

Cite as Det. No. 20-0108, 41 WTD 82 (2022)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of)	<u>D E T E R M I N A T I O N</u>
Assessment of)	
)	No. 20-0108
)	
...)	Registration No. . . .
)	

[1] WAC 458-20-254; RCW 82.32.070; RCW 82.32.100: SUITABLE RECORDS. Washington law requires taxpayers to provide all records maintained by an ordinary prudent business person, that must be kept in a systematic manner that conforms to accepted accounting methods and procedures. The records must also show gross receipts and sales from all sources, and must be supported by original source documents or records. If a person fails to keep and preserve these records, the Department of Revenue may make an estimate of that person’s tax liability in a manner the Department deems best.

[2] WAC 458-20-102; RCW 82.04.470: WHOLESale TRANSACTION – REQUIRED DOCUMENTATION. The burden of proving that a sale is a wholesale rather than a retail sale is on the seller. A seller may meet its burden by taking from the buyer a copy of a reseller permit or other authorized documentation under RCW 82.04.470 and WAC 458-20-102 (Rule 102).

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.

LaMarche, T.R.O. – A construction company disputes its tax assessment, arguing that the audit should have been based on cash basis rather than accrual basis accounting, and that its claimed wholesale sales should not have been reclassified as retail sales. The taxpayer also asserts that it had a client that paid subcontractors directly for certain services they performed on a construction project where taxpayer acted as the prime contractor, and it never received these payments. We deny the petition.¹

ISSUES

1. Under RCW 82.32.070, RCW 82.32.100, and WAC 458-20-254, did Taxpayer provide suitable records by which the Department could ascertain its tax liability?

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

2. Under RCW 82.04.470 and WAC 458-20-102, has Taxpayer shown that certain sales were made at wholesale?

FINDINGS OF FACT

. . . (Taxpayer) is a general contractor that specializes in improvements for commercial tenants. In Audit No. . . . , the Department of Revenue's (Department) Audit Division (Audit) examined Taxpayer's business activities for the period from January 1, 2013, through March 31, 2017.

Taxpayer did not provide documents to support its reported excise tax liability in response to Audit's initial requests, so a summons was issued on August 11, 2017, that requested federal income tax returns, monthly bank statements, quarterly workpapers used to file excise tax returns, a QuickBooks backup copy, sales invoices, and purchase invoices.

Taxpayer provided the federal income tax returns and a QuickBooks portable copy on August 29, 2017. The QuickBooks portable copy, however, could not be opened and used due to an update that needed to happen on the business's QuickBooks program. No other records were provided at that time in response to the summons.

Taxpayer's bookkeeper brought her laptop to a Department field office on May 10, 2018, to print QuickBooks reports that could be used for the audit review. However, she was unable to access the QuickBooks file on her laptop. The auditor offered to drive out to the business location to help pull the QuickBooks reports, but Taxpayer declined his offer. For this reason, QuickBooks records were not used in the original assessment.

The auditor states that the original assessment used Taxpayer's federal returns for an income reconciliation and to estimate the use tax due. The disallowed amount of wholesaling transactions was based on Taxpayer's filed excise tax returns. Based on these limited records, the Department issued the original assessment, Document No. . . . , on June 25, 2018, which totaled \$. . . . The total consisted of \$. . . in tax (\$. . . in retail sales tax; \$. . . in use tax; \$. . . in Retailing business and occupation (B&O) tax; a credit of \$. . . in Wholesaling B&O tax); \$. . . in interest; and \$. . . in penalties.

After receiving the assessment, Taxpayer provided additional records, and the audit was reopened, and a post-assessment adjustment (PAA) was prepared. One of the records provided was a working QuickBooks file, however the auditor's review of the file using an audit trail function showed that several invoices had been deleted from the file a few days before it was provided. Additional documentation, however, indicated that this was generally due to Taxpayer's misunderstanding of the records needed for the Audit Period. All but one of the invoices which had been deleted from QuickBooks were either outside of the Audit Period or were shown to be for out-of-state construction jobs.² However, one invoice, Invoice . . . [A], was deleted from QuickBooks, but fell

² Audit notes that the out-of-state jobs may have been confused with wholesale sales, and there may be some confusion about sales tax liability for government jobs. The Department offers many resources to taxpayers to assist them with their taxes and tax questions, including by telephone at (360) 705-6705 or at its website at www.dor.wa.gov. The Department can also give taxpayers written advice that is binding on the Department about how certain activities

within the Audit Period. Invoice . . . [A] was for certain construction activities provided under a contract with . . . , LLC (. . . [Corporation]), which we will discuss below.

