

Cite as Det. No. 14-0174, 33 WTD 452 (2014)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition for	)	<u>D E T E R M I N A T I O N</u>
Correction of Assessment of	)	
	)	No. 14-0174
...	)	
	)	Registration No. . . .
	)	

[1] RULE 254; RCW 82.32.070: RECORDS – SUBSTANTIATION – COMMISSION INCOME – BEST EVIDENCE. Rule 254(3) requires taxpayers to prepare and preserve original source documents or such other records as may be necessary to substantiate gross receipts. Where a business makes retail sales and also has commission income, reliance on amounts reported on Federal Form 1099s as best evidence of commission income received is appropriate absent other source documents to substantiate the nature of contested income.

[2] RULE 110, RCW 82.08.010, RCW 82.08.010 – LATE ORDER CHARGES – GROSS PROCEEDS OF SALES – SELLING PRICE: Charges for late orders which incur additional fees and postage charges fit within the statutory definition of “delivery costs” and are therefore to be included as part of the taxable selling price.

[3] RULE 254; RCW 82.32.070: RECORDS – SUBSTANTIATION. Where a seller received commission on sale completed by another party and is identified those invoices, the fact that those invoices itemize sales tax is independently insufficient to establish that the other party actually collected and remitted retail sales tax.

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.

Kreger, A.L.J. – A business selling school themed items, disputes the assessment of additional retail sales tax and retailing business and occupation (B&O), asserting that the assessment both overstates the measure of underreported income and also mischaracterizes commission income as retail sales. The Taxpayer has not provided sufficient records to show that the assessment is in error. The Taxpayer’s petition is denied.<sup>1</sup>

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

## ISSUES

1. Under WAC 458-20-254, has the Taxpayer provided sufficient documentation to substantiate that under-reported income was attributable to commission sales rather than retail sales?
2. Are additional postage and handling surcharges for late orders part of the sales price subject to retail sales tax under WAC 458-20-110?
3. Under WAC 458-20-254 has the Taxpayer provided records to substantiate that retail sales tax was remitted by another party on specific sales?

## FINDINGS OF FACT

[The Taxpayer] is a Washington corporation, and a sales representative for [the Affiliate].<sup>2</sup> The Taxpayer sells a variety of school items (such as letter jackets, senior portraits, school themed merchandize, etc.) through a retail location in . . . Washington, which is [the Affiliate's] branded store.

The Department of Revenue (Department) conducted an audit of the Taxpayer's business activities for the period of January 1, 2009 through June 30, 2012. At the conclusion of the audit the Audit Division (Audit) issued an assessment for additional tax due to the Taxpayer in the amount of \$. . .<sup>3</sup> The Taxpayer timely appealed the assessment.

Audit's examination of the Taxpayer's business records began with a review of bank records and the Taxpayer's federal tax returns, which disclosed that the Taxpayer had reported approximately \$. . . more in income on its federal tax returns than the gross income reported to the state. After this initial review the Taxpayer provided copies of QuickBooks business files to support the assertion that the bank record detail was not correct. However, the electronic detail did not reconcile with the tax returns filed with Washington, the federal tax returns, or the bank records. A revised version of the QuickBooks files was subsequently provided, which had changed amounts, however no detail or source documentation was produced to substantiate the revisions to the original electronic information provided. Based on a review of the records produced, the Audit Division determined that the bank records and federal tax return detail provided the most accurate record of the Taxpayer's business income and relied on this data for the Audit.

The assessment levied additional service and other activities (Service) B&O tax on commission income, based on Form 1099s for 2009 through 2012 that the Taxpayer received from [the Affiliate]. Audit concluded that the only commission income detailed in available 1099s was substantiated as being characterized as subject to Service B&O. Audit considered the remainder

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<sup>2</sup> [The Affiliate] is a company specializing in selling class rings, yearbooks, photo gifts (mugs key-chains, & other keepsakes with a picture on them), keepsake items customized for a school or class, graduation announcements, custom t-shirts and other apparel items.

<sup>3</sup> The assessment, Document No. 201315973 was comprised of \$. . . in retail sales tax, \$. . . in retailing B&O tax, \$. . . in service and other activities B&O, \$. . . in interest, and a 5% assessment penalty of \$. . .

of the underreported income to have been derived from retail sales and assessed retail sales tax and retailing B&O on these amounts.

