

Cite as Det. No. 16-0088, 36 WTD 338 (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. 16-0088
)	
... )	Registration No. . . .
)	

RULE 108; RCW 82.04.080: B&O TAX – BONA FIDE DISCOUNTS – ADEQUATE DOCUMENTATION. A taxpayer must provide adequate documentation to establish that it actually gave its customers discounts at the time of sale, before the taxpayer is entitled to a deduction from its gross income. When the taxpayer does not provide records sufficient to determine whether a taxpayer did indeed provide discounts to its customers, a taxpayer’s discount deductions must be disallowed.

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.

Weaver, A.L.J. – Taxpayer, a supplier of telecommunications equipment, protests the assessment of wholesaling business and occupation (B&O) tax. Taxpayer claims that the Department of Revenue (Department) failed to properly deduct income from wholesale transactions of sales performed outside of Washington, and that it is entitled to deduct certain discounts from its taxable sales income. We conclude that the taxpayer has failed to provide adequate documentation of its claims that its Washington sales are overstated, and further conclude that the discounts it seeks are not bona fide and are not deductible. Taxpayer’s petition is denied and the assessment is upheld.<sup>1</sup>

ISSUES

1. Whether, under RCW 82.32.070 and RCW 82.32.100, Taxpayer has provided records related to its out-of-state sales sufficient to result in the correction of an assessment.
2. Whether, under RCW 82.04.080 and WAC 458-20-108, either Taxpayer’s “order level” or “aggregate level” discounts qualify as bona fide discounts that should be deducted from Taxpayer’s Washington income.

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

## FINDINGS OF FACT

[Taxpayer] is an out-of-state company that sells communication equipment and services to address the internet protocol and cloud networking needs of its customers, which includes providing ultra-broadband fixed and wireless access to those customers. Taxpayer is a subsidiary of [Parent], and was formed with the merger of two companies . . . .

The Audit Division of the Department audited Taxpayer for the period of January 1, 2007, through December 31, 2010. The audit period coincided with the initial start-up of Taxpayer's consolidated operations. After the consolidation, Taxpayer consisted of a framework of former stand-alone affiliates and subsidiaries. Taxpayer's monthly filings reflected consolidated transactional activity prepared from separate accounting systems, each used by the pre-merger companies. The Audit Division was required to access five separate accounting systems, as well as other data feeds, to complete the audit.

Throughout the audit process, Taxpayer cited issues with its internal sales reporting system. In particular, Taxpayer was unable to correctly allocate transactions to the appropriate ship-to locations. The Audit Division and Taxpayer's staff collaborated to analyze numerous individual sales purchase orders and correlated invoices in an attempt to properly allocate Washington sales to Washington.

As a result of this collaboration, the Audit Division removed many non-Washington job sites from the revenue population reported for Washington. Because the actual sales documents were voluminous and Taxpayer's merged accounting systems produced inconsistent and unreliable data, the Audit Division estimated Taxpayer's Washington tax liability based upon the sales purchase orders and correlated invoices provided by Taxpayer.

The audit resulted in an assessment totaling \$ . . . , which included \$ . . . in wholesaling B&O tax, \$ . . . in service and other activities B&O tax, \$ . . . in interest, as well as a retail sales tax credit of \$ . . . , and a retailing B&O tax credit of \$ . . . .

Taxpayer filed a timely appeal of the assessment.

Taxpayer's original . . . petition requested an adjustment to the assessment based on "further documentation" that would be provided:

[S]uch as contracts, customers purchase orders, invoices, statement of works and projects records which will establish that there was income incorrectly designated to Washington which were for jobsites or location of use of tangible personal property, software and services outside the state of Washington.

*See* Taxpayer's . . . Petition.

The relief sought by Taxpayer in its original . . . petition was predicated on Taxpayer providing additional documentation to show that the Audit Division's income estimates included income

earned outside of Washington. Taxpayer failed to provide any further documentation . . . relating to the Audit Division's estimates of Taxpayer's Washington sales.

After filing its initial petition, Taxpayer did, however, employ outside representation that prepared briefing and documentary exhibits relating specifically to the issue of "Discounts and Incentives." . . . Taxpayer identifies two types of discounts that it argues it is entitled to deduct from its Washington sales income: 1) "order level" discounts, and 2) "aggregate level" discounts.

