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Cite as Det. No. 22-0129, Annual WTD Page (Year)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS 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. 22-0129
	)	
...	)	Registration No. . . .
	)	

[1] RCW 82.08.9998: EXEMPTION FROM RETAIL SALES TAX FOR SALES OF MEDICAL CANNABIS. Sellers making sales of cannabis products to buyers with recognition cards must keep records in the manner required by the Department.

[2] WAC 458-20-254; RCW 82.32.070(1): RECORDKEEPING OF SALES OF EXEMPT CANNABIS PRODUCTS. Sellers of cannabis products cannot claim the exemption from retail sales tax for selling to a buyer with a recognition card unless they keep copies of the recognition cards to provide to the Department.

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.

Willette, T.R.O. – Taxpayer protests the Department’s assessment which included adjustments due to disallowed deductions. Taxpayer took deductions for sales of marijuana products exempt from taxation under RCW 82.08.9998, which exempts from retail sales tax sales of marijuana products to persons with recognition cards. Although Taxpayer did not keep copies of recognition cards, Taxpayer asserts it met the recordkeeping requirements of RCW 69.50.375(3)(e) and WAC 314-55-080 and argues the Department’s requirement to keep a copy of each buyer’s recognition card contravenes the statute and rule. RCW 69.50.375 and WAC 314-55-080 set forth the requirements a licensed marijuana retailer must comply with to be issued a medical marijuana endorsement, not the Department’s recordkeeping requirements for the tax exemption under RCW 82.08.9998. 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.

## ISSUE

Has Taxpayer provided the Department suitable records in accordance with WAC 458-20-254 (Rule 254) to prove certain sales of marijuana products are exempt from retail sales tax under RCW 82.08.9998?

## FINDINGS OF FACT

Taxpayer is a licensed marijuana retailer with a medical marijuana endorsement doing business in . . . , Washington. The Department's Audit Division investigated Taxpayer's books and records for the period of January 1, 2017, through June 30, 2020 (Audit Period).

The Department requested the following to aid with its investigation: reports from the point of sales system, federal income tax returns, credit card statements for two business accounts, documentation for deductions taken, and supporting documentation for consumable purchases of business-use tangible personal property. Taxpayer provided Audit Division with the following: the requested report from the point of sales system, credit card statements, and purchase receipts for consumable purchases. After comparing Taxpayer's returns and the relevant books and records, Audit Division adjusted for disallowed deductions, unreported income, and deferred retail sales tax and/or use tax on purchases of consumable tangible personal property.

Audit Division disallowed all deductions taken by Taxpayer. Taxpayer regularly took . . . deductions on its excise tax filings during the Audit Period. Among them was a deduction from income subject to retail sales tax for "Marijuana Sold to Card Patient by Retailer." Audit Division asked Taxpayer to see a recognition card for each sale to prove the exemption from retail sales tax.<sup>[2]</sup> Audit Division stated it was necessary for Taxpayer to keep one copy, paper or digital, that could be used for all corresponding exempt sales. Taxpayer does not keep copies of recognition cards. Furthermore, although the point-of-sale system distinguishes between purportedly tax-exempt sales and regular sales, Taxpayer did not provide documentation to indicate the cardholding patient associated with the sales claimed as exempt from retail sales tax. Audit Division, therefore, disallowed the deductions from retail sales tax because it determined Taxpayer did not keep its records in a manner to substantiate which sales, if any, are exempt under RCW 82.08.9998.

Taxpayer also claimed an "Other" deduction from its income subject to the retailing business and occupation . . . [B&O] tax. RCW 82.08.9998 does not exempt sales from retailing B&O [tax]. In total, Audit Division disallowed \$. . . of deductions from retail sales tax under Marijuana Sold to Card Patient by Retailer and \$. . . of deductions from retailing B&O [tax] under Other.

Audit Division also adjusted for unreported income. Audit Division determined through income reconciliation that Taxpayer had \$. . . in unreported income subject to both retailing B&O tax and retail sales tax.

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<sup>[2]</sup> "Recognition card" means a card issued to qualifying patients and designated providers by a cannabis retailer with a medical cannabis endorsement that has entered them into the medical cannabis authorization database. RCW 69.51A.010(20).]

Audit Division's disallowance of deductions and addition of unreported income resulted in adjustments of \$. . . for retailing B&O tax and \$. . . for retail sales tax.

Additionally, Audit Division could not confirm whether Taxpayer had paid sales tax or use tax on consumable tangible personal property. Audit Division found debits from Taxpayer's bank accounts representing purchases from out-of-state-vendors for items to be used by the business. Audit Division asked Taxpayer to confirm whether Taxpayer paid Washington retail sales tax or, in the alternative, use tax on those purchases. Taxpayer did not verify retail sales tax or use tax was paid. As such, Audit Division assessed \$. . . of tax liabilities based on Taxpayer's \$. . . in purchases determined to be subject to retail sales tax or use tax.