In addition to sales made at its retail store, the Taxpayer also received income from on-line sales and sales made at schools within its designated jurisdiction. Students can place an order at the school, send in an order directly to [the Affiliate] either through a paper form or by placing the order on line, and the payments for those sales are made directly to [the Affiliate]. If that student's school is a school assigned to the Taxpayer, then [the Affiliate] will consider that sale a sale by the Taxpayer. The Taxpayer also noted that late orders will incur additional processing and shipping charges in addition to the sales price.

On appeal the Taxpayer acknowledges that it underreported tax, but asserts that a portion of the income characterized as retail in the assessment was overstated. The Taxpayer also asserted that a portion of the retail sales tax had actually been collected directly from the Schools and should have been remitted to the Department by [the Affiliate]. The Taxpayer also asserted that a \$. . . deposit was drawn from a business line of credit and so did not constitute business income.

As to the commission income it receives from [the Affiliate], the Taxpayer explained that it received a deposit every August, which was based on anticipated sales for the coming school year based on prior sales activity. At the same time, there would be a reconciliation of the prior year's sales activity, and additional commission income due would be paid.

On appeal, the Taxpayer produced additional records and detail including a listing of retail items from the audit workpapers detailing specific entries that the Taxpayer asserts should have been treated as service taxable, additional detail on deposits from [the Affiliate] for late orders, copies of commission statement's from [the Affiliate], and copies of invoices from [the Affiliate] for sales made directly to the schools that itemize sales tax.

### ANALYSIS

Washington imposes a B&O tax "for the act or privilege of engaging in business" in the State of Washington. RCW 82.04.220.<sup>4</sup> The measure of the B&O tax is the application of rates against "value of products, gross proceeds of sales, or gross income of the business, as the case may be." RCW 82.04.220. The B&O tax measure and rate are determined by the type or nature of the business activity in which a person is engaged. RCW 82.04.290.

Ordinary commission income, although based on sales activity, is taxed under the Service & Other Activities (Service) B&O tax classification at the rate specified in RCW 82.04.290(2), rather than under the retailing or wholesaling category. *See* Det. 89-286, 8 WTD 7 (1989). The Service B&O classification serves as a catch-all classification. If there is no specific statutory classification applicable to a business activity the default classification is Service B&O under RCW 82.04.290(2).

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<sup>4</sup> "Business" is defined as including all activities "engaged in with the object of gain, benefit, or advantage to the taxpayer or to another person or class, directly or indirectly." RCW 82.04.140. "[E]ngaging in business" means commencing, conducting, or continuing in business. RCW 82.04.150.

Taxpayer has the burden of proof when contesting a tax assessment. RCW 82.32.160; .180; *Budget Rent-A-Car of Washington-Oregon, Inc. v. Dep't of Revenue*, 81 Wn.2d 171, 500 P.2d 764 (1972). The burden of proof is on the taxpayer to prove that a tax assessment should be modified or cancelled. *Group Health Co-op v. Tax Comm'n*, 72 Wn.2d 422, 433 P.2d 201 (1967).

In this case, the Taxpayer does not dispute that there was underreported income but rather contests that assignment of that income to the retail classification. Specifically the Taxpayer asserts that the Audit Division mischaracterized a number of payments which it contends were actually commission income from [the Affiliate] as income from retail sales. Audit has reviewed the additional detail provided by the Taxpayer and notes while it has identified and characterized specific items as commission income, what is lacking is source documentation to substantiate this characterization. Based on this review, Audit relied on the federal Form 1099s as the most accurate record of the commission income paid by [the Affiliate] to the Taxpayer.

Taxpayers must maintain adequate records and provide the Department access to those records so that the Department can reasonably ascertain a taxpayer's tax liability. RCW 82.32.070. *See also* WAC 458-20-254 (Rule 254); Det. No. 99-341, 20 WTD 343 (2001). RCW 82.32.070 specifically requires that "[e]very 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 any tax for which he may be liable...." *See also* Rule 254. In the absence of suitable records, the Department is authorized proceed, in such manner as it may deem best, to obtain facts and information on which to base its estimate of the tax liability. *See* RCW 82.32.100.

