

Cite as Det. No. 16-0297, 36 WTD 259 (2017)

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. 16-0297
)	
...)	Registration No. . . .
)	

Rule 102; RCW 82.04.470: WHOLESALE TRANSACTION – REQUIRED DOCUMENTATION – FACTS AND CIRCUMSTANCES. The burden of proving that a sale is a wholesale rather than a retail sale is on the seller. A seller may meet its burden by taking from the buyer a copy of a reseller permit or other authorized documentation under RCW 82.04.470 and WAC 458-20-102 (Rule 102). The facts and circumstances exception provided in RCW 82.04.470(5) and Rule 102(7)(h) is not based on the taxpayer’s good faith belief, but requires establishing facts and circumstances showing that the sale was properly made at wholesale based on facts evidenced by supporting documentation.

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.

Eckholm, T.R.O. – A seller of marijuana products contests an assessment resulting from reclassification of certain sales from wholesale to retail, asserting that it has established facts and circumstances that the transactions at issue were properly reported as wholesale sales, under RCW 82.04.470(5) and WAC 458-20-102(7)(h). The taxpayer’s petition is denied.¹

ISSUE

Has the taxpayer met its burden of establishing by facts and circumstances that sales of marijuana products were properly reported as wholesale sales under RCW 82.04.470(5) and WAC 458-20-102(7)(h)?

FINDINGS OF FACT

[Taxpayer] sells marijuana products. The Department of Revenue (Department) Audit Division reviewed the taxpayer’s records for excise tax purposes for the period August 1, 2013, through June 30, 2015. In response to the auditor’s initial request for records, the taxpayer indicated that it kept handwritten records for the first portion of the audit period and did not maintain its records electronically until it retained the accounting services of its taxpayer representative in

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

approximately April 2014. The taxpayer provided a handwritten summary of transactions for October 2013 as a sample of its handwritten records. The sample summary did not contain basic details regarding the majority of the sales transactions, such as buyer name or address, and only noted whether the sale was at wholesale or retail, and the price. The taxpayer then provided the auditor electronic records for the entire audit period. The electronic records also did not contain any detail regarding the sales transactions for the initial part of the audit period. The electronic records included buyer identification for sales beginning in April 2014. The buyers included entities that were not registered with the Department and an entity that had closed its business a year prior to the taxpayer making a sale to the buyer.² The taxpayer's records evidence instances where it sold medical marijuana products at both wholesale and retail, in varying quantities, to the same buyers.³ The taxpayer did not provide any copies of reseller permits for the wholesale-denoted sales or records evidencing that at the time of the sales it electronically verified a buyer's valid reseller permit via the Department's online verification system.

When the auditor asked the taxpayer for reseller permit records, the taxpayer provided a list of buyers, their reseller permit numbers, and the current status of the permit, and attached reseller permit printouts for three of the buyers. Two of the attached reseller permits were not issued in the name of the buyer identified in the relevant transactions.⁴

The taxpayer provided snapshots of the buyers' webpages in support of its assertion that the buyers were medical marijuana retailers and the sales should be classified as wholesale under the facts and circumstances exception to the reseller permit requirement provided in RCW 82.04.470(5) and WAC 458-20-102(7)(h) (Rule 102(7)(h)). The taxpayer indicated that the retail nature of the buyers' businesses was evidenced by their advertising of medical marijuana product and photos of storefronts with hours of operation or availability of product delivery services. As additional support for its facts and circumstances argument, the taxpayer asserted that it operated primarily as a wholesaler and sold marijuana products in bulk quantities to the buyers in question.

The Audit Division determined the taxpayer had not presented sufficient evidence of facts and circumstances establishing the sales at issue were wholesale. Even though the taxpayer had not provided reseller permits for certain buyers, the Audit Division allowed wholesale classification where the Audit Division confirmed that the buyers were registered businesses reporting resale activity and remitting retail sales tax to the Department. The Audit Division denied wholesale classification of sales to buyers without reseller permits that were not registered with the Department or were out of business at the time of the sales.⁵ As a result, the Department issued an assessment totaling \$. . . , composed primarily of unpaid retail sales tax.⁶ The taxpayer sought

² See Audit No. . . . , Workpaper D.

