

# Advertising agencies - Requirements for excluding advances and reimbursements from gross income

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Generally, advertising agencies (ad agencies) aren't allowed an exclusion from gross income for advances and reimbursements from clients.

The gross income that ad agencies receive for advertising services is typically subject to business and occupation (B&O) tax under the service and other activities classification. Gross income can include, but is not limited to:

- Fees for arranging advertising space or time in a media outlet for a client.
- Fees for consultation, creating advertising campaigns, and graphic design services.
- Commissions earned for purchasing advertising products on behalf of a client.
- Fees for copy writing, editing, layout, and coordinating of advertising material.

If an ad agency arranges advertising space or time for clients, the advances or reimbursement amounts received from their clients are taxable if the agency has personal liability to pay the media outlets for the advertising. Following industry standards, ad agencies are generally liable for paying the media outlet.

Media outlets include:

- Television and radio stations.
- Newspapers.
- Magazines.
- Websites.

## Requirements for an exclusion

When the ad agency receives payment from their clients to buy advertising space or time, the actual cost of the advertising is generally included in the payment. There is no exclusion for this cost unless all three of these requirements are met:

- The amounts are reimbursements or advances made to pay obligations of a client.
- The agency cannot be performing the services – either directly, or indirectly through independent contractors.
- The agency can have no liability to pay the client's obligations, except as the agent of its clients.

Amounts ad agencies receive from clients to pay advertising expenses are not generally considered advances or reimbursements. The ad agency is not buying services on behalf of its clients but is providing services to its clients. The ad agency is liable to its clients to furnish the services and is often liable to the media outlets for payment of the services. Even if the client pays the media outlet directly, those amounts will be taxable to the ad agency because the agency is liable to pay for the advertising.

## Examples

### **Requirement 1: The agency must pay the obligations of its client.**

When an agency provides advertising services and secures and pays for advertising for its clients, the agency is discharging its own obligations, not the obligations of its clients. This does not satisfy the first requirement.

### **Requirement 2: The agency can't render or have liability for the services.**

The agency is required to provide an array of services, including advertising services, to its client. Included in these services is the purchase of advertising. The ad agency is obligated to provide the services and has liability to its client for the quality of these services.

Because it is providing the services, the ad agency does not satisfy this requirement. The amounts received for these services, including the actual cost of the advertising, are included in gross income as costs of doing business.

### **Requirement 3: The agency must act as an agent of its clients and cannot have any liability, except as agent.**

The third element requires that the ad agency be an agent of its clients and have no liability to pay the expenses, except as the agent. This element has two parts: *agency* and *liability*.

*Agency:* The client and the ad agency must agree to the ad agency acting under the direction of the client. The agency is providing the services either directly or indirectly, not acting as an agent to procure goods or services on

behalf of its clients. When the agency has discretion and control over how the services are provided, the element of control is not met.

**Liability:** The ad agency has liability to its clients to provide the services. The ad agency also typically has liability to the media outlet for the payment associated with the advertising expenses. Thus, the ad agency has liability other than as its client's agent.

## References

WAC 458-20-111

WAC 458-20-218



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