

Cite as Det. No. 99-292R, 19 WTD 845 (2000)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of)	<u>F I N A L</u>
Assessment and/or Refunds of)	<u>D E T E R M I N A T I O N</u>
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)	No. 99-292R
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RULE 203: B&O TAX – INTERCOMPANY TRANSACTIONS – ACCOUNTING RECORDS – IMPEACHMENT OF. Where a professional limited liability company and its corporate members initially account for payments from the PLLC to members as fees for accounting services, the PLLC and members may not amend their records for past periods to retroactively change the payments into non-taxable distributions of profits, absent clear, cogent and convincing evidence that the accounting entries were incorrect.

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:

An accounting firm petitions for reconsideration of Det. No. 99-292 that sustained business and occupation (B&O) taxes assessed on payments made from a limited liability company to its corporate members for accounting fees.¹

FACTS:

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

Okimoto, A.L.J. . . . (PLLC) is a professional limited liability company that provides professional accounting services to clients in . . . , Washington. The Department (Department) of Revenue's Audit Division (Audit) examined PLLC's books and records for the period November 15, 1994 through December 31, 1997. As a result of this examination Audit assessed additional taxes and interest in the amount of \$. . . and Doc. No. FY. . . was issued in that amount on June 10, 1998. PLLC protested the entire amount, was denied relief in Det. No. 99-292, and the amount remains due.

[Inc. 1] is an S corporation under the Internal Revenue Code and also a member of PLLC [Inc. 1] performs professional services. Audit examined [Inc. 1]'s books and records for the period March 16, 1994 through December 31, 1997. As a result of this examination, Audit assessed additional taxes and interest in the amount of \$. . . . Subsequent to being notified of an audit examination, [Inc. 1] filed amended returns and paid additional taxes due for 1994, 1995, and 1996. Audit applied payments accompanying these returns as pre-payments against the above tax assessment. [Inc. 1] petitioned for a refund stating that it had incorrectly paid B&O tax on partnership distributions. [Inc. 1]'s refund request was denied in Det. No. 99-292 and it now appeals that decision.

[Inc. 2] is also an S corporation performing professional services and a member of PLLC. Audit examined [Inc.2]'s books and records for the period November 18, 1994 through December 31, 1997. As a result of this examination Audit assessed additional taxes and interest in the amount of \$. . . . [Inc. 2] protested the entire amount, and it remains due. [Inc. 2] also petitioned for a refund stating that it had incorrectly paid B&O tax on partnership distributions. [Inc. 2]'s appeal and refund request were denied in Det. No. 99-292, and it now appeals that decision.

. . . (CPA) is a sole proprietorship and was a member of PLLC until November 18, 1994 when it was merged into [Inc. 2]. Audit examined CPA's books and records for the period January 1, 1994 through December 31, 1994. As a result of this examination Audit assessed additional taxes and interest in the amount of \$. . . . CPA protested the entire amount, and it remains due. CPA also petitioned for a refund stating that it had incorrectly paid B&O tax on partnership distributions. CPA's appeal and refund request were denied in Det. No. 99-292, and it now appeals that decision.

For discussion purposes, we will refer to all four entities as "Taxpayers" unless a more specific designation is required. Det. No. 99-292 adequately states the facts and is therefore incorporated by reference into this determination.

In Det. No. 99-292 we held that PLLC was a limited liability company and would not have been taxed on true distributions of profits or capital. In Det. No. 99-292, however, we found that PLLC had not accounted for these transactions on its general ledger as distributions but as payments for accounting services rendered by [Inc. 1] and [Inc. 2]. We further found that [Inc. 2]'s general ledger had similarly treated the transactions as revenue earned and not as contributions of capital or services. Based on these findings, we held that:

The right of [Inc.2] and [Inc. 1] to the accounting fees is absolute. [Inc. 2] and [Inc. 1] received the fees for services rendered, and therefore are fully subject to Washington's B&O tax.

Det. No. 99-292 at p.6.