Wholesale sales. Wholesale sales were apparently posted on a cash basis, and Audit used those cash basis figures when computing the assessment. Audit reclassified claimed wholesale sales as retail sales in cases where Taxpayer could not provide evidence, including reseller permits, to support their wholesale nature.

Invoice . . . [A]. Taxpayer asserts that a certain customer made direct payments to subcontractors, but Taxpayer did not supply documentation to support this assertion. However, Taxpayer sent an email on January 8, 2019, that indicated the payment to subcontractors was in relation to the . . . [Corporation] contract. Taxpayer states in the January 8 email, “The customer paid the subs direct with a three party check. The money never ran through our company because of this so we deducted the amount paid to the customer.”

Audit interpreted this to be referring to Invoice . . . [A] for the . . . [Corporation] project. Audit explained its interpretation of the email in the Auditor’s detail of differences and in Audit’s response to the petition, both of which were sent to Taxpayer, and Taxpayer has not challenged or corrected this interpretation.

However, Taxpayer has not provided proof that the sales tax was paid by . . . [Corporation]. The . . . [Corporation] contract names Taxpayer as the prime contractor, and in Section 2, states that the cost of labor, materials, equipment, supplies, and all payments made to subcontractors and suppliers, are included in the contract price. In an untitled attachment on page 19 of the . . . contract, the taxable amounts and sales tax for the job are listed by line item. The total taxable amount listed in the contract was \$. . . and the associated sales tax was \$. . . .

Audit found that Taxpayer had actually posted sales tax amounts from Invoice . . . [A] in its deleted QuickBooks entries. Audit determined the most accurate figures would be listed on the version of Invoice . . . [A] that existed before Taxpayer initially deleted the entry in QuickBooks. The invoice amounts for the earlier invoice were posted in QuickBooks as \$. . . in taxable income and \$. . . in sales tax, which Audit used as the basis for assessing retail sales tax and Retailing B&O tax on the [Corporation] transaction.

Sales Tax Payable account reconciliation. Audit found the information provided to be somewhat unreliable, and estimated the sales tax due. The auditor states that the Sales Tax Payable account on Taxpayer’s QuickBooks account shows \$. . . in sales tax posted. The auditor calculated that if the transactions during the Audit Period had been posted in that account on a cash basis, as Taxpayer argues, this would result in a slightly higher number, \$. . . .

Taxpayer also provided an Excel workbook which contained a QuickBooks summary and a bank deposit analysis. The summary showed \$. . . in sales tax collected on a cash basis, and the bank deposit analysis showed \$. . . collected on a cash basis. Audit determined that the QuickBooks records would be more reliable, since the Excel spreadsheet was derived from those records. Audit

should be treated for tax purposes. Information on this letter ruling process can be found on the website, or provided via phone at the number previously listed.

considered to be immaterial the small difference that resulted from treating the Sales Tax Payable account as a cash basis account, rather than an accrual basis account. QuickBooks indicated that the Sales Tax Payable account was based on the accrual basis method, and Audit decided to use the \$. . . figure [approximately \$1,000 greater than the QuickBooks summary] shown in the account.

Audit states that the income reconciliation used for the PAA, rather than relying on federal tax returns, as in the original assessment, was based instead on the sales tax reconciliation of the QuickBooks entries. The wholesaling and use tax portions of the audit remained unchanged because no suitable records were provided to support any adjustments.

. . . Taxpayer received a revised explanation of the balance due in a letter from the Department sent via secure email on March 11, 2019, which stated that the adjusted remaining balance on the account was \$. . . , with an extended due date of April 10, 2019. The balance on March 11, 2019, consisted of \$. . . in tax, \$. . . in penalties, and \$. . . in interest.³ Taxpayer did not pay the assessment, and filed a petition for review.

