

Cite as Det. No. 15-0315, 35 WTD 457 (2016)

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. 15-0315
)	
...)	Registration No. ...
)	

[1] RCW 82.04.030, Rule 203, ETA 3134.2009 – B&O – RETAIL SALES TAX -
- CONSTRUCTION -- RELATED ENTITIES. Each separately organized
corporation as a separate “person” within the meaning of the law, and each separate
entity in an affiliated group must file a separate excise tax return. Thus, a wholly-
owned entity performing custom construction for another wholly-owned entity is
taxable as a contractor.

[2] RCW 82.32.070; RULE 254 – BURDEN OF PROOF – RECORDS. Taxpayers
have the burden of demonstrating qualification for a tax benefit and there will be
no basis for adjustment in the absence of 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.

Bauer, A.L.J. – A management company objects to assessments of tax for its transactions with a
holding company that is commonly-owned, and further objects to the inclusion of certain amounts
in the taxable measure for which it has provided no documented evidence that they should be
exempt. The assessments are upheld.¹

ISSUES

1. In accordance with RCW 82.04.030 and WAC 458-20-203, are transactions between a
commonly owned management company and a holding company taxable?
2. Has a management company met its burden under RCW 82.32.070 and WAC 458-20-254 to
show through adequate records that Audit erroneously included an employee bonus and capital
contributions in the measure of tax?

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

FINDINGS OF FACT

[Representative], the representative in this action, built certain residential and commercial rental properties that were owned by his holding company, [Holding Company].² [Representative] formed [Taxpayer] to manage Holding Company's properties. [Representative] owned both Taxpayer and Holding Company in their entirety.

Rents from Holding Company's properties were paid directly to Taxpayer. Taxpayer paid for the properties' management and upkeep (rental turnover expenses and repairs, etc). Taxpayer transferred any funds over and above these expenses to Holding Company, as the properties' owner. Both Taxpayer and Holding Company had their own employees, including construction employees.

The Audit Division (Audit) of the Department of Revenue (Department) performed a limited-scope desk audit of Taxpayer, which had previously been unregistered, for the period January 1, 2007 through December 31, 2013 (audit period).³ The audit covered the property management services Taxpayer provided to Holding Company. On October 22, 2014, as a result of its review, Audit assessed the above-referenced assessments in the following total amounts:

\$. . .	Retail Sales Tax
. . .	Retailing B&O Tax
. . .	Service and Other Activities B&O Tax
. . .	Total Tax Due
. . .	Delinquent Penalty
. . .	Interest
. . .	5% Assessment Penalty (Substantial Underpayment)
. . .	5% Unregistered Business Penalty
\$. . .	Total Due

According to Taxpayer, Holding Company would occasionally "borrow" several of Taxpayer's construction employees to perform work on its properties while they were still on Taxpayer's payroll.

Taxpayer reimbursed itself from the rents it collected for Holding Company's use of the temporary employees and provided copies of the borrowed employees' paystubs to Audit. Audit reasoned that Taxpayer, through its employees, was providing construction services to Holding Company.⁴ Audit, therefore, assessed retailing B&O and retail sales taxes based on the payroll of these employees, plus 10% representing benefits payable to them.⁵

² [Representative], Taxpayer's managing member and representative in this case, is a builder in the . . . , Washington area. *See* . . . (last visited November 9, 2015).

³ The audit period was extended beyond the normal statutory period because of its unregistered status. [RCW 82.32.050(4).] Taxpayer, according to Audit, failed to provide adequate books and records.

⁴ [Representative's] email dated February 26, 2014 to the auditor: "Yes the two entities have separate employees and [Holding Company] had needs for additional help (employees) and I didn't want to hire more help when . . . had employees that were going to have to be laid off due to lack of work/down sizing, so [Holding Company] borrowed . . . employees."

⁵ The 10% is extremely conservative, as employee benefits can run closer to 30-40%.

Audit deemed that the amounts retained by Taxpayer over and above these construction reimbursements were payments for management services (the above-mentioned rental turnover expenses and repairs, etc), and taxed them under the service and other activities classification as payments for managing Holding Company's properties.

...

ANALYSIS

1. Intercompany Transactions. RCW 82.04.030 provides:

"Person" or "company", herein used interchangeably, means any individual, receiver, administrator, executor, assignee, trustee in bankruptcy, trust, estate, firm, copartnership, joint venture, club, company, joint stock company, business trust, municipal corporation, political subdivision of the state of Washington, corporation, limited liability company, association, society, or any group of individuals acting as a unit, whether mutual, cooperative, fraternal, nonprofit, or otherwise and the United States or any instrumentality thereof.

WAC 458-20-203 likewise states:

Each separately organized corporation is a "person" within the meaning of the law, notwithstanding its affiliation with or relation to any other corporation through stock ownership by a parent corporation by the same group of individuals.

Each corporation shall file a separate return and include therein the tax liability accruing to such corporation. This applies to each corporation in an affiliated group, as the law makes no provision for filing of consolidated returns by affiliated corporations or for the elimination of intercompany transactions from the measure of tax.

[Representative] argues that he owns 100% of Taxpayer and Holding Company, and that he is, in essence, managing his own properties. Therefore, there should not be any tax.

