

Cite as Det. No. 13-0267, 33 WTD 33 (2014)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

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| 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. 13-0267 |
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|) | |
|) | Registration No. . . . |
|) | Document Nos. . . . & Audit No |
|) | |
|) | Docket No. . . . |
|) | |

RULE 102, RULE 170; RCW 82.08.130, RCW 82.04.050, RCW 82.32.070, RCW 82.32A.030: – RETAIL SALES TAX – TAX PAID AT SOURCE DEDUCTIONS – RECORDS TO SUPPORT SUCH DEDUCTIONS. Taxpayer failed to maintain and provide the Department with records to support tax paid at source deductions it claimed. In addition, contrary to law, taxpayer erroneously claimed tax paid at source deductions against the measure of retailing business and occupation (B&O) tax it reported to the Department. Therefore, the Department properly disallowed tax paid at source deductions taxpayer claimed during the audit period.

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.

Pardee, A.L.J. – Taxpayer, a prime contractor, disputes the Department of Revenue’s (Department’s) disallowance of tax paid at source deductions it claimed during the audit period. We deny the petition.¹

ISSUE

Under RCW 82.08.130(2) and WAC 458-20-102(12), is Taxpayer allowed to claim tax paid at source deductions if Taxpayer does not substantiate them with invoices showing it paid sales tax, and takes those deductions against both its measure of retailing B&O tax and retail sales tax?

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

FINDINGS OF FACT

During the period May 1, 2008, through September 30, 2011 (audit period) . . . (Taxpayer), a Washington corporation,² remodeled residential and commercial real properties for its customers in Washington State. Taxpayer specialized in repairing fire and water damage to real property. Taxpayer had an office in [Washington] prior to January 2012, but now operates solely out of . . . Oregon.

The Department's Audit Division (Audit) examined Taxpayer's books and records for the audit period. On January 13, 2012, the Department issued Taxpayer an assessment (Document No. . . . – "Assessment") which totaled \$21,198,³ comprised of \$18,269 of retail sales tax, \$1,181 of retailing business and occupation (B&O) tax, a \$93 small business credit, a 5 percent assessment penalty of \$977, and interest of \$678.

Schedule 2 of the Assessment explains that for certain months in 2010,⁴ and for the first nine months in 2011, when Taxpayer filed tax returns with the Department, it took a tax paid at source deduction against both its measure of retailing B&O tax and retail sales tax. Audit disallowed the tax paid at source deductions Taxpayer took against the retailing B&O tax measure.

In Schedule 3 of the Assessment, Audit evaluated the tax paid at source deductions Taxpayer took against the measure of its retail sales tax during a six month period, from February 2011 through August 2011 (sample period). After Audit identified sales where the vendor did not charge retail sales tax but where Taxpayer took a tax paid at source deduction, it established an error rate (roughly 41 percent) for the sample period. Audit then applied that error rate to all tax paid at source deductions Taxpayer claimed during the audit period, and assessed retail sales tax on the disallowed tax paid at source deduction amounts. Audit explains that it was to Taxpayer's benefit for Audit to apply the 41 percent error rate to the entire audit period, since it could have disallowed all of the tax paid at source deductions that Taxpayer claimed during the period for which it did not provide the Department with any records. Taxpayer admits that it has no business records (e.g., invoices) showing that it paid retail sales tax to vendors in support of the tax paid at source deductions it claimed for roughly half of 2008, and all of 2009 and 2010.

Taxpayer timely appealed the Assessment, however, and provided the Department's Appeals Division with records in support of its appeal. The Appeals Division forwarded Taxpayer's submissions on to Audit to review. After reviewing the records Taxpayer provided, Audit issued

² Taxpayer's account is no longer active with the Department or the Washington Secretary of State's office.

³ Taxpayer has not paid the Assessment.

