

Cite as Det. No. 15-0104, 34 WTD 434 (2015)

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. 15-0104
)	
...)	Registration No. . . .
)	

[1] RULE 254; RCW 82.32.070; RCW 82.32.100: RETAILING B&O TAX – RETAIL SALES TAX – RECORDKEEPING – REASONABLE ESTIMATES. In the absence of actual sales records, the Department is authorized to estimate gross proceeds of sales based on a taxpayer’s bank records.

[2] RULE 102; RCW 82.04.470: WHOLESALING B&O TAX – TAXPAYER’S BURDEN – RESELLER PERMITS – FACTS AND CIRCUMSTANCES. A taxpayer must provide adequate documentation that it accepted a reseller permit at the time of the sale, or adequate documentation of facts and circumstances indicating the sale was wholesale in nature.

[3] Rule 254; RCW 82.08.130: RETAIL SALES TAX – TAX PAID AT SOURCE DEDUCTION – PRESERVATION OF RECORDS. A taxpayer may qualify for a tax paid at source deduction only if the taxpayer keeps and preserves adequate records that the taxpayer originally paid retail sales tax on the items in question, and that those items were subsequently resold.

[4] RULE 254; RCW 82.32.070: USE TAX – RECORDKEEPING – REASONABLE ESTIMATES. In the absence of actual purchase records, the Department is authorized to assess use tax on capital assets based on federal depreciation schedules filed by the taxpayer that list capital assets and their values.

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.

Yonker, A.L.J. – A “handyman” (Taxpayer) petitions for adjustment of a tax assessment on various grounds. First, Taxpayer contends that the amount of gross proceeds of sales of Taxpayer’s business, as calculated by the Department, contains amounts that are not part of the gross proceeds of sales. Second, Taxpayer contends that some of his business income should have been subject to wholesaling business and occupation (B&O) tax instead of retailing B&O tax and retail sales tax. Third, Taxpayer contends that he is entitled to deduct amounts of retail

sales tax that Taxpayer paid when purchasing materials that he subsequently resold to his customers. Finally, Taxpayer contends that certain capital assets he purchased should not be subject to use tax. We deny Taxpayer's petition as to each contention.¹

ISSUES

1. Has Taxpayer met his burden under RCW 82.32.070 and WAC 458-20-254 to show through adequate records that the measure of retail sales tax erroneously included amounts that were not part of Taxpayer's business income?
2. Has Taxpayer met his burden under RCW 82.04.470 to show through adequate records that some of his business income should be reclassified from the retailing B&O tax classification to the wholesaling B&O tax classification?
3. Has Taxpayer met his burden under RCW 82.08.130 to show that he entitled to a tax paid at source deduction for retail sales tax that Taxpayer claims he paid for materials that were subsequently resold to his customers as part of his handyman business?
4. Has Taxpayer met his burden under RCW 82.32.070 and WAC 458-20-254 to show through adequate records that the amount of use tax assessed in the tax assessment should be reduced further?

FINDINGS OF FACT

[Taxpayer] operates a sole proprietorship . . . based in . . . Washington. Taxpayer provides general residential and "occasional" commercial contractor services, including roofing, foundation pouring, and "everything in between." Taxpayer also provides some landscaping and lawn services. Taxpayer employs three other individuals; he also works with approximately four independent contractors for various types of work.

In 2014, the Department's Audit Division conducted a review of Taxpayer's books and records for the period of August 1, 2010, through December 31, 2013 (audit period). During the Audit Division's review, Taxpayer was unable to produce source documentation of the gross proceeds of sales of his handyman business from the audit period. Taxpayer represented that he had not issued invoices to any of his customers until 2013. However, even for the 2013 sales of Taxpayer's handyman services, he failed to produce any invoices.

