

Cite as Det. No. 14-0159, 34 WTD 257 (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. 14-0159
)	
...)	Registration No. ...
and)	
...)	Registration No. ...
)	
)	

[1] RULE 254; RCW 82.32.070: RETAIL SALES TAX – RECORDKEEPING. Taxpayers are required to maintain adequate records to determine their tax liability. The Department may rely on a taxpayer’s own records to determine tax liability. If a taxpayer claims that its own records are erroneous, that taxpayer has the burden of proving such through adequate evidence.

[2] RULE 108; RCW 82.08.010: RETAILING B&O TAX – CASH AND TRADE DISCOUNT DEDUCTION – DISCOUNT VOUCHERS. A taxpayer may not take a cash and trade discount for any business expenses associated with offering discount vouchers.

[3] RULE 254; RCW 82.32.070: RETAILING B&O TAX – RECORDKEEPING. Taxpayers are required to maintain adequate records to determine their tax liability. The Department may rely on a taxpayer’s own records to determine tax liability. If a taxpayer claims that its own records are erroneous, that taxpayer has the burden of proving such through adequate evidence

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. – Two affiliated limited liability companies, Taxpayer A and Taxpayer B, operate two restaurants. Taxpayers protest the retail sales tax and retailing business and occupation (B&O) tax assessed by the Department. Taxpayers contend that its records do not accurately reflect (1) the amount of retail sales tax actually collected from their customers and (2) the amount of Taxpayers’ actual gross proceeds of sales. Taxpayers also contend that they

are entitled to a larger cash and trade discount deduction than allowed by the Department. We [deny] Taxpayer A's petition. We deny Taxpayer B's petition.¹

ISSUES

1. Under 82.32.070 and WAC 458-20-254, are Taxpayers liable for the amounts of retail sales tax their records indicate they collected from customers but failed to remit to the Department?
2. Under 82.08.010(1)(b) and WAC 458-20-108, are Taxpayers entitled to a cash and trade discount deduction for amounts disallowed by the Department?
3. Under 82.32.070 and WAC 458-20-254, are Taxpayers liable for retailing B&O tax based on the amount of gross proceeds of sales indicated in their records?

FINDINGS OF FACT

[Taxpayer A] and [Taxpayer B] (referred to jointly as Taxpayers) are two affiliated limited liability companies that operate two restaurants located in . . . Washington. Taxpayers commenced operations at the restaurants in 2011.

After commencing operations, Taxpayers entered into agreements with online discount voucher providers (DVPs) to sell customers discount vouchers on the internet as an incentive to attract customers to the restaurants.² For example, under the terms of one such agreement, a customer could purchase a discount voucher online for \$25. The discount voucher had a face value of \$50. The customer could then redeem the discount voucher at either one of the restaurants for \$50 worth of food or drink. Under the terms of that agreement, the DVP retained for its services a thirty percent commission fee, and remitted the remaining portion of the purchase price to Taxpayers.

In 2013, the Department's Audit Division conducted a review of Taxpayers' books and records for the period of May 1, 2011 through December 31, 2012 (audit period). During that review, the Audit Division found that Taxpayers' point-of-sale (POS) system recorded that Taxpayers had collected more retail sales tax than they had remitted to the Department.³ Specifically, Taxpayer A's POS system indicated it collected \$. . . in retail sales tax, but then remitted only \$. . . , leaving a difference of \$. . . unremitted.⁴ Similarly, Taxpayer B's POS system indicated it collected \$. . . in retail sales tax, but then remitted only \$. . . , leaving a difference of \$. . . unremitted.

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

² Taxpayers' representative stated that the previous owners of the restaurants also entered into discount voucher agreements with DVPs and Taxpayers later chose to honor any discount vouchers that had been sold to customers on behalf of the previous owner even though Taxpayers reportedly did not receive any proceeds from the sale of those discount voucher. The records provided by Taxpayers, however, include only agreements entered into by Taxpayers' members since Taxpayers commenced operations.

³ Taxpayers both used the same type of POS system during the audit period.

⁴ The Audit Division's workpapers state that Taxpayer's A POS system indicated a total of \$. . . – as opposed to \$. . . – was collected, and, as a result, \$. . . was unremitted to the Department. This represents a one dollar rounding error that we have corrected here.

During its review, the Audit Division discussed this discrepancy with Taxpayers' current bookkeeper. . . . Based on this discussion, the Audit Division concluded that Taxpayers' POS system accurately reflected the amount of retail sales tax they collected from their customers, and assessed retail sales tax against Taxpayers accordingly.