Taxpayer contends that it offered "order level" discounts to certain of its customers, and that it is entitled to receive an adjustment based on those discounts. Taxpayer provided documents in the form of e-mails, price quotes, and letters with Taxpayer's vendors that show the existence of such discounts. However, Taxpayer has failed to show the actual amount of "order level" discounts on Washington sales during the audit period. Taxpayer requests an adjustment based on these discounts; but Taxpayer has not calculated the amount of "order level" discounts it gave to its customers in Washington, nor has it provided actual documentation that could be used to prove the actual amounts of those discounts in Washington. We cannot determine, on the record provided, whether the Taxpayer is entitled to deduct any additional "order level" discounts above and beyond the discounts allowed by the Audit Division.

Taxpayer further seeks an adjustment based on "aggregate level" discounts that were not previously presented to the Audit Division. The "aggregate level" discounts relate to one customer . . . ("Wireless Customer"). Taxpayer states that these "aggregate level" discounts are unique in that they are applied against the Wireless Customer's outstanding accounts receivable balance, and the discounts are not specifically taken against specific Washington sales. Indeed, Taxpayer's controller in charge of the Wireless Customer's account states that the "aggregate level" discounts are credited against Taxpayer's outstanding accounts receivable balance with Wireless Customer without taking into consideration a specific order.

## ANALYSIS

### I. Taxpayer's Records Are Insufficient to Merit Adjustment of the Audit Division's Estimate of Taxpayer's Washington Income.

The term "sale at wholesale" or "wholesale sale" includes any sale of "competitive telephone service, ancillary services, or telecommunications service as those terms are defined in RCW 82.04.065," which are not sold at retail. RCW 82.04.060(1)(g). RCW 82.04.065(5) defines "competitive telephone service" as follows:

"Competitive telephone service" means the providing by any person of telecommunications equipment or apparatus, or service related to that equipment or apparatus such as repair or maintenance service, if the equipment or apparatus is of a type which can be provided by persons that are not subject to regulation as telephone companies under Title 80 RCW and for which a separate charge is made.

RCW 82.04.065(5) (emphasis added). The term "sale at wholesale" also includes the sale of "tangible personal property," which is not a "sale at retail." RCW 82.04.050(1)(a)(v). There is no

dispute in this matter that Taxpayer was making both wholesale and retail-taxable sales of tangible personal property and competitive telephone services.<sup>2</sup> The assessment at issue includes the assessment of wholesaling B&O tax and credits for overpayment of retail sales tax and retailing B&O tax.

In this case, Taxpayer disputes the assessment at issue because it claims the Audit Division overstated its Washington income by including income from wholesale transactions of tangible personal property, software, and services delivered to or for use at locations outside of Washington. Taxpayer stated in its petition that it would provide documentation that proved it was assessed the wholesaling B&O tax on sales of tangible personal property made outside of Washington and wholesale competitive telephone services rendered outside of Washington. Taxpayer failed to provide any such additional documentation . . . .

RCW 82.32.070 provides that persons liable for any tax 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. RCW 82.32.070. The statute also provides that all of these books, records, and invoices shall be open for examination by the Department. *Id.* RCW 82.32.100 provides that if any person fails or refuses to make available for examination the required records, 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. RCW 82.32.100. RCW 82.32A.030(3) and (8) also list as a taxpayer responsibility, the keeping of accurate business records and to timely respond to Departmental communications.

These provisions require taxpayers to provide records so that the Department may accurately determine their tax liabilities. In this case, Taxpayer's records were incomplete, inconsistent, and unreliable. During the audit, Taxpayer was unable to correctly allocate sales transactions to the appropriate ship-to locations, and was unable to substantiate the actual location of its sales of tangible personal property or competitive telephone services, either wholesale or retail. Because Taxpayer's records were incomplete, inconsistent, and unreliable, the Audit Division and Taxpayer's staff collaborated to analyze numerous individual sales purchase orders and correlated invoices in an attempt to properly allocate Washington sales to Washington.

As a result of this collaboration, the Audit Division removed some non-Washington job sites from the revenue population Taxpayer's reported for Washington, and estimated Taxpayer's Washington tax liability based upon the sales purchase orders and correlated invoices provided by Taxpayer during the audit. Taxpayer has failed to provide any additional records or documentation . . . that merits an adjustment to the estimates made by the Audit Division or the resulting estimated tax assessment. *See* RCW 82.32.100.

Taxpayer's petition is denied on any issues pertaining to the Audit Division's estimates of Taxpayer's Washington income.

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<sup>2</sup> The term "sale at retail" or "retail sale" includes the providing of "competitive telephone service," as that term defined in RCW 82.04.065, to consumers. RCW 82.04.050(5). The term "sale at retail" also includes "purchases for the purpose of providing tangible personal property to consumers as part of competitive telephone service. RCW 82.04.050(1)(a)(v). Previous determinations by the Department have held that Taxpayer is engaged in competitive telephone services.. *See., e.g.,* Det. No. 10-0107; Det. No. 10-0107R; Det. No. 03-0301E.