ANALYSIS

1. Retail sales

Retail sales are subject to Retailing B&O tax under RCW 82.04.250. Retail sales are also subject to retail sales tax under RCW 82.08.020. RCW 82.04.050 includes in the definition of retail sale, the sale of or charge made for labor and services rendered in respect to the cleaning or improving of tangible personal property of or for consumers. RCW 82.04.050(2)(a). RCW 82.04.050(2)(b) also includes in the definition of retail sale, the “repairing, decorating, or improving of new or existing buildings or other structures under, upon, or above real property of or for consumers.” Except with regard to its claimed wholesale sales, which we will discuss later, there is no dispute that Taxpayer’s construction activities are retail sales.

RCW 82.08.050 requires buyers to pay retail sales tax to the seller, who in turn must report and remit this tax to the Department; sellers are liable for the amount of any unpaid tax. RCW 82.08.050(1)-(6). Under RCW 82.08.050 and WAC 458-20-217, retail sales tax shall be deemed held in trust by the seller until paid to the Department.

RCW 82.32.070 requires every person liable for payment of excise taxes to keep and preserve for a period of five years, suitable records as may be necessary to determine the person’s tax liability. The law also requires the person to make those records open for examination at any time by the Department of Revenue. *Id.*

WAC 458-20-254, the Department’s recordkeeping rule, states that suitable records include copies of all federal income tax and state tax returns, books, records and invoices. *Id.* These records must show:

³ We note that a payment of \$. . . with an effective date of August 18, 2017, was posted March 1, 2019, and a second payment of \$. . . was made on the account on December 31, 2019.

1. The amounts of gross receipts and sales from all sources, however derived, including barter or exchange transactions, whether or not such receipts or sales are taxable, and must be supported by original source documents or records, such as purchase invoices, sales invoices, contracts, and such other records as may be necessary to substantiate gross receipts and sales, and
2. The amounts of all deductions, exemptions, or credits claimed through supporting records or documentation required by statute or administrative rule, or other supporting records or documentation necessary to substantiate the deduction, exemption, or credit.

WAC 458-20-254(3)(b).

If a taxpayer fails to keep and preserve suitable records, then RCW 82.32.100(1) provides that the Department “shall proceed, in such manner as it may deem best, to obtain facts and information on which to base its estimate of the tax.” Thus, in the absence of suitable records, the Department has the authority to estimate tax liability based on the available information “as it may deem best.” RCW 82.32.100(1-2).

Here, the Department made many requests for records, namely federal income tax returns, monthly bank statements, quarterly workpapers used to file excise tax returns, a QuickBooks backup copy, sales invoices, and purchase invoices. Taxpayer only provided records after the Department issued a summons, after which it provided only its federal tax returns and its QuickBooks records, which, as we discuss above, could not be accessed. Because Audit did not have suitable documents, it was authorized under RCW 82.32.100 to make an estimate, which it did based on unexplained gross income reconciliation differences from the federal tax returns. Additionally, due to lack of documentation, wholesale sales were reclassified to retailing, and use tax was estimated for the Audit Period.

After the initial assessment was issued, Taxpayer did come forth with additional records, including bank statements, and QuickBooks records that, this time, could be accessed. Although the QuickBooks records had been altered in some cases, Audit was able to retrieve historical entries, and compare them with Taxpayer’s bank records, invoices, the . . . [Corporation] contract, and tax returns from which it prepared the PAA.

As mentioned above, Audit noted that the QuickBooks Sales Tax Payable account was designated as an accrual basis account, and chose the \$. . . in sales tax posted, rather than treating the account as a cash basis account, as Taxpayer insisted, which would have slightly increased the tax due.

We note that Taxpayer’s argument that it used cash basis accounting appears to be based on the premise that accrual basis accounting would result in less sales tax due. However, WAC 458-20-199 (Rule 199), the Department’s rule that addresses cash and accrual basis accounting, requires taxpayers using an accrual basis to report and pay sales tax in the period where the sale was made—even if they have not yet received payment. Retail sales tax is held in trust by the seller, and must be remitted to the Department in the same period it is posted or collected. RCW 82.08.050; Rule 199. Thus, sales tax represented in the amounts posted in the Sales Tax Payable account, regardless of what accounting method is used, must be timely reported and paid.

With regard to the invoice that did not initially appear in QuickBooks, Invoice . . . [A], Audit used Taxpayer's original and unaltered QuickBooks entries for that transaction. Taxpayer asserts that . . . [Corporation] paid the sales tax on some transactions, and states in the January 8, 2019, email mentioned above, "The customer paid the subs direct with a three-party check. The money never ran through our company because of this so we deducted the amount paid to the customer."