The Audit Division also found that Taxpayers had not properly reported their gross proceeds of sales related to discount vouchers. Based on its review of Taxpayers records related to discount voucher transactions, the Audit Division found that Taxpayers had claimed larger cash and trade discount deductions than they were entitled to claim. Taxpayers' current bookkeeper reported to the Audit Division that during the audit period, Taxpayers had claimed the cash and trade discount deduction to reduce the amount of Taxpayers' gross proceeds of sales from discount vouchers down to the amount Taxpayers actually received from the DVPs, not including any amounts the DVPs retained for their fees.

Based on Taxpayers' records, the Audit Division allowed the cash and trade discount deductions for the difference between the amounts paid by Taxpayers' customers for the discount vouchers and the face value of those vouchers. The Audit Division disallowed any additional amount originally claimed by Taxpayers. For Taxpayer A, the Audit Division disallowed \$. . . of the total cash and trade discount deduction Taxpayer A claimed for the audit period, which ultimately resulted in an assessment of an additional \$. . . in retailing B&O tax against Taxpayer A. For Taxpayer B, the Audit Division disallowed \$. . . of the total cash and trade discount deduction Taxpayer B claimed for the audit period, which ultimately resulted in an assessment of an additional \$. . . in retailing B&O tax against Taxpayer B.

The Audit Division also found that Taxpayers had failed to report some of their gross proceeds of sales. Specifically, Taxpayer A's POS system indicated that it had a total gross income of \$. . . , but reported to the Department gross income of only \$. . . , leaving a difference of \$. . . unreported. Similarly, Taxpayer B's POS system indicated that it had a total gross income of \$. . . , but reported to the Department gross income of only \$. . . , leaving a difference of \$. . . unreported. The Audit Division also compared the combined total gross receipts indicated in Taxpayers' POS system, which was \$. . . , with the combined total deposits in Taxpayers' respective bank accounts, which was \$. . . . Based on the relative closeness of these two figures, the Audit Division concluded that Taxpayers' POS system accurately reflected Taxpayers' gross proceeds of sales. As a result, the Audit Division relied on Taxpayers' POS system to assess additional retailing B&O tax for unreported sales.

On June 20, 2013, based on the results of the Audit Division's review, the Department issued a tax assessment against Taxpayer A for a total of \$. . . , which included \$. . . in retail sales tax, \$. . . in retailing B&O tax, \$. . . in use tax, \$. . . in . . . County Food and Beverage Tax, and \$. . . in interest.

On June 21, 2013, based on the results of the Audit Division's review, the Department issued a tax assessment against Taxpayer B for a total of \$. . . , which included \$. . . in retail sales tax, \$. . . in retailing B&O tax, \$. . . in . . . County Food and Beverage Tax, and \$. . . in interest.

Taxpayers timely appealed the retail sales tax and retailing B&O tax components of their respective tax assessments. Taxpayers' representative made a number of arguments on appeal.

First, he argued that Taxpayers' POS system did not accurately record the amount of retail sales tax Taxpayers actually collected from their customers. . . . Also, regarding the additional retailing B&O tax imposed, Taxpayers' representative argued that for most of the audit period there was "little authority or direction" on the tax treatment of discount vouchers.

On appeal, Taxpayers provided some additional documentation, including seven additional records from discount voucher transactions with a copy of both the discount voucher and receipt.

ANALYSIS

1. Retail Sales Tax

All retail sales in the state of Washington are subject to retail sales tax unless specifically excluded or prohibited. RCW 82.08.020(1); *see generally* Chapter 82.08 RCW. The retail sales tax is "to be collected by the seller" and is "deemed to be held in trust by the seller until paid to the department." RCW 82.08.050(2). The retail sales tax a seller collects "must be stated separately from the selling price in any sales invoice or other instrument of sale." RCW 82.08.050(9). If a seller fails to collect the retail sales tax as required or collects the tax but fails to remit it to the Department, the seller is "personally liable to the state for the amount of the tax." RCW 82.08.050(3). Moreover, any retail sales tax a seller actually collects from its customers must be remitted to the Department. *Kitsap-Mason Dairymen's Ass'n v. Washington State Tax Commission*, 77 Wn.2d 812, 816-17, 467 P.2d 312 (1970). The sale of meals by a restaurant is a retail sale. WAC 458-20-124(1). Thus, Taxpayers here made retail sales and were required, as the sellers, to collect retail sales tax from their customers and remit any such taxes they collected to the Department. The Audit Division, however, found that according to Taxpayers' records, they failed to remit all retail sales tax they had collected from their customers.

Taxpayers argue on appeal that their own records are inaccurate for determining the amount of retail sales tax they collected from their customers. Every taxpayer is required to "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" RCW 82.32.070. *See also* RCW 82.32A.030 (taxpayers must "[k]eep accurate and complete business records"). WAC 458-20-254 (Rule 254) sets forth specific requirements for a taxpayer to maintain and disclose books, records, and other sources of financial information to the Department. Rule 254 states the following:

(3) Recordkeeping requirements – General.