⁴ February 2010 through March 2010, and October 2010 through December 2010. Taxpayer provided the Department's Appeals Division with a copy of its June 2010 combined excise tax return as evidence that it did not claim a tax paid at source deduction against both its measure of retailing B&O tax and retail sales tax. While true, this does not negate the fact that Taxpayer claimed tax paid at source deductions against both measures of tax in the months described above.

a post assessment adjustment (PAA) on February 11, 2013 totaling \$19,836,⁵ comprised of \$16,617 of retail sales tax, retailing B&O tax of \$1,181, a \$93 small business credit, a 5 percent assessment penalty of \$895, and interest of \$665. The sole adjustment that Audit made in the PAA was based on a cancelled check for \$1,652 for retail sales tax that Taxpayer paid to one of its vendors Audit gave Taxpayer credit for this amount in the PAA.⁶

ANALYSIS

The term “sale at retail” or “retail sale” includes:

(1)(a) . . . [E]very sale of tangible personal property (including articles produced, fabricated, or imprinted) to all persons irrespective of the nature of their business and including, among others, without limiting the scope hereof, persons who install, repair, clean, alter, improve, construct, or decorate real or personal property of or for consumers

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(2) . . . [T]he sale of or charge made for tangible personal property consumed and/or for labor and services rendered in respect to the following: . . .

(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, including the installing or attaching of any article of tangible personal property therein or thereto, whether or not such personal property becomes a part of the realty by virtue of installation, and also includes the sale of services or charges made for the clearing of land and the moving of earth excepting the mere leveling of land used in commercial farming or agriculture;

RCW 82.04.050.

WAC 458-20-170(1)(a) (Rule 170(1)(a)), defines a “prime contractor” as: “[A] person engaged in the business of performing for consumers, the constructing, repairing, decorating, or improving of new or existing buildings or other structures under, upon or above real property.” Rule 170(1)(b) defines a “subcontractor” as: “[A] person engaged in the business of performing a similar service for persons other than consumers” Generally, prime contractors are taxable under the retailing B&O tax classification, and subcontractors under the wholesaling B&O tax classification, upon the gross contract price. Rule 170(3)(a).

Prime contractors and subcontractors may purchase materials that become part of the structure being built or improved without paying the supplier the retail sales tax by providing a reseller’s

⁵ Taxpayer has paid nothing toward the PAA.

⁶ Taxpayer also provided records to the Department concerning retail sales tax it paid to another vendor,. . . . However, Audit explains that in Workpaper A3 of its Assessment it already gave Taxpayer credit for retail sales tax paid to this vendor.

permit to the seller. Rule 170(4)(c). However, the retail sales tax applies upon sales and rentals to prime contractors and subcontractors of tools, machinery and equipment, and consumable supplies. Rule 170(4)(d). Taxpayer did not provide the Department with invoices showing it paid retail sales taxes to vendors for which it later claimed a tax paid at source deduction.

Tax paid at source deductions claimed by Taxpayer during the audit period

RCW 82.32.070(1) mandates that Taxpayer keep and preserve suitable records as necessary to determine the amount of tax for which it is liable:

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 . . .

Department rule expounds on this recordkeeping requirement:

(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. . .

(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.

WAC 458-20-254(3) (Rule 254(3)) (emphasis added).

Also, under RCW 82.32A.030, taxpayers have certain responsibilities, including to:

(3) Keep accurate and complete business records; . . .

(5) Ensure the accuracy of the information entered on their tax returns; . . .

We conclude that Taxpayer has not provided the Department with adequate records under RCW 82.32.070(1), RCW 82.32A.030, or Rule 254(3) that substantiate the tax paid at source deductions it claimed during the audit period.

RCW 82.08.130 explains that taxpayers may take a tax paid at source deduction against the measure of their retail sales tax liability under certain circumstances, and states:

(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.

(Emphasis added).

WAC 458-20-102 (Rule 102), the administrative regulation wherein the Department explains tax paid at source deductions and the prerequisites for taxpayers to claim them, states:

(12) **Purchases for dual purposes.** A buyer normally engaged in both consuming and reselling certain types of tangible personal property, and not able to determine at the time of purchase whether the particular property purchased will be consumed or resold, must purchase according to the general nature of the buyer's business. RCW 82.08.130. If the buyer principally consumes the articles in question, the buyer should not give a reseller permit for any part of the purchase. If the buyer principally resells the articles, the buyer may furnish a reseller permit for the entire purchase. For the purposes of this subsection, the term "principally" means greater than fifty percent.

