

Cite as Det. No. 92-295, 13 WTD 160 (1993)

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition)	<u>D E T E R M I N A T I O N</u>
For Correction of Assessment of)	
)	No. 92-295 ¹
)	
...)	Registration No. ...
)	.../Audit No. ...
)	
)	

- [1] RULE 197 -- TAX LIABILITY -- CONTRACTOR -- ACCRUAL BASIS RECORD KEEPING. Tax liability arises for an accrual basis taxpayer when either: 1) the taxpayer became legally entitled to receive the consideration or 2) when the taxpayer in accordance with its regularly employed accounting system enters a charge against the purchaser. Accord: Det. No. 87-80, 2 WTD 407 (1987).
- [2] RULE 230 -- RETAIL SALES TAX -- NONCLAIM PERIOD -- COLLECTED BUT NOT REMITTED. Under RCW 82.08.050 retail sales tax collected is deemed to be held in trust until paid to the Department. Therefore, a taxpayer is liable for all retail sales tax collected and not remitted to the Department notwithstanding the nonclaim period in RCW 82.32.050.

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.

TAXPAYER REPRESENTED BY: ...

DATE OF TELEPHONE CONFERENCE: ...

NATURE OF ACTION:

Taxpayer petitions for correction of assessment of retailing B&O tax and retail sales tax on construction income.

¹ The reconsideration determination, Det. No. 92-295R, is published at 13 WTD 166 (1993).

FACTS:

Lewis, A.L.J. -- [Taxpayer's] business records were audited by the Department of Revenue (Department) for the period January 1, 1987 through December 31, 1990. The audit resulted in an assessment of retailing B&O tax, retail sales tax, and interest

The taxpayer derived income as a speculative and custom builder. The taxpayer's business records were kept on a fiscal year ending [in June] for financial and federal income tax purposes. The taxpayer, used the "completed contract" method for recognizing income for the period July 1, 1986 through June 30, 1987. This method of accounting for construction income recognizes income only when the contract is complete, or substantially complete. The taxpayer made a [June 1987] fiscal year end adjustment to its business records, thereby recognizing \$. . . of previously unrecognized income. The taxpayer protests the Department's assessment of retailing B&O and retail sales tax on this previously unrecognized income.

ISSUE:

Does the nonclaim period prevent the Department from assessing retailing B&O tax and retail sales tax on income that is earned and received outside the audit period but recognized as income in the audit period?

DISCUSSION:

[1] The taxpayer protests the assessment of retailing B&O tax and retail sales tax on the income recorded by a [June 1987] fiscal year end journal entry to its accounting records. The taxpayer argues that the construction contract was completed and the money received prior to January 1, 1987. Since the income was earned and received entirely in the 1986 calendar year taxation of this amount is barred by the nonclaim period.

RCW 82.32.050 provides:

No assessment or correction of an assessment for additional taxes due may be made by the department more than four years after the close of the tax year, except (1) against a taxpayer who has not registered as required by this chapter, (2) upon a showing of fraud or of misrepresentation of a material fact by the taxpayer, or (3) where a taxpayer has executed a written waiver of such limitation.

(Emphasis added.)

To determine whether the statute bars the assessment of additional taxes, we must first determine the "close of the tax year" for purposes of the statute. RCW 82.04.020 provides:

"Tax year" or "taxable year" means either the calendar year, or the taxpayer's fiscal year when permission is obtained from the department of revenue to use a fiscal year in lieu of the calendar year.

There is no indication that the taxpayer ever requested or the Department ever granted permission to use a fiscal year. Thus, for this taxpayer "tax year" means a calendar year and "close of the tax year" means December 31st of the year in which the tax liability arose.

The measure of tax is the "gross income of the business." RCW 82.04.280 provides:

"Gross income of the business" means the value proceeding or accruing by reason of the transaction of the business engaged in...

(Emphasis added.)

"Value proceeding or accruing" is defined by RCW 82.04.090 to mean:

...the consideration, whether money, credits, rights, or other property expressed in terms of money, actually received or accrued. The term shall be applied, in each case, on a cash receipts or accrual basis according to which method of accounting is regularly employed in keeping the books of the taxpayer.

(Emphasis added.)

Thus, an accrual basis taxpayer must report taxable income when he accrues the income and not when he actually receives payment.

RCW 82.04.090 and RCW 82.04.280 are implemented by two administrative rules: WAC 458-20-199 and RCW 458-20-197. The Administrative Code Rules have the same force and effect as the law. RCW 82.32.300.

WAC 458-20-199 (Rule 199) concerns accounting methods. It states in part:

Persons operating their business on the accrual basis must report under the business and occupation tax and the retail sales tax for each tax reporting period the gross proceeds from all cash sales made during such period, together with the total amount of charge sales during such period.

WAC 458-20-197 (Rule 197) deals with when tax liability arises. It states in part:

Gross proceeds of sales and gross income shall be included in the return for the period in which the value proceeds or accrues to the taxpayer.

...

