of his acts or representations for his own advantage, or from asserting a right which he otherwise might have had." *Bennett v. Grays Harbor County*, 15 Wn.2d 331, 341, 130 P.2d 1041 (1942). The Washington Supreme Court recently addressed the prerequisites for estoppel in *Department of Ecology v. Theodoratus*, 135 Wn. 2d 582, 599, 957 P.2d 1241 (1998). The court stated:

> To establish equitable estoppel requires proof of (1) an admission, statement or act inconsistent with a claim later asserted; (2) reasonable reliance on that admission, statement, or act by the other party; and (3) injury to the relying party if the court permits the first party to contradict or repudiate the admission, statement or act. *Berschauer/Phillips Constr. Co. v. Seattle Sch. Dist. No. 1*, 124 Wash. 2d 816, 831, 881 P.2d 986 (1994). Equitable estoppel against the government is not favored. *Kramarevcky v. Department of Social & Health Serv*., 122 Wash. 2d 738, 743, 863 P.2d 535 (1993). Therefore, when the doctrine is asserted against the government, equitable estoppel must be necessary to prevent a manifest injustice, and the exercise of government functions must not be impaired as a result of estoppel. *Id.*

The Department has adopted these guidelines for applying estoppel. *See* Det. No. 99-042, 19 WTD 784 (2000); Det. No. 93-300, 13 WTD 396 (1994). "The doctrine of estoppel will not be lightly invoked against the state to deprive it of the power to collect taxes. The state cannot be estopped by unauthorized acts, admissions or conduct of its officers." *Kitsap-Mason Dairymen v. Tax Commission*, 77 Wn.2d 812, 819, 467 P.2d 312 (1970). For tax to be waived based on estoppel, the Department's instructions must be incorrect, and a taxpayer's reliance upon them must be reasonable. Det. No. 99-6, 19 WTD 533, 540 (2000); s*ee also Liebergesell v. Evans*, 93 Wn.2d 881, 613 P.2d 1170 (1988); Det. No. 89-372, 8 WTD 115 (1989).

In the instant matter, according to the taxpayer's testimony, the Department's employees did not disagree with his opinion that the out-of-state income was deductible, but this is not a misstatement of a material fact. The taxpayer's reliance on the Department's alleged failure to disagree with oral statements by the taxpayer does not provide a basis for estoppel.

As to the telephone conversations with Department employees, ETA 419.32.99 controls. . . . For the reasons explained in this ETA, the Department is not estopped from asserting the disputed tax because of alleged oral statements made by Department employees. The Department's employees' oral responses were based on oral information the taxpayer provided and the oral questions the taxpayer asked. We simply do not know exactly what transpired in those conversations. This uncertainty is precisely the reason the Department is not bound by oral statements pertaining to a taxpayer's potential tax liability or responsibilities.

Regarding the taxpayer's suggestion that the Department implicitly approved of the out-of-state deductions he took on his early tax returns, *Kitsap-Mason Dairymen v. Tax Commission, supra*, applies, again. Reacting to a similar argument, the court said:

> This is not a case in which auditors changed their interpretation of a statute or rule. It is one in which they overlooked through ignorance, neglect or inadvertence (sic) Kitsap's error in computing the tax. The fact that the oversight only recently has been discovered does not relieve Kitsap of its liability for the correct tax during the audit period now under consideration.

The same rationale applies in the instant case, although the Department personnel receiving the taxpayer's early returns had even less reason to catch the erroneous deduction in that they were not conducting an audit of the taxpayer. Additionally, and as explained earlier in this decision, legitimate deductions are possible with the tobacco products tax. The Department's employees presumed that the taxpayer's deductions were legitimate.
They do not have the resources or the responsibility to question every deduction every time one is claimed. *See also* Det. No. 99-6, *supra;* Det. No. 89-482, 8 WTD 293 (1989); Det. No. 87-299, 4 WTD 97 (1987).

On the issue of estoppel, the taxpayer's petition is denied.

DECISION AND DISPOSITION:

The taxpayer's petition is denied.

Dated this 19th day of January 2005