Cite as 6 WTD 299 (1988)

BEFORE THE INTERPRETATION AND 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. 88-316
. . .)	Registration No. . . .
)	Tax Assessment No. . . .
)	

[1] **RULE 193A and RULE 136:** B&0 TAX -- LIABILITY -- RELIANCE ON PRIOR AUDIT. During the period of taxpayer's audit, Washington taxpayers who made and sold products out of state were taxable under the Manufacturing classification of the B&O tax for those sales and under the Wholesaling or Retailing classification for their in-state sales. Taxpayers are obligated to inform themselves of tax ramifications of their activities. Prior audit which missed asserting tax on taxpayer's out-of-state sales does not entitle taxpayer to rely on error and escape taxation on those activities in later years.

[2] **RULE 100:** APPEAL PROCEDURES. Department of Revenue is not required to hold a conference between the taxpayer and the auditor's supervisor prior to the issuance of an assessment. Taxpayer failed to show actual injury where conference occurred eight days after issuance of the assessment and where such conference resulted in adjustments to the assessment in taxpayer's favor.

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:

Taxpayer petitions for correction of assessment of manufacturing B&O tax asserted against its out-of-state sales.

FACTS AND ISSUES:

Johnson, A.L.J. (successor to Chandler, A.L.J.) -- Taxpayer is a producer of prepackaged computer software programs. Some of its products are sold to Washington customers who are either retailers

to end users or are themselves the end users. The remainder of its sales are to out-of-state customers. During an audit covering the period October 1, 1981, through June 30, 1985, tax was asserted against taxpayer's out-of-state sales, which had not been reported during that period. The auditor determined that income from those sales was reportable under the manufacturing B&O tax classification. Taxpayer contends that it should not be expected to report this income, because no tax was asserted against the income during a previous audit covering the period from January 1, 1978, through September 30, 1981. Additionally, taxpayer's petition contends that it was denied its deductions for bad debts. Finally, taxpayer complains that the assessment was issued on November 5, 1985, and that a conference with the audit supervisor did not occur until November 13, 1988. Its contention is that the Department approached the conference unwilling to consider taxpayer's arguments on its taxability.

In support of its argument, taxpayer submitted an affidavit from its accounting manager, who stated that she did not reach agreement with the auditor prior to the assessment. The auditor's file reports that agreement was substantially reached except as to reporting instructions for future returns.

DISCUSSION:

[1] At the present time and during the period of this audit, taxpayers who sold computer software were taxable under the Business and Occupation Tax upon the gross proceeds received from those activities. If the sale was to an out-of-state customer, the taxpayer reported its earnings under the manufacturing--other classification of the B&O tax. WACs 458-20-136, 458-20-155, 458-20-193A (Rules 136, 155, 193A), which have the same legal force and effect as the law itself. RCW 82.32.300. If the sale was to a Washington customer who resold the product, the income was reported by the taxpayer under the wholesaling classification; and no retail sales tax was collected if the purchaser produced a resale certificate. Rules 155 and 136. If the sale was to a Washington customer for his or her own use, the income was reported under the retailing B&O classification; and the seller was obligated to collect retail sales tax on the sale. Rules 155 and 136.[1]

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[1]RCW 82.04.440, governing the taxation of multiple activities by a single taxpayer, was amended effective August 12, 1987. The amendment changed the method of reporting income to equalize tax treatment of persons engaged in intrastate and interstate commerce; the amendment will affect this taxpayer, who should be reporting income under Rule 136 (manufacturing). WAC 458-20-19301 (Rule 19301) is the administrative regulation implementing the statute. This treatment is prospective and does not change

Taxpayer's complaint that a prior auditor's failure to assert tax against its out-of-state sales justifies its failure to properly report its income in later returns is without merit. It is the obligation of taxpayers in this state to correctly inform themselves of the tax consequences of their activities. This Department maintains a staff of qualified personnel to whom inquiries regarding such matters may be addressed, and information is freely available without charge. Had the taxpayer inquired, it would certainly have been advised that it was required to pay taxes on its out-of-state sales income. Rule 193A, relied upon by taxpayer in its petition, clearly stated that sales by the taxpayer to Washington customers would be taxable under the wholesaling or retailing classification, depending upon the intended use of the product by the purchaser. The paragraph apparently used to bolster the argument for nontaxability of out-of-state sales follows immediately:

> Where the seller agrees to and does deliver the goods to the purchaser at a point outside the state, neither retailing nor wholesaling business tax is applicable.

Reading the complete text of the rule, the next full paragraph stated:

> EXTRACTING, MANUFACTURING. Persons engaged in these activities in Washington and who transfer or make delivery of articles produced to points outside the state are subject to business tax under the extracting or manufacturing classification and are not subject to tax under the retailing or wholesaling classification. See also WAC 458-20-135 [extracting] and 458-30-136 [manufacturing]. The activities taxed occur entirely within the state, are inherently local, and are conducted prior to the commercial journey. The tax is measured by the gross value of products as determined by the selling price. See WAC 458-20-112. (Emphasis and parenthetical text supplied.)