³ See Audit No. . . . , Workpapers F and H.

⁴ See the taxpayer's email to the auditor, dated November 16, 2015, with attached reseller permit of . . . , (submitted for the taxpayer's sales to . . .) and attached reseller permit of . . . , an identified administrative management entity not reporting resale activity (submitted for the taxpayer's sales to . . .). In regards to the taxpayer's sales to . . . , the auditor allowed wholesale classification beginning October 2013 when the entity began reporting retailing activity and remitting retail sales tax. See Audit No. . . . , Workpaper D.

⁵ See Audit No. . . . , Workpaper D.

⁶ Document No. . . . includes assessment of retail sales tax of \$. . . , retailing business and occupation (B&O) tax of \$. . . , wholesaling B&O tax of \$. . . , use tax and/or deferred sales tax of \$. . . , interest of \$. . . , and assessment penalty of \$. . . , for a total amount of \$

review of the assessment and asserted the sales at issue qualified as wholesale sales based on the facts and circumstances of the transactions under RCW 82.04.470(5) and Rule 102(7)(h).

ANALYSIS

Washington imposes B&O tax on every person for the act or privilege of engaging in business activities in Washington. RCW 82.04.220. Depending on the nature of the business activity being conducted, the tax is levied upon the value of products, the gross proceeds of sales, or the gross income of the business. *Id.* The tax rate also depends on the nature of the business activity being conducted. *Id.* Persons making wholesale sales of tangible personal property in Washington are subject to wholesaling B&O tax on the gross proceeds of sales. RCW 82.04.060; RCW 82.04.270. Persons making retail sales are subject to retailing B&O tax on the gross proceeds of sales. RCW 82.04.050; RCW 82.04.250.

All Washington sales of tangible personal property to consumers are subject to retail sales tax unless the sales are otherwise exempt from taxation. RCW 82.08.020(1); RCW 82.04.050(1). During the audit period, sales of marijuana products were not exempt from retail sales tax.⁷ Retail sales tax does not apply to sales for resale. RCW 82.04.050(1)(a)(i). Retail sales tax is to be paid by the buyer to the seller, and remitted by the seller to the state. RCW 82.08.050(1), (2). It is the seller's responsibility to collect retail sales tax from the buyer, and if the seller fails to do so, the seller is personally liable for the amount of tax unless the seller maintains proper records of exempt transactions and provides them to the Department when requested. RCW 82.08.050(3).

The burden of proving that a sale is wholesale rather than retail is on the seller, as provided in RCW 82.04.470(1), as follows:

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.

If a seller does not have qualifying reseller permit records, RCW 82.04.470 lists alternative documentation that a seller can provide to meet its burden. If no alternative documentation is available, the statute explains:

A seller that does not comply with subsection (1), (2), (3), or (4) of this section may 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.

RCW 82.04.470(5).

⁷ Beginning July 1, 2016, certain sales and donations of marijuana products for medical use are exempt from retail sales tax and use tax as specified in RCW 82.08.9998 and RCW 82.12.9998. See Special Notice, "Sales and Use Tax Exemptions for Marijuana Retailers with a Medical Endorsement," dated May 16, 2016 (http://dor.wa.gov/Docs/Pubs/SpecialNotices/2016/sn_16_med_endorsement.pdf).

A seller may also meet its burden of proving a wholesale transaction if it maintains records establishing that it used electronic means to verify, at least once per calendar year, the validity of its customers' reseller permits according to the specific statutory requirements. RCW 82.04.470(6).

Rule 102(7)(h), the Department's rule that sets forth the criteria it will consider when evaluating whether the taxpayer has met its burden of proving that a sale was a wholesale sale rather than a retail sale by demonstrating facts and circumstances, provides as follows:

Seller must provide documentation or information. If the seller has not obtained a reseller permit or the documentation described in (a), (b), (d), or (f) of this subsection, 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. Facts and circumstances that should be considered include, but are not necessarily limited to, the following:

- The nature of the buyer's business. The items being purchased at wholesale must be consistent with the buyer's business. For example, a buyer having a business name of "Ace Used Cars" would generally not be expected to be in the business of selling furniture;
- The nature of the items sold. The items sold must be of a type that would normally be purchased at wholesale by the buyer; and
- Additional documentation. Other available documents, such as purchase orders and shipping instructions, should be considered in determining whether they support a finding that the sales are sales at wholesale.