II. Taxpayer is Not Entitled to An Adjustment for Discounts that it is Unable to Prove Were Actually Taken on a Particular Article.

RCW 82.04.4283 reads, in relevant part, as follows:

In computing tax there may be deducted for the measure of tax the amount of cash discount actually taken by the purchaser . . . .

RCW 82.04.4283.

WAC 458-20-108 (Rule 108) is the Department's administrative rule on returned goods, allowances, and cash discounts. It reads in pertinent part:

(7) **Bona fide discounts.** When a sale is made subject to a cash or trade discount, the gross proceeds actually derived from the selling price are determined by the transaction as finally completed. A sale is made subject to a discount when the sales price is reduced under terms known to the buyer and seller at the time of sale, and the price reduction occurs at the time of the sale or within a time agreed and understood by the parties at the time of sale.

The selling price or sales price of a service or of an article of tangible personal property does not include bona fide discounts actually taken by the buyer. The amount of bona fide discounts may be deducted only if the amount has been included in the gross amount reported.

Discounts are not deductible when the retail sales tax is based on the selling price or sales price before the discount is taken and no portion of the tax is refunded to the buyer.

Rule 108(7).

Taxpayers have a duty to maintain their records in such a manner that their tax liabilities can be determined. RCW 82.32.070. This includes a specific obligation to generate, maintain, and preserve records and documentation necessary to establish tax liability. RCW 82.32.070(1); Rule 254(2)(a). Taxpayers must keep and preserve suitable records, and make them available for examination by the Department for five years. RCW 82.32.070 and RCW 82.32A.030. Thus, according to these principles, the burden rests with the Taxpayer to provide suitable detail and information to classify the discounts as bona fide under Rule 108.

With respect to Taxpayer's "order level" discounts, we hold that Taxpayer has failed to provide adequate documentation to determine the actual amount of "order level" discounts it gave to its customers in Washington. Because we cannot determine, on the record provided, whether the Taxpayer is entitled to deduct any additional "order level" discounts above and beyond the discounts allowed by the Audit Division, we hold that Taxpayer is not entitled to deduct any additional "order level" discounts.

[Based on the limited evidence presented, it is the Department's understanding that] Taxpayer's "aggregate level" discounts are not computed with respect to particular sales, but rather are based on volume discounts for an entire class of sales. [It appears that] [s]ales prices are not reduced by

the “aggregate level discounts”; instead, Taxpayer’s Wireless Customer is given credits, which are taken against Taxpayer’s outstanding accounts receivable balances with Wireless Customer without taking into consideration any specific orders.

The Washington Court of Appeals, in *Klein, Inc. v. Dep’t of Revenue*, 184 Wn. App. 344, 336 P.3d 663 (2014), has held that “dealer cash,” which is an incentive program where funds are paid to car dealerships from an automobile manufacturer on each car sale made during a specified period of time, is not a bona fide discount to the wholesale purchase price of vehicles. *Klein, Inc.*, 184 Wn. App. at 354, 336 P.3d at 667. The taxpayer’s argument in *Klein, Inc.* failed “because its wholesale purchase of vehicles from [the manufacturer] is not made ‘subject to’ the dealer cash payment, as required by the . . . language in WAC 458-20-108(1).” *Id.* at 355, 336 P.3d at 668. The “dealer cash” incentive is not a discount on the purchase price, and the dealer cash was not negotiated at the time the vehicles were purchased. *Id.* Instead, the dealer cash incentive was later given to the taxpayer in *Klein, Inc.* based on its eventual sales of the automobiles it purchased at wholesale from the dealer. In other words, the amount of the dealer cash incentive was not “known” at the “time of sale.” *See* Rule 108.

Likewise, in this case, the evidence provided in this case shows that the “aggregate discounts” do not reduce the selling price of Taxpayer’s goods or services to the Wireless Customer at the time of sale. The amount of the “aggregate discount” is not “known” at the “time of sale.” *Id.* Therefore, under the [limited] facts presented, Taxpayer has not met its burden of showing that its “aggregate discounts” are bona fide discounts as that term is defined in Rule 108(7).

Because we hold the “aggregate discounts” that Taxpayer provided to its Wireless Customer are not bona fide, as that term is defined in Rule 108(7), Taxpayer is not entitled to deduct the aggregate discounts from its Washington income.

#### DECISION AND DISPOSITION

Taxpayer’s petition is denied.

Dated this 3rd day of March 2016.