* * *

(b) **Tax paid at source deduction.** If the buyer has not provided a reseller permit to the seller but has paid retail sales tax on all articles of tangible personal property and subsequently resells a portion of the articles, the buyer must collect the retail sales tax from its retail customers as provided by law. When reporting these sales on the excise tax return, the buyer may then claim a deduction to recover the sales tax paid for the property resold.

(i) This deduction may be claimed under the retail sales tax classification only. It must be identified as a "taxable amount for tax paid at source" deduction on the deduction detail worksheet, which must be filed with the excise tax return. Failure to properly identify the deduction may result in the disallowance of the deduction. When completing

the local sales tax portion of the tax return, the deduction must be computed at the local sales tax rate paid to the seller, and credited to the seller's tax location code.

(ii) The following example illustrates the tax paid at source deduction on or after July 1, 2008.

A seller is located in Spokane, Washington, and purchases equipment parts for dual purposes from a supplier located in Seattle, Washington. The supplier ships the parts to Spokane. The seller does not furnish a reseller permit for the purchase, and remits retail sales tax to the supplier at the Spokane tax rate. A portion of these parts are sold and shipped to a customer in Kennewick, with retail sales tax collected at the Kennewick tax rate. The seller must report the amount of the sale to the customer on its excise tax return and compute the local sales tax liability using the Kennewick location code (0302) and rate. The seller would claim the tax paid at source deduction for the cost of the parts resold to the customer and compute the local sales tax credit using the Spokane location code (3210) and rate.

(iii) Claim for deduction will be allowed only if the taxpayer keeps and preserves records in support of the deduction that include the names of the persons from whom such articles were purchased, the date of the purchase, the type of articles, the amount of the purchase and the amount of tax that was paid.

(iv) Should the buyer resell the articles at wholesale, or under other situations where retail sales tax is not to be collected, the claim for the tax paid at source deduction on a particular excise tax return may result in a credit. In such cases, the department will issue a credit notice that may be used against future tax liabilities. However, a taxpayer may request in writing a refund from the department.

(Emphasis added).

With regard to a substantial portion of the tax paid at source deductions it claimed during the audit period, Taxpayer failed to provide the Department with records in support of the deductions, including the names of the persons from whom tangible personal property was purchased, the date of the purchases, the type of articles, the amount of the purchases, and the amount of retail sales tax it paid. In addition, for several months during the audit period, Taxpayer took a tax paid at source deduction against the measure of its retailing B&O tax liability, also contrary to the requirements of RCW 82.08.130(2) and Rule 102(12). Since Taxpayer failed to preserve records showing that it paid retail sales tax to certain vendors during the audit period, the Department correctly disallowed a portion of the tax paid at source deductions that Taxpayer claimed during the audit period. Department precedent supports this conclusion.

As Det. No. 04-0132, 24 WTD 254 (2005) explains: "In all instances . . . a claim for a credit for retail sales tax paid at source must be supported by adequate documentation showing that retail sales tax was in fact paid." In 24 WTD 254, the taxpayer therein contended that he should be entitled to a presumption that he paid retail sales tax where he could produce a credit card receipt ending in an uneven amount. The Department responded as follows in 24 WTD 254:

Taxpayer contends that he should be entitled to a presumption that retail sales tax was paid in cases where he can produce a credit card receipt ending in an uneven amount, suggesting that the total charge included sales tax. We disagree. RCW 82.32.070 requires taxpayers to preserve suitable records for a period of five years, and a taxpayer who fails to comply is not entitled to dispute the correctness of any assessment.

Taxpayer failed to preserve sales invoices showing that retail sales tax was paid. We do not agree that a credit card receipt for an amount ending in uneven cents is a reliable indication that the total includes retail sales tax.

(Emphasis added).

As with the taxpayer in 24 WTD 254, Taxpayer has failed to support its claimed deductions for tax paid at source. We therefore uphold the Department's assessment.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 27th day of August 2013.