Due to the lack of source documentation for Taxpayer's gross proceeds of sales of Taxpayer's business from the audit period, the Audit Division used Taxpayer's bank records to estimate his gross proceeds of sales from the handyman services based on the deposits evident in those records. Taxpayer provided bank records from multiple bank accounts, but the Audit Division found that only two of those accounts related to the handyman business activity. The Audit Division found that the amount of deposits demonstrated a higher level of gross proceeds of sales from the handyman services than Taxpayer had previously reported to the Department.

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

Taxpayer represented during the Audit Division's review that some of the deposits made into those two accounts were not related to the handyman business activity. The Audit Division requested documentation supporting Taxpayer's representation, however, no such documentation was received during the review. The Audit Division ultimately subtracted certain deposits for which there was adequate evidence that they were not related to the handyman services, but assessed retailing B&O tax and retail sales tax on the remaining additional gross proceeds, consistent with the tax classification Taxpayer had historically reported to the Department.

In addition, The Audit Division found that Taxpayer did not have documentation of paying retail sales tax or use tax on certain capital assets. The Audit Division reviewed the depreciation schedules attached to Taxpayer's federal income tax returns that he filed during the audit period, and identified a number of capital assets on those schedules for which Taxpayer did not have documentation of paying retail sales tax or use tax.²

Based on the items identified in those depreciation schedules, the Audit Division requested receipts for the purchase of each item. Taxpayer did not provide any receipts for the items listed on the depreciation schedules, but represented to the Audit Division that the depreciation schedules included items that did not represent capital assets. Taxpayer provided no further documentation related to his representation during the Audit Division's review.

On August 4, 2014, as a result of the Audit Division's findings, the Department issued a tax assessment for \$. . . , which included \$. . . in uncollected retail sales tax, \$. . . in retailing B&O tax, \$. . . in use tax and/or deferred sales tax, a \$. . . five-percent assessment penalty, and \$. . . in interest. Taxpayer subsequently appealed only the retail sales tax and the use tax components of the tax assessment.

On April 17, 2015, as a result of further review, the Audit Division issued a post assessment adjustment (PAA) in which the Audit Division reduced the amount of use tax and/or deferred sales tax from \$. . . to \$. . . because some of the items the Audit Division originally identified as capital assets did not end up being capital assets. As such, the total amount of tax liability due on the tax assessment was reduced to \$. . . .

On appeal, Taxpayer provided additional documentation regarding the proper classification of his gross proceeds of sales of Taxpayer's handyman business during the audit period. Specifically, Taxpayer provided two 1099-MISC forms from 2012 issued to Taxpayer. One was issued by [Contractor A] to Taxpayer indicating an income of \$. . . in 2012. The second was issued by [Contractor B] to Taxpayer indicating an income of \$. . . in 2012. Taxpayer represented that these third parties were management companies for which Taxpayer had provided handyman services in 2012.

Taxpayer also provided four receipts from [a Building Supplies Retailer] from 2012, in which Taxpayer purchased various items, and also paid retail sales tax. Taxpayer represented that these receipts are representative receipts showing that Taxpayer paid retail sales tax on materials he purchased as part of his provision of handyman services to his customers.

² The Audit Division subsequently concluded that some of the capital assets it originally identified on the depreciation schedules did not represent capital assets, and made appropriate adjustments, as described below.

Finally, Taxpayer provided a copy of a signed, but undated, lease agreement between Taxpayer, the owner of the property, and a tenant of that property. The lease agreement indicates the tenant shall pay a monthly rent of \$. . .

We requested, but Taxpayer did not provide, any additional documentation that certain deposits into his bank accounts were not related to the handyman business. Nor did Taxpayer provide any additional documentation on appeal related to the items identified as capital assets from Taxpayer's depreciation schedules.

ANALYSIS

1. Estimated Amount of Gross Proceeds of Sales from Taxpayer's Business

We first address Taxpayer's recordkeeping responsibility. RCW 82.32.070 requires taxpayers to maintain suitable records as may be necessary to determine the amount of any tax for which they may be liable. WAC 485-20-254 (Rule 254), which is the administrative rule regarding recordkeeping, states in pertinent part:

(3) Recordkeeping requirements—General.