The only part of the transaction which was and is taxed differently if the purchaser is out of state is the collection of retail sales tax. Because the activity is not inherently local, an out-of-state purchaser is not liable to Washington for payment of sales tax:

> RETAIL SALES TAX
>
> The retail sales tax is imposed upon all retail sales made within this state. . . The retail sales tax applies

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the outcome of the audit in question. The information is supplied for taxpayer's benefit.

> to all sales to customers of goods located in the state when delivery is made in Washington. . .
>
> The retail sales tax does not apply when, as a necessary incident to the contract of sale, the seller agrees to, and does, deliver the property to the buyer at a point outside the state. . .

Rule 193A. Rule 136 contains similar language.

The state may not be estopped from collecting taxes due it because of a mistake or oversight by one of its employees. In Kitsap-Mason Dairymen's Assoc. v. Tax Commission, 77 Wn.2d 812, 818 (1970), the Washington Supreme Court addressed facts matching those of this taxpayer:

> This is not a case in which the auditors changed their interpretation of a statute or rule. It is one in which they overlooked through ignorance, neglect or inadvertance 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. (Emphasis supplied.)

In this case, therefore, the taxpayer is not excused from correct payment of its taxes because the Department, in a previous audit of its records, failed to assess tax on similar transactions.

This taxpayer received the benefit of an auditor's mistake for the 1978-1981 period of an earlier audit. However, it was obligated by statute to pay B&O tax on its activities during that time and during the period of the audit now in question. The auditor in the questioned current audit correctly performed the audit procedures and classifications of income and correctly asserted tax on the gross income from the out-of-state sales under manufacturing--other. That a previous auditor's oversight allowed taxpayer's out-of-state sales income to escape taxation does not relieve the taxpayer of the obligation to correctly report and pay taxes; nor does such mistake obligate the Department to continue making the same mistake in future audits.

[2] The taxpayer contends that it was injured because it did not receive a conference with the supervising auditor prior to issuance of the assessment. RCW 82.32.050 provides that

> [i]f upon examination of any returns or from other information obtained by the department it appears that a tax or penalty has been paid less than that properly due, the department shall assess against the taxpayer such additional amount found to be due . . .The department

> shall notify the taxpayer by mail of the additional amount and the same shall become due and shall be paid within ten days from the date of the notice. . .

The use of the word "shall" by the Legislature makes these procedures mandatory. The statutory obligations of the Department are to assess taxes not paid and to give the taxpayer notice of amounts due.

WAC 458-20-100 (Rule 100) states that

> [i]n any case of an account under audit where substantial agreement has not been reached between taxpayer and field auditor, the taxpayer is entitled to a preliminary conference with the auditor's immediate superior, the field audit unit supervisor, prior to finalization and submission of the audit report. Such conference is informal in nature, and is intended to clarify the issues in dispute resolving them where possible, and in any event effecting agreement as to the facts and figures involved.

In his report, the auditor states that the

> adjustments resulting from this audit have been discussed with... [the] accounting manager. No disagreement is found with respect to the audit adjustments; however, agreement has not been reached regarding future reporting instructions.

With regard to the years audited, the report states that there was agreement. Subsequently, during an extension granted for that purpose, taxpayer filed its appeal. Following a telephone conference on the matter, taxpayer's accounting manager submitted her affidavit contending that

> [Taxpayer] did not agree with the audit adjustments. I told [the auditor] that I understood his reasoning, but that [taxpayer's] decision as to agreement with the adjustments could only be made by the president of the company. I also made it clear to [the auditor] that [taxpayer] wanted a preliminary conference.

Taxpayer's petition contends that the assessment was issued on November 5, 1985, and the conference was not until November 13, 1988. Further, taxpayer states that

> [t]his unauthorized procedure was unfair to the taxpayer: the Department had already made up its mind and issued the assessment prior to the preliminary conference. As a result, the Department could not and did not approach the conference ready to hear and consider [taxpayer's]

> arguments. Since this case involves matters of equity and fairness, the Department's failure to engage in an unbiased discussion of the issues has worked a real hardship against the taxpayer.

There is a factual dispute in this case as to whether the auditor knew that the taxpayer did not agree with the audit. All of the documents in the file indicate that the future reporting instructions, not the audit itself, were the subject of disagreement. The accounting manager's statement indicates understanding of the procedures and does not indicate a lack of agreement; it is merely an indication of the manager's unwillingness to take responsibility for the action of agreeing with an audit which assessed taxes owed by her employer.

There is no language in Rule 100 making mandatory the sequence of events which taxpayer would have preferred. Indeed, the taxpayer was statutorily obligated to report its income from out-of-state sales during the years in question; and since the Department is an administrative agency empowered only to uphold the laws, not change them, the conference would not have changed the outcome of the audit with regard to the income generated by taxpayer's out-of-state sales. Taxpayer's injury is speculative at best. It had full use of the money owed as taxes for the years during which the income was improperly recorded.

In addition, taxpayer contends that the Department approached the conference without an open mind. However, in April of 1986, while this appeal was still under consideration, the audit division independently considered records produced by the taxpayer and granted deductions for bad debts which had been denied in the original audit, issuing an adjustment which lowered the amount of the assessment.

The facts presented do not show that taxpayer was prejudiced in any way by the timing of the issuance of the assessment and the supervisor's conference.

DECISION AND DISPOSITION:

Taxpayer's petition is denied.

DATED this 10th day of August 1988.