Under the United States federal income tax, commonly controlled corporations may file consolidated returns that allow taxes on certain intercompany transactions to be either eliminated or deferred.⁶ Unlike the federal income tax, though, Washington's Revenue Act regards each separately organized corporation as a separate "person" within the meaning of the law, notwithstanding its affiliation with or relation to any other corporation through stock ownership. And, the Revenue Act makes no provision for the filing of consolidated returns by affiliated corporations, or for the elimination of intercompany transactions from the measure of tax. Therefore, for tax purposes, individuals as well as separately organized entities (such as partnerships, corporations, joint ventures, etc.) are separate persons, and each separate entity in an affiliated group must file a separate excise tax return and include therein the tax liability accruing to such corporation. ETA 3134.2009 (Transactions Between Related Entities).

⁶ See 26 CFR 1.542-4.

Title 82 RCW, Washington's Revenue Act, imposes excise tax on the privilege of doing business in this state. Therefore, whenever there is a transaction (e.g., a purchase and sale, a provision of services, etc.) between two or more persons (each of whom are separate entities), Washington excise tax applies, even if all entities are wholly-owned by the same individual.⁷ Thus, just as an individual is a separate person from the corporation he owns (even if he owns all of the corporate shares), transactions between related entities are also treated just as if they are transactions between unrelated entities. [*Dep't of Revenue v. Nord NW Corp.*, 164 Wn. App. 215, 230, 264 P.3d 259 (2011).]

Under the Revenue Act, persons who perform custom construction upon land owned by related entities are custom prime contractors and must pay retailing B&O tax and collect sales tax on their charges in accordance with RCW 82.04.260 and RCW 82.08.020. Taxpayer, by "loaning" its construction employees to Holding Company to work on Holding Company's properties in exchange for the amount of payroll that Taxpayer owed them, with a 10% markup for additional employee benefits was, therefore, taxable under the retailing B&O and retail sales tax as a contractor in accordance with RCW 82.04.050(2)(b).^[8]

Persons who engage in a business activity that is not taxed implicitly under another section of The Revenue Act are taxed under the service and other activities classification of the Revenue Act in accordance with RCW 82.04.290(2)(a).⁹ Taxpayer's business activity of property management is not specifically defined under any other section of The Revenue Act, so is taxable under service and other activities classification of The Revenue Act.

2. Burden of Proof. RCW 82.32.070 requires taxpayers to maintain suitable records as may be necessary to determine the amount of any tax for which they may be liable.

WAC 458-20-254(3)(b), which is the administrative rule regarding recordkeeping, states in pertinent part:

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: . . . (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.

(Emphasis added.) Taxpayer argues that there was no basis for the 10% added to the payroll amount, and that some of what Taxpayer received and Audit taxed were capital contributions made by [Representative].

⁷ See Det. No. 90-68, 9 WTD 139 (1990); Det. No. 87-342, 4 WTD 229 (1987).

⁸ [Typically, the measure of the retailing B&O tax and the retail sales tax is the amount the customer paid the contractor under a contract for the construction services. See RCW 82.08.010(1)(a)(i) ("selling price" for retail sales tax); RCW 82.04.250 (retailing B&O based on gross proceeds of sales). Because Taxpayer and Holding Company apparently had no formal contract for these services, Audit estimated the contract price based on the employee wages paid, plus 10% for employee benefits.]

⁹ We note that [Representative] has offered no objections to the tax classifications assigned.

Tax benefits and all other deductions, exemptions, and credits, however, must be strictly construed, though fairly, and in keeping with the ordinary meaning of their language, against the taxpayer. See, e.g., *Budget Rent-a-Car, Inc. v. Dep't of Revenue*, 81 Wn. 2d 171, 500 P.2d 764 (1972); *Group Heath Coop. v. Tax Comm'n*, 72 Wn.2d 422, 429, 433 P.2d 201 (1967); Det. No. 07-0034E, 26 WTD 212 (2007). "The burden of showing qualification for the tax benefit afforded . . . rests with the taxpayer." Thus, Taxpayers must prove they are entitled to the benefit. *Group Health*, 72 Wn.2d at 429. Taxation is the rule; exemption is the exception. *Spokane County v. City of Spokane*, 169 Wash. 355, 358, 13 P.2d 1084 (1932). Exemptions from a taxing statute must be narrowly construed. *Budget Rent-A-Car*, 81 Wn.2d at 174; *Evergreen-Washelli Memorial Park Co. v. Dep't of Revenue*, 89 Wn.2d 660, 663, 574 P.2d 735 (1978).¹⁰

Audit asked for documentation supporting Taxpayer's assertions concerning the 10% employee bonus and capital contributions in the beginning of June 2014, and extended the deadline several times to the end of September 2014. Taxpayer -- aside from the paystubs of two employees from 2007 to 2013 that Taxpayer produced on July 1, 2014 -- has never provided the necessary supporting documentation.¹¹ We, therefore, conclude that there is no basis for adjusting the assessment.

We uphold the assessments.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 18th day of November, 2015.

¹⁰ See also Det. No. 14-0217, 33 WTD 623 (2014), Det. No. 14-0386, 34 WTD 273 (2015).

¹¹ Audit's email to [Representative] dated September 22, 2014.