- (a) Every taxpayer liable for a tax or fee imposed by the laws of the state of Washington for which the department of revenue has primary or secondary administrative responsibility. . . must keep complete and adequate records for which the department may determine any tax liability for such taxpayer.
- (b) It is the duty of each taxpayer to prepare and preserve all records in a systematic manner conforming to accepted accounting methods and procedures. Such records are to be kept, preserved, and presented upon request of the department or its authorized representatives which will demonstrate:
 - (i) 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. These amounts must be supported by original source documents or records including but not limited to all purchase invoices, sales invoices, contracts, and such other records as may be necessary to substantiate gross receipts and sales.
 - (ii) 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.
 - (iii) The payment of retail sales tax or use tax on capital assets, supplies, articles manufactured for your own use, and other items used by the taxpayer as a consumer.

- (c) The records kept, preserved, and presented must include the normal records maintained by an ordinary prudent business person. Such records may include general ledgers, sales journals, cash receipts journals, bank statements, check registers, and purchase journals, together with all bills, invoices, cash register tapes, and other records or documents of original entry supporting the books of account entries. The records must include all federal and state tax returns and reports and all schedules, work papers, instructions, and other data used in the preparation of the tax reports or returns.

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 authority to estimate tax liability based on the available information “as it may deem best.” . . . With these preliminary considerations in mind, we turn to Taxpayer’s two arguments.

Here, Taxpayer did not provide invoices, or other documentation of his actual sales, from which the Audit Division could determine Taxpayer’s actual gross proceeds of sales for the audit period. Without access to sales records, the Audit Division chose to use Taxpayer’s bank records from the two bank accounts that it concluded were used in Taxpayer’s “handyman” business activity to estimate Taxpayer’s gross proceeds of sales during the audit period. We conclude that, in the absence of suitable documentation of actual sales, the Audit Division was authorized to estimate Taxpayer’s gross proceeds of sales “as it deemed best” pursuant to RCW 82.32.100(1). We find nothing unreasonable in the Audit Division’s choice to rely on Taxpayer’s bank statements to determine the estimated amount of gross proceeds of sales Taxpayer had during the audit period, and have upheld estimates based on bank deposits previously. *See* Det. No. 14-0170, 34 WTD 030 (2015); Det. No. 14-0106, 33 WTD 402 (2014).

On appeal, we requested, but Taxpayer did not provide, additional documentation in support of his contention that some of the deposits evident in his bank records were not part of Taxpayer’s gross proceeds of sales of his handyman business.³ As such, we conclude that Taxpayer has failed to satisfy his burden of proving that he is entitled to any reduction in the amount the Audit Division determined to be Taxpayer’s estimated gross proceeds of sales for the audit period.

2. Reclassification of a Portion of Gross Proceeds of Sales to Wholesaling

RCW 82.04.220(1) imposes a tax for the privilege of engaging in “business activities” in Washington. The tax is based on the “value of products, gross proceeds of sales, or gross income of the business, as the case may be.” *Id.* The rate of the tax depends on the classification of the business activity. *See generally* chapter 82.04 RCW.

³ While Taxpayer provided a lease agreement that suggested he received a rental income of \$. . . each month from a tenant, the lease agreement is undated, and Taxpayer provided no other records of specific deposits he contended represented these rental payments during the audit period. Moreover, the Audit Division reported that Taxpayer maintained multiple bank accounts, including one that appeared to be specific to his rental property. As such, we conclude that the lease agreement Taxpayer provided is not adequate evidence to support any reduction in the amount of estimated gross proceeds of sales of the handyman services as determined by the Audit Division.

