

Cite as Det. No. 00-016, 19 WTD 703 (2000)

BEFORE THE APPEALS 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. 00-016
)	
...)	Registration No. ...
)	FY. . ./Audit No. ...
)	FY. . ./Audit No. ... (PAA)

- [1] RULE 197 and 199: ACCOUNTING METHODS – ACCRUAL METHOD. When a taxpayer maintains its books and records on a purely accrual method, it must report its excise taxes on an accrual method.
- [2] RULE 197 and 199: ACCOUNTING METHODS – ACCRUAL METHOD. The changes to Rule 199 in 1996 do not affect a taxpayer whose books and records are maintained exclusively on an accrual basis.
- [3] RULE 197 and 199: ACCOUNTING METHODS – ACCRUAL METHOD. When a taxpayer utilizing an accrual accounting method consistently reported income in the wrong month and the Department’s Audit Division corrects the errors in a tax assessment, an adjustment for later periods may be necessary. If such an adjustment is necessary, taxpayers are encouraged to work with the Department’s Audit Division to determine the best method to accomplish the adjustment.

NATURE OF ACTION:

An interexchange telecommunication carrier protests the Audit Division’s conclusion that it must report its income on an accrual basis using the dates customers use its services.¹

FACTS:

Coffman, A.L.J. -- The taxpayer is an interexchange telecommunication carrier. That is, the taxpayer leases telephone lines from local exchange carriers (LECs) to provide its customers access to long distance services. The taxpayer does not have individual contracts with its

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

customers; rather the taxpayer's customers obtain access to the leased lines by dialing ". . .". The taxpayer provides call information to the LECs each week. The LECs bill the customer and collect the charges for the taxpayer. On a monthly basis, the LECs provide the taxpayer with the details of the billed amounts, including the retail sales tax. The monthly reports also identify amounts the LECs determined were uncollectible. The LECs were contractually obligated to provide the monthly reports to the taxpayer no later than the 15th of the month following service or according to schedules mutually agreed upon so that the taxpayer may file its tax returns. The taxpayer claims this report provides it the information it needs to accurately complete the combined excise tax return.²

The taxpayer received actual payment of the amounts collected by the LECs on approximately the 15th of the second month following the long distance call. During the audit period, the taxpayer reported these receipts on its monthly (or quarterly for part of the audit period) for the third month following the long distance call. For example, if a customer makes a long distance phone call using taxpayer's leased telephone lines in January, the taxpayer reported the income from that call on its April combined excise tax return. The taxpayer believes it should be allowed to report its receipts in the month it receives the funds from the LECs. The taxpayer admits its practice of waiting an additional month was in error.

The taxpayer filed its first combined excise tax return in January 1996 covering the fourth quarter of 1995. However, the Audit Division found:

[The taxpayer] obtained a certificate of authority from the State of Washington Secretary of State effective August 24, 1993. [The taxpayer] registered with the Department of Revenue to do business in Washington with an opening date of September 1, 1993. No business activities in this state were reported on the excise tax returns of [the taxpayer] until the fourth quarter of 1995 covering the period October 1, 1995 through December 31, 1995.

Additional documentation provided by ... , Tax Manager, after completion of the original audit indicated that [the taxpayer] had the opportunity to do business or was doing business in this state prior to the fourth quarter of 1995. A tariff agreement between [the taxpayer] and the Washington Utilities and Transportation Commission indicated that [the taxpayer] was approved to do business in Washington effective January 15, 1995. In addition, a memo from a representative of [an LEC] who leased telephone lines to [the taxpayer] on which the long distance telephone calls were provided, indicated that [the taxpayer] used the leased telephone lines as of January 5, 1995. As a result of this documentation, the opening date in Washington was found to be January 5, 1995.

The Audit Division of the Department of Revenue (Department) reviewed the taxpayer's books and records for the period January 5, 1995 through September 30, 1996. Initially, the taxpayer

² The taxpayer provided copies of two "combined excise tax returns" as examples of the complexity. The local sales tax breakdown on these examples were 5 pages each.

did not provide any records for the long distance telephone calls made during the 1st and 2nd quarters of 1995. Therefore, the Audit Division projected the volume of calls based on information from the subsequent periods. As a result, the Department issued tax assessment FY. . . in the amount of \$. . . (including interest). Then the taxpayer provided the Audit Division additional records and the Department issued post assessment adjustment FY. . . reducing the amount due to \$. . . (including interest).

