

Cite as Det No. 12-0277, 32 WTD 194 (2013)

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. 12-0277
)	
... )	
)	Registration No. . . .
)	Document No. . . . /Audit No. . . .
)	
)	Docket No. . . .
)	

[1] RULE 254; RCW 82.32.070, RCW 82.32.100: RECORDS – GROSS INCOME – BANK DEPOSITS. Where the taxpayer failed to produce records to explain the discrepancy between the deposits in the bank account and the amounts reported on the excise tax returns, Audit was justified in using the bank deposits to estimate gross income.

[2] RULE 13501; RCW 82.08.02565, RCW 82.12.02565: RETAIL SALES AND USE TAX -- MACHINERY AND EQUIPMENT EXEMPTION – EXTRACTING TIMBER. The taxpayer’s purchase of a CAT excavator for use in extracting timber did not qualify for the manufacturer’s machinery and equipment exemption.

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.

Chartoff, A.L.J. – A Washington business engaged in site preparation activities and extracting timber for sale, petitions for correction of an audit assessment that includes retailing business and occupation (B&O) tax and retail sales tax on underreported income, and use and/or deferred sales tax on the purchase of a CAT excavator used for extracting timber. The taxpayer contends the Audit Division erred when it determined gross income based on the taxpayer’s bank deposits, because the bank deposits include the proceeds of bank loans. The taxpayer also contends that logging equipment is exempt from retail sales and use tax. Because the taxpayer failed to provide any documentation regarding the bank loans, and because the purchase of equipment for extracting timber is not exempt from retail sales or use tax, we deny the petition.<sup>1</sup>

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

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## ISSUES

1. Did the Audit Division err when it determined the taxpayer's gross income using the deposits recorded on the taxpayer's bank statements?
2. Was the purchase of a CAT excavator for use in extracting timber exempt from retail sales or use tax?

## FINDINGS OF FACT

The taxpayer engages in site preparation activities such as excavating, grading, demolition of buildings and other structures, septic system installation, and house moving. The taxpayer also engages in extracting timber for sale.

The taxpayer was audited for the period January 1, 2007 through December 31, 2010. The audit resulted in an assessment of \$ . . ., consisting of \$ . . . retail sales tax, \$ . . . retailing B&O tax, \$ . . . use tax and/or deferred sales tax, \$ . . . small business credit, (\$- . . .) wholesaling B&O and \$ . . . interest.

The taxpayer petitioned the Appeals Division for correction of the assessment. First, the taxpayer disputes retailing B&O tax and retail sales tax assessed on underreported income in schedules 3A and 3B of the audit. These schedules contain a reconciliation of income taxable under the retailing and retail sales tax classifications through a comparison of amounts recorded in the business records with the amounts reported on the excise tax returns. Audit found significant differences between the amounts deposited in the business bank account, and amounts reported on the excise tax returns. Audit assessed retailing B&O and retail sales tax on these underreported deposits. The taxpayer argues that the amounts deposited in the business bank account include the proceeds of loans. However, the taxpayer has not provided any records to the Audit Division or the Appeals Division to substantiate the bank account deposits included loan proceeds.

Second the taxpayer disputes the assessment of use tax and/or deferred sales tax on the purchase of a CAT excavator. Audit found that the taxpayer did not pay retail sales tax on the purchase of a CAT excavator, and that the taxpayer uses the CAT excavator for harvesting timber. The taxpayer does not dispute Audit's factual findings, but argues that logging equipment is exempt from sales and use tax.<sup>2</sup>

## ANALYSIS

1. Did the Audit Division err when it determined the taxpayer's gross income using the deposits recorded on the taxpayer's bank statements?

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<sup>2</sup> The taxpayer argued that logging equipment was exempt but did not state which exemption applies.

[1] RCW 82.32.070(1) imposes a duty of each taxpayer to keep complete and accurate records for which the department may determine the liability for such taxpayer. RCA 82.32.070(1) states, in pertinent part:

Every 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, which records shall include copies of all federal income tax and state tax returns and reports made by him. All his books, records, and invoices shall be open for examination at any time by the department of revenue.

WAC 458-20-254 (Rule 254) defines the requirements for the maintenance and retention of books, records, and other sources of information. Rule 254 requires the records to include “the normal records maintained by an ordinary prudent business person.”