Taxpayer timely filed a petition for administrative review (Petition). Taxpayer disputes the entirety of the assessment. Petition, p.1. Taxpayer, however, sets forth an argument only to the adjustments<sup>3</sup> due to the disallowance of the deductions for marijuana sales exempt from taxation under RCW 82.08.9998(1) in the Petition and supplemental briefing (Suppl. Brief).

Taxpayer asserts there is no statute "that grants the Department of Revenue the right to demand copies of recognition cards as a prerequisite to allowing an exemption" from retail sales tax and thus the Department's requirement exceeds its regulatory authority. Suppl. Brief, p. 3-4. Taxpayer argues the recordkeeping requirements are governed by RCW 69.50.375(3)(e) and it has met its recordkeeping obligations under the provision by entering recognition card information into the liquor and cannabis board's (LCB) traceability system. *Id.* at 6. Taxpayer states it is not required to keep a copy of the purchaser's recognition card when making sales exempt from retail sales tax. *Id.* Taxpayer additionally argues WAC 314-55-080 supports its position that there is no statutory obligation to keep a copy of the recognition card. *Id.* at 3. Taxpayer asserts it may be a violation of the Health Insurance Portability and Accountability Act (HIPAA) to keep a copy of consumers' recognition cards for purposes of proving the claimed exemption. *Id.* at 7-8. Taxpayer also asserts the Department "could retrieve these records [copies of recognition cards and/or the related sales] from LCB." *Id.* at 6.

## ANALYSIS

Washington requires persons making retail sales in the state to collect and remit retail sales tax unless an exemption applies. RCW 82.08.020; RCW 82.08.050. "Retail sale" is statutorily defined and includes the sale of tangible personal property. RCW 82.04.050(1)(a). "Tangible personal property" means property that can be "seen, weighed, measured, felt, or touched . . ." WAC 458-20-193(1)(c). Generally, the sale of marijuana is a retail sale subject to retail sales tax. Accordingly, Taxpayer must remit retail sales tax for retail sales and pay retailing . . . [B&O] tax on its gross proceeds of sales<sup>4</sup> unless an exemption applies. RCW 82.08.020; RCW 82.04.250.

The legislature provides an exemption from retail sales tax for the sale of "marijuana concentrates, useable marijuana, or marijuana-infused products . . . by marijuana retailers with medical

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<sup>3</sup> Because Taxpayer only addresses the adjustments that resulted from the Department's denial of its deductions, we read Taxpayer's petition as a protest of \$. . . of the total balance due. Rounding differences may be present.

<sup>4</sup> Gross proceeds mean the value accruing from the sale of tangible personal property without any deductions. RCW 82.04.070.

marijuana endorsements to qualifying patients or designated providers who have been issued recognition cards[.]” RCW 82.08.9998(1)(a). Taxpayer is a marijuana retailer with a medical marijuana endorsement. However, Audit Division determined Taxpayer could not verify which sales, if any, were made to qualifying patients or designated providers who have been issued recognition cards.

Because RCW 82.08.9998 provides an exemption from a prescribed tax, we construe its application narrowly. *See Budget Rent-A-Car, Inc. v. Dep’t of Revenue*, 81, Wn.2d 171, 500 P.2d 764 (1972); Det. No.[.] 01-007, 20 WTD 214, 231 (2001) (Department construes exemptions narrowly in favor of taxation). Additionally, the taxpayer has the burden to prove the right to any exemption from taxation. *See* Det. No. 19-0185R, 40 WTD 231, 234 (2021).

Taxpayer argues it has met its burden for the claimed deductions under RCW 82.08.9998(1) because it asserts compliance with RCW 69.50.375(3)(e). RCW 69.50.375(3) sets forth the requirements for a marijuana retailer “to be issued an endorsement,” and they include the following:

- (a) Not authorize the medical use of marijuana for qualifying patients at the retail outlet or permit health care professionals to authorize the medical use of marijuana for qualifying patients at the retail outlet;
- (b) Carry marijuana concentrates and marijuana-infused products identified by the department under subsection (4) of this section;
- (c) Not use labels or market marijuana concentrates, useable marijuana, or marijuana-infused products in a way that make them intentionally attractive to minors;
- (d) Demonstrate the ability to enter qualifying patients and designated providers in the medical marijuana authorization database established in RCW 69.51A.230 and issue recognition cards and agree to enter qualifying patients and designated providers into the database and issue recognition cards in compliance with department standards;
- (e) Keep copies of the qualifying patient’s or designated provider’s recognition card, or keep equivalent records as required by rule of the state liquor and cannabis board or the department of revenue to document the validity of tax exempt sales; and
- (f) Meet other requirements as adopted by rule of the department or the state liquor and cannabis board.

Although subsection (e) allows for the taxpayer to comply in three manners, the taxpayer must also comply with five other requirements “[t]o be issued an endorsement[.]” RCW 69.50.375(3) (emphasis added). Taxpayer asserts it is not required to keep copies of the qualifying patient’s recognition cards because it has kept equivalent records as required by the LCB by entering the recognition card information into the LCB’s traceability system. *See* Suppl. Brief, p. 6; RCW 69.50.375(3)(e). However, although Taxpayer may comply in the number of ways set forth in the provision to be issued a medical marijuana endorsement, RCW 69.50.375(3)(e) does not set forth the requirements for Taxpayer to prove entitlement to the tax exemption under RCW 82.08.9998. RCW 82.08.9998 includes the requirements to claim the exemption:

(2) Each seller making exempt sales under subsection (1) of this section must maintain information establishing eligibility for the exemption *in the form and manner required by the department*.