If the Audit Division is correct as to the timing of the taxpayer's reporting obligation, the taxpayer claims the Audit Division failed to credit its account for payments of the assessed amounts subsequent to the audit period. Specifically, the taxpayer claims that the amount of tax assessed for the last two months of the audit period (August and September 1996) were paid in October and November 1996. Therefore, the taxpayer argues, the assessment is overstated by the amount of those payments.

ISSUES:

1. When must the taxpayer report its gross proceeds of sales from calls made on its leased telephone lines?
2. Did the Audit Division over-assess taxes by failing to credit the taxpayer for payments made on receipts relating to August and September 1996?

DISCUSSION:

[1] The taxpayer maintains its books and records on an accrual basis. The taxpayer generates reports of calls made from Washington customers on a weekly basis. The only information that the taxpayer does not know when it submits the summary to the LEC is the local retail sales tax code and rate. The taxpayer acknowledges that it could estimate the percentage of calls in each local tax area and make an adjustment the following month when it obtains the actual figures. However, this would require it to add the function to its computer systems and the taxpayer would prefer not to be required to perform this activity.³

WAC 458-20-197 (Rule 197) is the Department's rule concerning when taxpayers must report their gross income or gross proceeds of sales. Rule 197 states:

(1) 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. . . .

(2) ACCRUAL BASIS.

(a) When returns are made upon the accrual basis, value accrues to a taxpayer at the time:

(i) The taxpayer becomes legally entitled to receive the consideration, or,

³ The Audit Division suggested a possible solution to the taxpayer's dilemma. Specifically, the taxpayer request a permanent extension for filing its combined excise tax returns. See WAC 458-20-228(9).

(ii) In accord with the system of accounting regularly employed, enters as a charge against the purchaser, customer, or client the amount of the consideration agreed upon, whether payable immediately or at a definitely determined future time.

(b) Amounts actually received do not constitute value accruing to the taxpayer in the period in which received if the value accrues to the taxpayer during another period. It is immaterial if the act or service for which the consideration accrues is performed or rendered, in whole or in part, during a period other than the one for which return is made. The controlling factor is the time when the taxpayer is entitled to receive, or takes credit for, the consideration.

(Emphasis added.)

WAC 458-20-199 (Rule 199) defines accounting methods for the purposes of Washington excise tax taxes. Rule 199 was amended effective June 30, 1996; thus there were two versions of the rule applicable during the audit period. The changes to Rule 199(3) are reflected below. The underlined portions were added and the strikethrough shows portions deleted.

A taxpayer who does not regularly keep books of account on a ~~strictly~~-cash receipts basis must file returns with figures based on the accrual method. These taxpayers must report the gross proceeds from all cash sales made in the tax reporting period in which the sales are made, together with the total amount of charge sales during such period. The law does not require a taxpayer to use a particular accounting system. However, the taxpayer must report based on the system of accounting used by the business, regardless of the taxpayer's reasons for selecting a particular accounting system. It will be presumed that a taxpayer who is permitted under federal law or regulations to report its federal income taxes on a cash basis and does so is maintaining the records on a cash basis. A taxpayer who maintains a general ledger on an accrual basis and files federal tax returns on an accrual basis must also report state tax returns on an accrual basis. ~~For example, if a taxpayer reports to the federal government on a cash basis, but maintains accounting records on an accrual basis, the taxpayer is still obligated to report the excise taxes to the state on the accrual basis.~~

[2] We understand that the taxpayer maintained its accounting system strictly on an accrual basis. Therefore, the changes to Rule 199 did not affect the taxpayer's reporting obligations to the State of Washington. Under both versions of Rule 199, the taxpayer was required to report its excise tax obligations on an accrual basis. The taxpayer becomes entitled to receive payment for services provided to its customers upon completion of the phone call. Therefore, the Audit Division correctly assessed taxes for the audit period.

[3] The taxpayer raises a secondary issue of possible tax credits for amounts paid with the combined excise tax returns for the months following the audit period that reflected services provided during the audit period. While we understand the taxpayer's concern, if we were to allow the taxpayer credit for amounts previously reported on the October 1996 excise tax return (for example) that should have been reported on the July 1996 excise tax return, then the amounts reported for October would be zero. We recognize that an adjustment (or truing up) to

the taxpayer's reporting may be necessary. However, because the taxpayer continued to erroneously report its gross proceeds of sales, the problem continues. Therefore, we have discussed this problem with the Audit Division and they have agreed to work with the taxpayer to determine the best method to report the adjustment. We suggest the taxpayer contact the Audit Division to calculate the amount of the credit and how to report the adjustment.

DECISION AND DISPOSITION:

The taxpayer's petition is denied.

Dated this 16th day of February 2000.