Pursuant to RCW 82.04.250(1), retailing B&O tax is assessed on the gross proceeds of sales that are retail sales. Similarly, pursuant to RCW 82.08.020(1), retail sales tax is levied on “each retail sale” in Washington. RCW 82.04.050(2) includes the following activities in the definition of “retail sale”:

- (a) The installing, repairing, cleaning, altering, imprinting, or improving of tangible personal property of or for consumers . . . ;
- (b) The constructing, repairing, decorating, or improving of new or existing buildings or other structures under, upon, or above real property of or for consumers

RCW 82.04.050(3) also includes the following activities in the definition of “retail sale”:

- (e) Landscape maintenance and horticultural services

See also WAC 458-20-170 (for constructing activities); WAC 458-20-226 (for landscape and horticultural services). Based on this authority, the “handyman” services, as described by Taxpayer, were “retail sales” under RCW 82.04.050, and generally subject to retailing B&O tax and retail sales tax. We note that retail sales tax “must be paid by the buyer to the seller.” RCW 82.08.050(1). But “if any seller fails to collect” the retail sales tax “the seller is, nevertheless, personally liable to the state for the amount of the tax.” RCW 82.08.050(2). Thus, to the extent that Taxpayer’s gross proceeds of sales of his handyman business are classified under the retailing B&O tax classification and subject to retail sales tax, Taxpayer, as the seller, is liable for any amounts of retail sales tax that he did not collect and remit to the Department.

Taxpayer does not dispute that his handyman business activity falls under the definition of retail sale under RCW 82.04.050. However, Taxpayer argues that a portion of his sales were “wholesale sales.” According to RCW 82.04.060(3), a “wholesale sale” includes “[a]ny charge made for labor and services rendered for persons who are not consumers, in respect to real or personal property, if such charge is expressly defined as a retail sale by RCW 82.04.050 when rendered to or for consumers.” Thus, a “wholesale sale” includes sales of labor and services by a subcontractor to a prime contractor. WAC 485-20-170(3)(a). We note that RCW 82.04.470(1) states the following:

The burden of proving that a sale is a wholesale sale rather than a retail sale is on the seller. A seller may meet its burden of proving a sale is a wholesale sale rather than a retail sale by taking from the buyer, at the time of sale or within 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.

Alternatively, RCW 82.04.470(2) states that a seller may accept a “uniform exemption certificate approved by the streamlined sales and use tax agreement governing board” or any other “exemption certificate as may be authorized by the department.” RCW 82.04.470(5) goes on to state that even if a seller does not accept any of these forms at the time of the purchase, it may still “meet its burden of proving that a sale is a wholesale sale rather than a retail sale by

demonstrating facts and circumstances, according to rules adopted by the department, that show the sale was properly made without payment of retail sales tax.”

WAC 458-20-102 (Rule 102), the Department’s administrative rule regarding reseller permits further clarifies that

If the seller has not obtained a reseller permit or [the alternative documentation allowed in RCW 82.04.470], the seller is liable for the tax due unless it can sustain the burden of proving that a sale is a wholesale sale by demonstrating facts and circumstances that show the sale was properly made at wholesale. The department will consider all evidence presented by the seller, including the circumstances of the sales transaction itself, when determining whether the seller has met its burden of proof. It is the seller’s responsibility to provide the information necessary to evaluate the facts and circumstances of all sales transactions for which reseller permits are not obtained. . . .

Rule 102(h). *See also* RCW 82.32.070; Rule 254. Rule 102(h) goes on to identify three categories of facts and circumstances that should be considered, including (1) the nature of the buyer’s business, (2) the nature of the items sold, and (3) any additional documentation. *Id.*

Taxpayer has provided no evidence that it accepted a reseller permit or any other authorized form at the time of the sale from any of its customers. Instead, Taxpayer provided two 1099-MISC forms on appeal, one issued by [Contractor A], and the other issued by [Contractor B], for work Taxpayer apparently did for those companies in 2012. Taxpayer argued that “[T]his represents work done on behalf of these two property managers who are the entities that collect the sales tax on the work performed, so essentially this represents non-sales taxable income, i.e., wholesale income.”