Rule 102(7)(h).

The burden of maintaining proper records rests with the taxpayer, as provided in RCW 82.32.070(1), that states:

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 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.

RCW 82.32.070(1).

The Department's rule that describes the specific types of records that taxpayers must maintain, WAC 458-20-254 (Rule 254), includes records of original source documents establishing the nature of a sale, such as sales invoices. Rule 254(3)(c).

As an initial matter, we note that the taxpayer has not provided complete and reliable records of the sales transactions to support the asserted wholesale nature of those sales. For example, in many instances the taxpayer's records lack basic identification of the buyer by business name or address and simply denote the sale as a wholesale. In addition, during the audit period, the taxpayer did not verify whether any of its buyers held valid reseller permits. The taxpayer conducted its business based on its understanding of the nature of the buyers' businesses and assumptions that the buyers intended to resell the medical marijuana products. The taxpayer's method of conducting business and lack of reliable documentation of the sales make it difficult to determine the circumstances of the transactions in order to apply the Rule 102(7)(h) facts and circumstances exception.

The taxpayer seeks qualification for the Rule 102(7)(h) exception for sales spanning the entire audit period based on its limited business records, buyer webpage snapshots advertising the availability of medical marijuana and photos of storefronts or stated delivery services, and its assertion that it operated primarily as a wholesaler selling in bulk quantities to the buyers in question. This evidence is not sufficient to establish that the nature of the buyers' businesses was the retail sale of medical marijuana and that the buyers would normally purchase the type of products sold at wholesale as required by Rule 102(7)(h). The buyers included entities that were not registered with the Department and an entity that had closed its business a year prior to the taxpayer making a sale to the buyer.⁸ If the taxpayer had attempted to verify whether these entities maintained reseller permits, it would have discovered these important facts indicating that the buyers were not legitimately registered retailing establishments. In addition, the taxpayer's own sales records evidence that it sold medical marijuana products at both wholesale and retail, in varying quantities, to the same buyers.⁹ This evidence is not sufficient to substitute for reliable documentation of the wholesale nature of the sales as required by RCW 82.04.470 and Rule 102.

The taxpayer argues that the Department's published notice during the audit period stating that sales of medical marijuana are subject to retail sales tax, in conjunction with the webpage evidence of the medical marijuana storefront photos or delivery services, is sufficient to establish that the buyers were retailers of medical marijuana and the taxpayer's sales to these entities were sales for resale.¹⁰ Even setting aside the insufficiency of the taxpayer's records in regards to the specific sales transactions, acceptance of the taxpayer's argument would obviate the need for any taxpayer to establish a wholesale transaction because a taxpayer could simply point to the tax laws that govern retail sales of the products involved. The taxpayer is essentially asserting a good faith argument: that from outward appearances, these businesses appeared to be functioning as sellers of products that, by law, are subject to retail sales tax; therefore, its asserted good faith belief that the buyers were retailers is sufficient to override the requirement to obtain the required reliable documentation. The facts and circumstances exception provided in RCW 82.04.470(5) and Rule 102(7)(h) is not based on the taxpayer's good faith belief, but requires establishing facts and circumstances showing that the sale was properly made at wholesale based on facts evidenced by supporting documentation.

⁸ See Audit No. . . . , Workpaper D.

⁹ See Audit No. . . . , Workpapers F and H.

¹⁰ See the Department's former Special Notice, dated May 31, 2011, "Sales of Medical Cannabis Remain Subject to Sales Tax."

The taxpayer has not met its burden of establishing by facts and circumstances that the transactions at issue were properly treated as wholesale rather than retail sales under RCW 82.04.470(5) and Rule 102(7)(h). . . .

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 15th day of September 2016.