(Emphasis added). In RCW 82.08.9998, the “department” refers to the Department of Revenue. *See* RCW 82.02.010(1). Thus, Taxpayer is mistaken that the Department has no authority to determine the requirements for entitlement to the exemption. In RCW 82.08.9998(2), the legislature explicitly granted the Department the authority to determine the “information establishing eligibility for the exemption” Taxpayer must maintain.

Taxpayer’s assertion that WAC 314-55-080 governs its tax obligations is similarly mistaken. WAC 314-55-080 is the [state liquor and cannabis board’s] rule<sup>[1]</sup>, not the Department’s, and explains the requirements for a marijuana retailer to be issued a medical marijuana endorsement. In fact, the rule explicitly states that to “maintain a medical marijuana endorsement in good standing,” the taxpayer must “[k]eep records to document the validity of tax exempt sales *as prescribed by the department of revenue* for a minimum of five years.” WAC 314-55-080(3)(h) (emphasis added). Although the subsection goes on to state, “licensees are not required to separately keep copies of the qualifying patient’s or designated provider’s recognition card . . .,” the limiting clause applies “for the documentation requirements in RCW 69.50.375(3)(e).” *Id.* As stated above, RCW 69.50.375(3) has no bearing on the Department’s authority, granted by the Washington Legislature, to determine the information the taxpayer must maintain to establish the eligibility for the retail sales tax exemption. *See* RCW 82.08.9998(2).

Every taxpayer “must” keep and preserve, for a period of five years, “suitable records” as may be necessary to determine the tax for which taxpayer is liable. RCW 82.32.070(1). The Department’s administrative rule detailing recordkeeping explains further what suitable records must be kept. With regards to exemptions, the taxpayer must keep “complete and adequate records” to demonstrate the amounts of all exemptions claimed “through supporting records or documentation required by statute or administrative rule, or other supporting records or documentation necessary to substantiate” the deduction. Rule 254(3)(a)(ii). RCW 82.08.9998(2) does not contain specific requirements but states the seller “must maintain information establishing eligibility for the exemption *in the form and manner required by the department*.” (Emphasis added.)

The Department clarified what information taxpayers must maintain for the retail sales and use tax exemptions for marijuana retailers with a medical endorsement by issuing a Special Notice on May 6, 2016 (Special Notice). In addition to the fact that the Special Notice predates the Audit Period, it explicitly states it is intended for marijuana retailers, like Taxpayer, with a medical endorsement. Special Notice, p. 1. Under the section titled “How do I document these exemptions?”, the Department stated:

Retailers must:

- Verify the qualifying patient or designated provider has a current recognition card.
- Enter the qualifying patient or designated provider’s recognition card number into LCB’s traceability system.

- Keep a copy of the qualifying patient or designated provider's recognition card as required by RCW 69.50.375[3](e). Retailers only need to keep one copy of each valid recognition card and do not need to get multiple copies of the same card for repeat customers.
- Keep records of tax exempt sales, including the applicable recognition card number used by the purchaser, for at least five years.

*Id.* at 3. The Special Notice also clarifies that there is no B&O tax exemption for sales exempt from retail sales tax. *Id.* at 4. Furthermore, because the legislature granted the Department the authority to set forth the requirements for the exemption from retail sales tax, the Special Notice falls squarely within the Department's [statutory] authority. *See* RCW 82.08.9998(2).

The Special Notice explicitly states one copy of each valid recognition card is necessary to prove the exemption.<sup>5</sup> Additionally, taxpayers must document the tax-exempt sales by recording the applicable recognition card number used for each sale to the sale at issue. Taxpayer met neither of these requirements. *See* Suppl. Brief at 6 (asserting the Department could get any necessary records from LCB). Taxpayer holds the burden to prove the right to any exemption, and it is not the Department's burden or responsibility to verify tax exempt sales beyond Taxpayer's records.

Because Taxpayer cannot verify tax exempt sales, Audit Division properly imposed retail sales tax on Taxpayer's retail sales during the Audit Period. Furthermore, the Special Notice makes clear RCW 82.08.9998 does not provide an exemption from the retailing B&O tax. Audit Division properly imposed the retailing B&O against Taxpayer's gross proceeds of sales. Thus, we deny Taxpayer's petition on those issues.

#### DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 26th day of July 2022.

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<sup>5</sup> Besides a general assertion that, under HIPAA, recognition cards may be protected health information, Taxpayer does not cite to a specific provision that would be violated by the Department's requirement for marijuana retailers to keep a copy of a person's recognition card. Furthermore, Taxpayer acknowledges that providing recognition cards to the Department without prior authorization from cardholders is likely permitted. Suppl. Brief, p. 8. Thus, we do not address Taxpayer's HIPAA argument.