

Cite as Det. No. 16-0218, 36 WTD 063 (2017)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of) D E T E R M I N A T I O N
Assessment of)
) No. 16-0218
)
)
...) Registration No. . . .
)

RCW 82.04.220 – BUSINESS AND OCCUPATION TAX - TAXATION OF PERSONS – The Department of Revenue will assess taxes against an entity whose records show it was engaged in business in Washington.

RCW 82.32.070; RCW 82.32A.030 – RECORD REQUIREMENTS – Washington law requires taxpayers to provide all records maintained by an ordinary prudent business person, that must be kept in a systematic manner that conforms to accepted accounting methods and procedures. The records must also show gross receipts and sales from all sources, and must be supported by original source documents or records. If a person fails to keep and preserve these records, the Department of Revenue may make an estimate of that person's tax liability in a manner the Department deems best.

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.

Fisher, T.R.O. – A taxpayer protests the assessment of business and occupation [(B&O)] taxes and retail sales taxes based off of bank records and argues taxes were assessed against the wrong entity. The taxpayer's petition is denied.¹

ISSUES

1. [Did] the Department of Revenue ("Department") assess taxes against [the proper entity]?
2. Do the taxpayer's records meet the requirements of RCW 82.32.070 and WAC 458- 20-254 for purposes of determining the amount of the taxpayer's cash sales and associated tax liability?

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

FINDINGS OF FACT

[Sole Proprietorship] was a sole proprietorship that cut trees for residential and commercial customers. Sole Proprietorship was created by [Taxpayer] and her husband. Taxpayer applied for a business license for Sole Proprietorship in November of 2011, but did not start doing business until 2012. When attempting to solicit contracting bids from landscapers, Taxpayer learned they needed the correct business license, bonding, and insurance. Taxpayer got another Tax Registration Number under the name [LLC], bonds, and insurance, and started to do business.

Taxpayer alleges it received e-mails from the Department stating she was not filing tax returns for the LLC. Taxpayer alleges it intended to file taxes under the LLC and close the Sole Proprietorship; instead, the Department's records show that Taxpayer reported taxes under the Sole Proprietor quarterly, and closed the LLC. The Department's records indicate that Taxpayer filed returns for the Sole Proprietorship in the following periods: Quarter 4, 2011; Quarter 1, 2012; Quarter 2, 2012; Quarter 3, 2012; Quarter 4, 2012; Quarter 2, 2013; Quarter 3, 2013; Quarter 4, 2013; Quarter 1, 2014, Quarter 2, 2014; Quarter 3, 2014; and Quarter 4, 2014. Taxpayer filed one return for the LLC for the year of 2014, but reported no business activities on that return. The LLC return indicates the LLC closed on January 1, 2014. It is signed by Taxpayer and is dated December 12, 2014.

Sole Proprietorship was selected to be examined by the Department's Audit Division ("Audit") to ensure compliance with tax reporting requirements. During the examination, Audit discovered that Taxpayer did not have records related to the Sole Proprietorship's revenue or expenses. Audit requested Taxpayer provide bank account statements in order to estimate the Sole Proprietorship's tax liability.

During the examination period, Taxpayer had ten bank accounts. Five of those accounts belonged to Taxpayer's children with Taxpayer merely being an authorized signer; Audit did not assess taxes on any of those five accounts. Another account was used for rent collected separately from the Sole Proprietorship, and Taxpayer provided copies of deposits and a rental agreement; Audit did not assess taxes on this account. Audit did assess taxes on the remaining four bank accounts (hereafter, "the bank accounts"). One of the bank accounts was a . . . account under the name ". . .".

Taxpayer asserted that some of the income in the bank accounts was unrelated to the Sole Proprietorship, alleging some of the income was for sales of personal property, rental income, and loans to Taxpayer's children. Audit requested documentation, and in September Taxpayer faxed Audit a copy of a receipt book which Taxpayer contended substantiated the deposits in the bank accounts. The receipts are not in chronological order, and the numbering system matches the date of the transaction rather than the order in which the transactions occurred. Audit disregarded the receipt book and assessed taxes based on deposits in the bank accounts. Audit assessed \$. . . in retail sales taxes, \$. . . in retailing [B&O] taxes, a \$. . . credit for Taxpayer's previously reported and paid extracting [B&O] taxes, a \$. . . small business credit, \$. . . in delinquent payment penalties, a \$. . . substantial underpayment penalty, and \$. . . in interest.