Where a taxpayer fails to make available for examination the records required by RCW 82.32.070 and Rule 254, the Department is authorized to estimate a taxpayer’s tax liability based on available documents. RCW 82.32.100 provides, in part:

(1) If any person fails or refuses to make any return or to make available for examination the records required by this chapter, 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; and to this end the department may examine the records of any such person as provided in RCW 82.32.110.

In the present case, the auditor found that the deposits in the bank account exceeded the amounts reported on the excise tax returns. The auditor discussed this discrepancy with the taxpayer prior to issuing the assessment and gave the taxpayer an opportunity to provide additional records to explain the discrepancy. The taxpayer argued that the bank deposits included proceeds from a bank loan, but did not provide any supporting records to substantiate its argument. Because records were not available to explain the discrepancy between the deposits in the bank account and the amounts reported on the excise tax returns, Audit was justified in using the bank deposits to estimate gross income. RCW 82.32.100(1).

Starting with bank deposit records and requiring a taxpayer to identify and document all non-income deposits is an accurate method for reconciling taxable income with reported income. *See* Det. No. 10-0167, 30 WTD 89 (2011); *See also Parks v. C. I. R.* 94 T.C. 654, 658 (Tax Court, 1990) (Bank deposits are prima facie evidence of the receipt of income.) The Department’s auditor is required to determine the amount of any tax for which the taxpayer may be liable. The auditor is the person who has the opportunity to look at the taxpayer’s various records. A Department auditor is particularly qualified by training and experience to determine which records are suitable for determining the amount of tax due. We generally will not second-guess the auditor’s decision as to which records should be used for determining whether the taxpayer has correctly and completely reported. Because the taxpayer failed to provide any records

substantiating its argument that the deposits included bank loans, we deny the petition on this issue.

2. Was the purchase of a CAT excavator for use in extracting timber exempt from retail sales or use tax?

[2] The next issue is whether the taxpayer owes use and/or deferred sales tax on the purchase of a CAT excavator that it uses for extracting timber. Persons engaging in “the felling, cutting (severing from the land), or taking of trees” are taxable under the extracting classification for B&O tax. RCW 82.04.100; WAC 13501(2). Persons engaged in “the cutting into length (bucking), delimiting, and measuring (for bucking) of felled, cut (severed), or taken trees” are taxable under the manufacturing classification for B&O tax. RCW 82.04.120; WAC 13501(2). In the present case, Audit found that the taxpayer was engaged in extracting activities and did not engage in manufacturing. The taxpayer did not dispute that it engaged in timber harvesting activities as an extractor, and not as a manufacturer.

WAC 458-20-13501 (Rule 13501) is the Department’s administrative rule that explains the application of the B&O, public utility, retail sales, and use taxes to persons performing activities with timber harvest operations. With regard to equipment and supplies used in timber harvest operations, Rule 13501(7) states: “[t]he retail sales tax applies to all purchases of equipment, component parts of equipment, and supplies by persons engaging in timber operations unless a specific exemption applies.” Rule 13501(7)(a) further states that “RCW 82.08.02565 and 82.12.02565 provide a retail sales and use tax exemption for certain machinery and equipment used by manufacturers.” Because the taxpayer in this case does not engage in manufacturing, the manufacturer’s machinery and equipment exemption does not apply, and there is no other exemption that applies to the purchase of logging equipment by an extractor. Det. No. 11-0097, 31 WTD 31 (2012); Det. No. 00-138, 20 WTD 167 (2001). Accordingly, we conclude the taxpayer’s purchase of a CAT excavator for use in extracting timber is not exempt from retail sales or use tax.

In sum, we deny the taxpayer’s claim that the Audit Division erred when it determined gross income based on the taxpayer’s bank deposits because the taxpayer has failed to provide any records substantiating the bank deposits included bank loans. We also deny the taxpayer’s claim that its purchase of the CAT excavator for use in extracting activities is exempt from sales or use tax. Accordingly, we sustain the audit assessment and deny the petition.

#### DECISION AND DISPOSITION

Taxpayer's petition is denied

Dated this 10<sup>th</sup> day of October 2012.