CONTENTIONS & ARGUMENTS:

On reconsideration, Taxpayers' primary argument is that the intent of the parties involved in the professional limited liability company agreement was that PLLC would render the accounting services to all clients and report the appropriate B&O taxes. Taxpayers state that it was further the intent of the members that:

. . . each Member was entitled to the revenues or fees from the accounting work each Member performed. So the payments by [PLLC] to the two professional service corporations were nothing more than distributions from a PLLC to its Members. Under the Department of Revenue's longstanding interpretation, distributions to "partners" are not subject to B&O tax when tax has been paid on the revenues by the partnership, LLC or PLLC.

In support of this argument, Taxpayers have submitted amended state and local combined excise tax returns during the audit period, filed amended federal income tax returns, and made adjusting journal entries to their respective general ledgers to retroactively correct allegedly inaccurate accounting records during the audit period. Taxpayers argue that the substance and intent of the members should control over "mere" accounting entries. Taxpayers cite Fidelity Title Co. v. Department of Revenue, 49 Wn. App. 662, 745 P. 2d 530 (1987), and Time Oil Co. V. State, 79 Wn. 2d 143, 483 P. 2d 628 (1971) in support of their argument.

ISSUE:

Where a professional limited liability company and its corporate members initially account for payments from the PLLC to members as fees for accounting services on their accounting records, may the PLLC and members amend their records for past periods to retroactively change these payments into non-taxable distributions of profits?

DISCUSSION:

WAC 45-20-203 (Rule 203) states how transactions between separate entities are to be taxed. It states in part:

Each separately organized corporation is a "person" within the meaning of the law, notwithstanding its affiliation with or relation to any other corporation through stock ownership by a parent corporation by the same group of individuals.

Each corporation shall file a separate return and include therein the tax liability accruing to such corporation. This applies to each corporation in an affiliated group, as the law makes no provision for filing of consolidated returns by affiliated corporations or for the elimination of intercompany transactions from the measure of tax.

Each unincorporated association organized under the Massachusetts Trust Act of 1959 (chapter 23.90 RCW) is likewise taxable in the same way as are separate corporations.

Therefore, the general rule is that each separate S corporation and each separate PLLC are separate entities, and transactions between them are fully taxable “notwithstanding its affiliation with or relation to any other corporation.” Although, as Taxpayers point out, the Department’s longstanding position is that distributions of profits are not taxable transactions, this is not applicable to Taxpayers’ case. Taxpayers have simply not accounted for the payments from PLLC to [Inc. 2]² as non-taxable distributions of profits. Instead, [Inc. 2] has accrued revenue on its general ledger income accounts for accounting services rendered; [Inc. 2] has also filed state combined excise tax returns on all accounting services income received; and it has also filed federal income tax returns consistent with this treatment. All of these facts suggest that [Inc. 2] was earning and receiving income for performing accounting services. In essence, [Inc. 2] accounted for these transactions during the audit period as if [Inc. 2] was a subcontractor hired by PLLC to perform accounting services for PLLC’s clients. This is a fully taxable transactions. See, Rule 203.

Nor do we believe that [Inc. 2]’s subsequent filing of amended state and federal income tax returns or its subsequent general ledger adjusting journal entries retroactively change the tax status of past transactions. We believe that when certified public accountants make entries into their own books of record, they are or should be aware of the consequences and implications of those accounting entries. Certified public accountants possess unique and specialized expertise in this very technical area. Consequently, a later claim that the substance of the transactions should prevail over its form will be strictly scrutinized. The Department will not recognize such a claim absent clear, cogent and convincing evidence. Det. 92-166, 12 WTD 211 (1992), See also, Det. No. 85-112A, 1 WTD 343, (1985) Taxpayers have submitted neither clear nor convincing evidence that the substance of the transactions were distributions of profits. On the contrary, the fact that [Inc. 2]’s general ledger accrued the accounting fees as earned income, that both [Inc. 2] and [Inc. 1] reported this income to the state on its B&O tax returns, and that [Inc. 1] reported this income as accounting fees on its federal income tax returns, all support the finding that the accounting fees were earned income to [Inc. 2] and [Inc. 1] Accordingly, Taxpayers’ petition for reconsideration is denied.

DECISION AND DISPOSITION:

The taxpayers’ respective petitions for correction of assessment are denied.

² Although Taxpayers have only submitted samples of . . . Inc.’s books of account for our examination we presume that they are representative of [Inc. 1]’s and CPA’s books of account, also.

Dated this 5th day of June, 2000.