In this case, the issue is not one of needing to estimate the tax liability due to absence of business records, but rather an issue of the accuracy and completeness of the records provided. Audit made a determination that the bank records and federal tax return detail provided the most accurate information of the business income. Thus the assessment was based on this detail rather than the QuickBooks records that were provided, which did not reconcile with the other business records produced. We find this conclusion credible and appropriate. The Taxpayer has asserted that it has commission income in excess of that reflected on the Form1099s produced, but has not provided source documentation to substantiate its characterization of the income at issue. We affirm Audit's conclusion that the Form1099s provide the best evidence of the commission income received. Where Audit has characterized specific records as the best evidence available to characterize or quantify a specific item of income taxpayer's have a duty to produce specific documentation that provides better detail. *See* Det No. 99-300, 19WTD 477 (2000)(Affirming characterization of receipts commission income rather than wholesale sales absent records detailing sales direct to retailer by taxpayer.) The Taxpayer has not provided source documentation that would substantiate a different measure of commission income and accordingly we sustain the Audit Division's reliance on the Form 1099s.

As to the late charges and additional postage costs for the late orders, we note that these times would be part of the selling price charged to the customer. RCW 82.08.010(1) defines "selling price" as: . . . the consideration paid, whether money, credits, rights, or other property . . . expressed in the terms of money paid or delivered by a buyer to a seller." The statute goes on to

include “delivery charges” as an item for which no deduction is allowed. RCW 82.0822010(1)(a)(iV)

RCW 82.08.010(4) defines “Delivery charges” to include “charges by the seller of personal property or services for preparation and delivery to a location designated by the purchaser of personal property or services including, but not limited to, transportation, shipping, postage, handling, crating, and packing.” WAC 458-20-110 (Rule 110) is the administrative regulation addressing delivery charges and defines delivery charges to include costs for “preparation and delivery” to a designated location. Rule 110(2). The rule goes on to address examples where postage and other delivery charges are considered part of the selling price. Based on the information available, the late charges at issue here are in the nature of delivery charges and were appropriately characterized as part of the retail selling price by the Audit Division. We deny the Taxpayer’s petition on this issue.

The Taxpayer also contests a portion of the retail sales tax assessed, asserting that the tax was actually collected and remitted by [the Affiliate] on some sales. The Taxpayer has provided representative invoices that show separately stated sales tax; however, what is lacking is substantiation that the itemized tax at issue was actually remitted to the Department. The Taxpayer is asserting that it is being charged for retail sales tax that was already remitted, but it has not provided any evidence to substantiate the payment of the retail sales tax at issue. Thus there is evidence that retail sales tax was charged, but not that this tax was actually paid to the Department. We note that the invoices provided identify the Taxpayer as both the “ship to” and “bill to” party. Therefore, from the information contained on the documents there is nothing to indicate that the retail sales tax at issue was remitted by another party. We affirm the Audit Division’s conclusion that the Taxpayer has not provided sufficient detail to establish that the disputed retail sales tax amounts were actually remitted and deny the Taxpayer’s petition on this issue. If the event that the Taxpayer can subsequently provide such detail, it may apply for a refund.

Finally the Taxpayer also disputes that assessment of the 5% substantial underpayment asserting that the penalty was applied to 2012 in error as the assessment actually provided a credit for that year. The assessment penalty at issue was applied for the entire tax period, but due to the formatting of the assessment, the amount appears at the bottom of the last column of the assessment. The 5% substantial underpayment of tax penalty was assessed in accordance with RCW 82.32.090(2), which provides:

If the department of revenue determines that any tax has been substantially underpaid, there is assessed a penalty of five percent of the amount of the tax determined by the department to be due.... As used in this section, “substantially underpaid” means that the taxpayer has paid less than eighty percent of the amount of tax determined by the department to be due for all of the types of taxes included in, and for the entire period of time covered by, the department's examination, and the amount of underpayment is at least one thousand dollars.

In this case the criteria for the application of the penalty were met, and accordingly it was assessed. While the penalty is recorded under the final year of the tax assessment the amount noted is 5% of the total tax liability due.

#### **DECISION AND DISPOSITION**

Taxpayer's petition is denied.

Dated this 2nd day of June, 2014.