In the case of building and construction contractors value proceeds or accrues to the taxpayer as follows:

(1) When the taxpayer maintains his accounting records on the accrual basis, as of the time the contractor becomes entitled to compensation under the contract:

(a) If by the terms of the contract the taxpayer becomes entitled to compensation only upon completion of the work, value accrues thereunder as of the time of completion;

(b) If by the terms of the contract the taxpayer becomes entitled to compensation upon estimates as the work progresses, value, to the extent of such estimates, accrues as of the time that each estimate is made and the balance at the time of the completion of the work or of the final estimate.

(Emphasis added.)

In this case, the . . . contract is the subject of the unreported income. It was signed [February 1986] and provided:

#2. The work to be performed under this contract shall be commenced not later than _____ and shall be completed not later than 120 days after the foundation is completed.

#3. The owner shall pay the contractor for the performance of the contract, in current funds in the total sum of \$. . . including sales tax. Payments on this contract shall be made as follows:
5% (\$. . .) deposit and balance by Washington Federal Savings
Loan draw schedule.

...

Final payment shall be made to the contractor within 30 days after full completion of the work to the satisfaction of the owner, the Washington Federal Savings and Loan Association, and the receipt of final compliance inspection report.

The contract required that the contract price include retail sales tax and that progress payments be made by a progress payment draw schedule. Additionally, the contract required that the contract "shall be completed not later than 120 days after the foundation is completed" and that final payment to the contractor shall be made "within 30 days after full completion of the work to the satisfaction of the owner."

The contract provided for progress payments. Rule 197 provides that tax is due and the income should be reported when the taxpayer either: 1) became legally entitled to receive the consideration or 2) entered a charge in accordance with its regularly employed accounting system against the purchaser. Here the contract provided that payment would be made as construction progressed and billings were issued for the amount of work performed. According to Rule 197, the tax was due at the time the progress billings were made.

If the terms of the contract were adhered to it is very possible that all progress payments were made in 1986. Construction could have begun soon after the February 1986 signing of the contract with completion following within 120 days of completion of the foundation. The job could have been

completed by the summer of 1986. Presumably, the progress billings were rendered as the work progressed. If this were the case, and all income was accrued in 1986, the Department would be barred by the nonclaim period from assessing tax in 1987.

RCW 82.32.070 provides:

Every person liable for any fee or tax imposed by chapters 82.04 through 82.27 RCW shall keep and preserve, for a period of five years, suitable records as may be necessary to determine the amount of tax for which he may be liable, which records shall include copies of all federal income tax and state tax returns and reports made by him. All his books, records, and invoices shall be open for examination at any time by the department of revenue.... Any person who fails to comply with the requirements of this section shall be forever barred from questioning, in any court action or proceedings, the correctness of any assessment of taxes made by the department of revenue based upon any period for which such books, records, and invoices have not been so kept and preserved.

Thus, RCW 82.32.070 requires the taxpayer to preserve and make available for a five year period suitable records as may be necessary to determine the tax liability. Failure to comply with this requirement prevents a taxpayer from questioning, in any court action or proceeding, the correctness of the assessment. In this case, the taxpayer has not provided a schedule of progress billings, accounts receivable journal, or other substantive evidence to support the contention that the income in question was accrued prior to January 1, 1987. Construction could have begun anytime after the contract was signed. Because it is possible that the income in question was billed in 1987, the taxpayer's petition is denied regarding correction of the B&O tax assessment. However, if the taxpayer documents that the income accrued in 1986 and not 1987, the taxpayer's petition will be granted for correction of the retailing B&O tax assessment.

[2] The taxpayer has also petitioned for a correction of the retail sales tax assessed. Even if the retail sales tax liability arose prior to January 1, 1987, the taxpayer is still liable for any retail sales tax collected and not remitted to the Department, notwithstanding the nonclaim period in RCW 82.32.050. Retail sales tax collected is deemed to be the State's money, held in trust by the taxpayer until paid to the Department. Assessment of retail sales tax collected but not remitted is not barred by the non claim statute. WAC 458-20-230 specifically states:

No assessment or correction of an assessment for additional taxes due may be made by the department of revenue more than four years after the close of the tax year, except:

...

(4) Sales tax collected by the seller upon retail sales. Such tax shall be deemed to be held in trust until paid to the department. (RCW 82.08.050).

The . . . contract provided that the contract amount includes retail sales tax. The taxpayer's attorney in his [September 1992] letter stated "...it appears to me that sales tax was credited to the liability account as the credits to the . . . sales account were odd amounts not usually used in calculating

draws." Thus, by the terms of the contract and the recording of odd amounts on the taxpayer's books of record there is a strong presumption that sales tax was included and collected in the draw amounts. Accordingly, the taxpayer's request for correction of the retail sales tax assessed is denied.

DECISION:

The taxpayer's petition for correction of assessment is remanded to the Audit Division. The taxpayer is allowed thirty days from the date of this determination to provide additional information to support its contention that the income in question was accrued in 1986. If the taxpayer does not present additional information or if the information is unpersuasive to the auditor, the assessment will become immediately due and the unpaid portion . . . plus extension interest . . . will be due by that date. After payment, however, the taxpayer may present any additional information and petition for a refund within the period allowed by RCW 82.32.050 and RCW 82.32.060.

Dated this 28th day of October 1992.