We conclude that the 1099-MISC forms that Taxpayer submitted and Taxpayer’s explanation do not meet Taxpayer’s burden of proving through facts and circumstances that the work Taxpayer did for [Contractor A] and [Contractor B] were wholesale sales. Department records do not support Taxpayer’s statement that those companies “are the entities that collect the sales tax on the work performed.” Indeed, neither company has ever had a reseller permit, suggesting that any sales Taxpayer made to those companies were not wholesale sales. In addition, Taxpayer has provided no additional information or documentation regarding the nature of the work he did for those companies, or proving that those companies were not the “consumers” of the work Taxpayer did for them. As such, Taxpayer has failed to prove that any of his estimated gross proceeds of sales of his handyman business should be reclassified under the wholesaling B&O tax classification.

3. Tax Paid at Source Deduction

Pursuant to RCW 82.08.130, a taxpayer may take a tax paid at source deduction against the measure of its retail sales tax liability under certain circumstances.

- (2) A buyer who pays a tax on all purchases and subsequently resells property or services at retail, without intervening use by the buyer, must collect the tax from the purchaser as otherwise provided by law and is entitled to a deduction on the buyer’s tax return equal to

the cost to the buyer of the property or service resold upon which retail sales tax has been paid. The deduction is allowed only if the taxpayer keeps and preserves records that include the names of the persons from whom the property or services were purchased, the date of the purchase, the type of property or services, the amount of the purchase, and the tax that was paid.

See WAC 458-20-102(12)(b); *see also* RCW 82.32.070; Rule 254.

Taxpayer argued that he paid retail sales tax on certain items he purchased for resale to his customers. Taxpayer provided a copy of his reseller permit, which was effective from January 28, 2013. Taxpayer also provided four examples of receipts from [a Building Supplies Retailer] for purchases of various items in 2012, and represented that he had many more similar receipts. Together, Taxpayer argued that these documents show that Taxpayer did not have a reseller permit at the time of the purchases evidenced in the receipts, and, thus, must have paid retail sales tax. Indeed, each of the receipts indicates retail sales tax was paid on the items purchased.

However, Taxpayer has provided no documentation that the items purchased were subsequently resold to Taxpayer's customers. In fact, Taxpayer conceded on appeal that he had not kept records, such as invoices, describing the work he did for his customers until 2013, and even for the work done in 2013, Taxpayer has never provided any invoices. As such, Taxpayer has not provided adequate records entitling him to any deduction of retail sales tax he paid during the audit period.

4. Use Tax and/or Deferred Sales Tax

RCW 82.12.020 imposes a use tax on "the privilege of using within this state as a consumer" any article of tangible personal property that has not already been subjected to retail sales tax. The measure of the use tax is "the value of the article used."

Here, Taxpayer did not produce records of the original purchase price of capital assets he purchased during the audit period. Instead, Taxpayer provided his federal income tax returns, which included depreciation schedules identifying certain capital assets, and assigning values to those assets. The Audit Division used the depreciation schedules to identify the capital assets purchased, and to determine the value of those articles. This method is consistent with Excise Tax Advisory No. 3029.2009 (ETA 3029), which states the following:

A taxpayer's own records are an admission of the minimum value of tangible personal property set up as a capital asset. The Department is entitled to use, but is not necessarily bound by the taxpayer's records.

The Audit Division subsequently agreed to adjust the amount of use tax assessed in the tax assessment regarding some of the items listed on the depreciation schedules that the Audit Division later concluded did not represent capital assets. As a result of those adjustments, the Department issued the PAA. Taxpayer has failed to provide any documentation besides his depreciation schedules that identify the capital assets he purchased, and the value of such assets. Thus, As such, we conclude there is no basis for any further adjustments to the amount of use

tax assessed in the tax assessment. *see* RCW 82.32.070; Rule 254. We, accordingly, affirm the amount of use tax assessed in the PAA.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 20th day of April, 2015.