If . . . [Corporation] is the customer Taxpayer refers to in the email, as Audit presumed, Taxpayer is listed in the . . . [Corporation] contract as the prime contractor, and money from the gross amount of the contract would be subject to sales tax. *See* WAC 458-20-170 (Rule 170). This would most likely be accounted for in the audit, since the audit was based on what Taxpayer posted in QuickBooks, deposited into its bank accounts, and reported on its state and federal tax forms. If transactions Taxpayer posted included sales tax amounts that were actually paid by . . . [Corporation], or were altered to account for non-payment, it is Taxpayer's burden under Rule 254 and RCW 82.32.070(1) to provide suitable records to show this, which it has not done.

We find that Audit's approach was reasonable, given that it was based almost entirely on Taxpayer's own records. To the extent that Audit had to estimate, it was due to Taxpayer's failure to provide suitable records as required under RCW 82.32.070 and Rule 254. Based on the foregoing, we deny the petition as to this issue.

2. Wholesale sales

Rule 170 is the rule covering the construction industry. Rule 170(3)(a) provides that "Prime contractors" are taxable under the retailing B&O tax classification and subject to retail sales tax, and "subcontractors" under the wholesaling B&O tax classification upon the gross contract price. Rule 170 further defines a "prime contractor" as a person engaged in the business of performing construction work for consumers and a "subcontractor" as a person engaged in the business of performing a similar service for persons other than consumers, either for the entire work or a specific portion, thereof. *Id.*

Here, Taxpayer claims certain sales were made at wholesale.⁴ Sales are presumed to be at retail, and the seller has the burden of proving that a sale is a wholesale sale rather than a retail sale. RCW 82.04.470(1); WAC 458-20-102(5) (Rule 102). The seller may meet its burden of proof "by taking from the buyer, at the time of sale or a reasonable time after the sale as provided by rule of the department, a copy of a reseller permit issued to the buyer by the department under RCW 82.32.780 or 82.32.783." RCW 82.04.470(1).

Taxpayer did not meet the requirements of RCW 82.04.470(1), because it could not show a copy of a reseller's permit taken at the time of the disputed sales or within a reasonable time thereafter.

⁴ See note 4.

The statute also provides Taxpayer other ways to substantiate the wholesale nature of its sales. RCW 82.04.470(2) states the following:

- (2)(a) In lieu of a copy of a reseller permit issued by the department, a seller may accept from a buyer that is required to be registered with the department under RCW 82.32.030:
- (i) A properly completed uniform exemption certificate approved by the streamlined sales and use tax agreement governing board; or
 - (ii) Any other exemption certificate as may be authorized by the department and properly completed by the buyer.
- (b) Certificates authorized under (a)(i) and (ii) of this subsection (2) must include the reseller permit number issued by the department to the buyer.
- (c) A seller who accepts exemption certificates authorized in (a) of this subsection (2) is not required to verify with the department whether the buyer is required to be registered with the department under RCW 82.32.030. Nothing in this subsection (2)(c) may be construed to modify any of the provisions of RCW 82.08.050.

RCW 82.04.470(2)(a)-(c). Similarly, in circumstances where a buyer is *not* required to be registered with the Department, the statute provides the following:

- (3)(a) In lieu of a copy of a reseller permit issued by the department, a seller may accept from a buyer that is not required to be registered with the department under RCW 82.32.030:
- (i) A properly completed uniform sales and use tax exemption certificate developed by the multistate tax commission;
 - (ii) A properly completed uniform exemption certificate approved by the streamlined sales and use tax agreement governing board; or
 - (iii) Any other exemption certificate as may be authorized by the department and properly completed by the buyer.
- (b) A seller who accepts exemption certificates authorized in (a) of this subsection (3) is not required to verify with the department whether the buyer is not required to be registered with the department under RCW 82.32.030. Nothing in this subsection (3)(b) may be construed to modify any of the provisions of RCW 82.08.050.

RCW 82.04.470(3)(a) and (b).

Here, however, Taxpayer did not provide any of the evidence required under RCW 82.04.470 and Rule 102 to verify that its claimed sales were made at wholesale. Accordingly, we must deny the petition as to this issue.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 3rd day of April 2020.