(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. The 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.

(iv) The amounts of any refunds claimed. . . .

(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.

Because Taxpayers are required to maintain “accurate” records for determining their tax liability, we conclude that the Audit Division has the right to rely on Taxpayers’ records in determining tax liability. *See* Det. No. 89-280, 7 WTD 375 (1989). When a taxpayer claims that its own records are inaccurate, the taxpayer has the burden to affirmatively show the records are erroneous. *See id.* Mere “self-serving” statements are not sufficient to meet this burden. *See* Det. No. 05-0045, 24 WTD 413 (2005); Det. No. 04-0098, 23 WTD 331 (2004).

While Taxpayers’ representative stated on appeal that the POS system did not accurately reflect the true amount of retail sales tax Taxpayers collected from their customers, such a statement alone, without additional evidence of such inaccuracy, is not adequate to reach Taxpayers’ burden of proving that their own records are incorrect. Taxpayers’ representative argued that Taxpayers should not have to pay retail sales tax they never collected from their customers, yet Taxpayers provided insufficient evidence that the amount of retail sales tax they collected from their customers was less than the amounts evident in Taxpayers’ POS system. Moreover, as the Audit Division observed, Taxpayers’ bank statements reveal that its total bank deposits between the two restaurants closely matched the total gross receipts recorded in the POS system. This observation further supports the presumption that Taxpayers’ POS system records are accurate.

Without actual evidence that Taxpayers’ POS records are inaccurate, we must conclude that the Audit Division appropriately relied on Taxpayers’ records to determine the amount of retail sales tax that Taxpayers collected during the audit period. Taxpayers have failed to meet their burden of proving that they collected less retail sales tax from its customers than that which is documented in their own records. We affirm the assessment of retail sales tax to the extent that the assessment matches the amount of retail sales tax recorded in Taxpayers’ POS system.

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2. Retailing B&O Tax

Taxpayers also protest the amount of retailing B&O tax assessed by the Audit Division. The amount of retailing B&O tax the Audit Division assessed consists of two components, (1) a

partial disallowance of Taxpayers' claimed deduction for cash and trade discounts, and (2) some additional unreported sales.

Every person in the business of making retail sales within Washington generally owes retailing B&O tax equal to the gross proceeds of sales of the business, multiplied by the applicable tax rate. RCW 82.04.250. "Gross proceeds of sales" is defined as the following:

[T]he value proceeding or accruing from the sale of tangible personal property, . . . and or/for other services rendered, **without any deduction on account of the cost of property sold, the cost of materials used, labor costs, interest, discount paid, delivery costs, taxes, or any other expense** whatsoever paid or accrued

RCW 82.04.070 (emphasis added). We also note that unless a taxpayer has records to support a deduction or exemption from taxation, it is not entitled to it. RCW 82.32.070; Rule 254. Further, both the Department and Washington courts consistently hold that exemptions and deductions are narrowly construed. *Budget Rent-A-Car of Washington and Oregon, Inc. v. Dep't of Revenue*, 81 Wn.2d 171, 174, 500 P.2d 764 (1972); Det. No. 98-027, 17 WTD 340 (1998).

A. Cash and Trade Discount Deduction

Taxpayers dispute the Audit Division's partial disallowance of the cash and trade discount deduction Taxpayers originally claimed. RCW 82.08.010(1)(b) allows taxpayers to exclude from the selling price any "[d]iscounts, including cash, term, or coupons that are not reimbursed by a third party that are allowed by a seller and taken by a purchaser on a sale." WAC 458-20-108 (Rule 108) further explains the tax treatment of discounts:

(5) The selling price of a service or of an article of tangible personal property does not include the amount of bona fide discounts actually taken by the buyer and **the amount of such discount may be deducted from gross proceeds of sales** providing such amount has been included in the gross amount reported.

(Emphasis added). The Department has long recognized that discounts are "bona fide" when they are "reduced prices" and the buyer is not required to do anything in return for the reduced price. *See* Det. No. 05-0142, 26 WTD 256 (2007); Det. No. 83-180, 11 WTD 5 (1983).

Here, Taxpayers made sales to customers that involved discount vouchers. Similar to gift certificates, discount vouchers are instruments that a customer purchases to redeem later for goods or services. The main difference is that the face value of a gift certificate generally matches the price the customer paid for the certificate, whereas, the face value of a discount voucher is higher than the price the customer paid for voucher, thereby giving customers the opportunity to receive goods or services valued at the face value, but only paying a discounted price without having to perform any other action. Accordingly, the difference between the face value of the discount voucher and actual price customers paid for the discount voucher constitutes a "bona fide discount" under Rule 108.

WAC 458-20-103 (Rule 103) states the following regarding the timing of the tax liability associated with gift certificates:

Where gift certificates are sold which will be redeemed in merchandise, or in services which are defined by the Revenue Act as retail sales, the sale is deemed to occur and the retail sales tax shall be collected **at the time the certificate is actually redeemed** for the merchandise or services.

(Emphasis added). Consistent with the tax treatment of gift certificates, the Department issued a Special Notice on discount vouchers on August 23, 2012.⁵ The Special Notice provides the following instructions regarding discount vouchers:

- The purchase of a discount voucher prior to redemption is not taxable.
- The seller of a product or products purchased using a discount voucher **must include the amount the customer paid for the discount voucher in the gross proceeds of sales** or gross income of the business, as the case may be.
- If a discount voucher is redeemed by a customer for a product subject to retail sales tax . . . , then the amount paid by the customer is included in the table sales price of the product.
- The **seller may not deduct advertising or similar expenses (fees) paid to the [DVP]**, even if the [DVP] “nets out” those expenses (fees) before remitting payment to the seller.

(Emphasis added). Thus, to properly report income from discount vouchers, a taxpayer must report the amount the customer paid for the voucher without deducting any amount for the fees retained by the DVP. After reviewing Taxpayers’ records, the Audit Division allowed a cash and trade discount deduction for the amount of the “bona fide discount,” which was the difference between any amounts the customer paid for the discount voucher, or any additional amounts the customer actually paid to Taxpayers at the time the customer redeemed the voucher, and the face value on the discount voucher. RCW 82.04.070 clearly prohibits [the deduction of] business expenses associated with the gross proceeds of sales. Moreover, RCW 82.08.010 and Rule 108 clearly allow a deduction only for amounts that represent a “bona fide discount.” Based on that authority, we conclude that the Audit Division properly disallowed any additional amount of cash and trade discount deduction beyond the “bona fide discount” amount.

Taxpayers, however, argued that prior to the issuance of the Special Notice on August 23, 2012, there was “little authority or direction” on the tax treatment of discount vouchers. The Washington tax system is based largely on voluntary compliance. The Revenue Act imposes on taxpayers the responsibility to inform themselves about applicable tax laws, register with the Department, and accurately and timely pay taxes. Chapter 82.32 RCW. Indeed, all taxpayers have the responsibility to “[k]now their tax reporting obligations, and when they are uncertain about their obligations, seek instructions from the department of revenue.” RCW 82.32A.030(2). Taxpayers provided no evidence that they sought the advice of the Department on this issue or that the Department provided incorrect written instruction to them on how to properly report its gross proceeds of sales from discount voucher transactions. The record before us simply indicates that Taxpayers relied on the advice of their tax professionals to properly report its gross proceeds of sales to the Department during the audit period. Any confusion Taxpayers had on this issue is not a basis upon which we may allow the cash and trade discount deduction beyond the amount allowed under RCW 82.08.010 and Rule 108, and as explained in the Special Notice.

⁵ Found at http://dor.wa.gov/docs/pubs/specialnotices/2012/sn_12_discountvouchers.pdf, last visited on May 5, 2014.

Taxpayers have provided no other evidence to suggest that they are entitled to a larger cash and trade discount deduction than the total amount of “bona fide discounts” found by the Audit Division. Likewise, although Taxpayers’ representative argued that Taxpayers did not actually receive some of the proceeds from DVPs for all of their customers’ purchases of discount vouchers, Taxpayers provided no evidence to support this statement. Thus, we conclude that the Audit Division’s partial disallowance of Taxpayers’ cash and trade discount deduction was correct.

B. Unreported Sales

Based on Taxpayers’ POS system records, the Audit Division discovered a difference between the amount of gross proceeds of sales recorded in Taxpayers’ POS system and the amount of gross proceeds of sales Taxpayers reported to the Department. As we concluded earlier, under RCW 82.32.070, RCW 82.32A.030, and Rule 254, the Audit Division was entitled to rely on Taxpayers’ records to determine their tax liability unless Taxpayers proved that their own records were inaccurate. Taxpayers failed to offer any evidence, besides Taxpayers’ representative’s statement, to show that their POS system was inaccurate for the purpose of determining Taxpayers’ total gross proceeds of sales. We conclude, therefore, that the Audit Division properly relied on the POS system records to determine the amount of Taxpayers’ gross proceeds of sales, and in turn, the amount of unreported sales during the audit period.

DECISION AND DISPOSITION

Taxpayer A’s petition is [denied].

Taxpayer B’s petition is denied.

Dated this 14th day of May 2014.