Additionally, during the examination of Sole Proprietorship, Taxpayer requested that the Sole Proprietorship be closed and asked that taxes instead be assessed against the LLC. Taxpayer alleged it was doing business as the LLC and not as the Sole Proprietorship. However, the LLC was not an active tax account with the Department, so the Department assessed taxes against the Sole Proprietorship.

Taxpayer timely appealed, asserting that taxes should have been assessed against the LLC instead of the Sole Proprietorship, and that Audit should have taken into account the receipt book when determining the tax liability.

ANALYSIS

1. The Department Examined and Assessed Taxes Against the Correct Entity

Washington imposes a [B&O] tax “for the act or privilege of engaging in business” in this state. RCW 82.04.220. The [B&O] tax is “extensive and is intended to impose . . . tax upon virtually all business activities carried on in the State.” *Analytical Methods, Inc. v. Dep’t of Revenue*, 84 Wn. App. 236, 241, 928 P.2d 1123 (1996) (quoting *Palmer v. Dep’t of Revenue*, 82 Wn. App. 367, 371, 917 P.2d 1120 (1996)). Additionally, all retail sales in Washington are subject to retail sales tax. RCW 82.08.020. The tax is imposed on the buyer but is collected and remitted by the seller. RCW 82.08.050. Washington entities doing business in Washington must report and pay taxes. RCW 82.32.045(1).

Taxpayer asserts that the Department should have examined and assessed taxes against the LLC rather than the Sole Proprietorship. Taxpayer contends it believed it was doing business under the LLC instead of the Sole Proprietorship, and disagrees with Audit’s assessing taxes against the Sole Proprietorship.

Audit conducted the examination of and assessed taxes against the appropriate entity – the Sole Proprietorship. Taxpayer reported business activity under the Sole Proprietorship; only after the Audit began and the auditor indicated her intention of assessing taxes against the Sole Proprietorship did Taxpayer attempt to file amended returns to report taxes under the LLC. Furthermore, Taxpayer filed its annual 2014 tax return for the LLC, indicating that the LLC did no business and was closed. The examination covered business activities from January 1, 2012, through March 31, 2015; it is not reasonable for Taxpayer to claim taxes should be assessed against a business Taxpayer closed during the examination period. Moreover, during the Audit period, Taxpayer had a . . . account under the name “. . . ,” which received deposits. Finally, Taxpayer filed quarterly returns in 2012 through the end of 2014 for the Sole Proprietorship and only one annual return for the LLC in 2014 reporting zero business activities.

Audit selected the Sole Proprietorship for examination randomly because it filed returns reporting business activities. Taxpayer’s mistaken belief that it was filing under the LLC instead of the Sole Proprietorship is not enough to overcome the documentation showing Taxpayer closing the LLC

and repeatedly reporting business activity under the Sole Proprietorship.² The correct entity was examined and assessed.

2. Due to a lack of suitable records, the Department Properly Used Taxpayer's Bank Accounts to Estimate Tax Liability.

RCW 82.32.070 provides:

(1) 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 or she may be liable, which records shall include copies of all federal income tax and state tax returns and reports made by him or her. All his or her books, records, and invoices shall be open for examination at any time by the department of revenue. . . .

RCW 82.32.070(1) (emphasis added). *See also* RCW 82.32A.030(3) ("To ensure consistent application of the revenue laws, taxpayers have certain responsibilities under chapter 82.32 RCW, including, but not limited to, the responsibility to . . . (3) [k]eep accurate and complete business records . . .").

To implement RCW 82.32.070(1), the Department adopted WAC 458-20-254, which is more specific about the kinds of records a taxpayer must preserve:

(3) Recordkeeping requirements -- General.

(a) Every taxpayer liable for a tax or fee imposed by the laws of the state of Washington for which the department of revenue has primary or secondary administrative responsibility . . . must keep complete and adequate records from which the department may determine any tax liability for such taxpayer.

(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.

² We note that even if Taxpayer could establish the LLC owed the taxes instead of the Sole Proprietorship, the same amount of taxes would still be owing; one of the LLC or the Sole Proprietorship did business in Washington during the audit period, so one of those entities would be liable for the taxes, penalties, and interest. Because the evidence before us tends to show the Sole Proprietorship was doing business, the assessment is correct.

. . . .

(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)(a)-(c) (emphasis added).

In summation, the law requires taxpayers to provide suitable records, RCW 82.32.070(1), which means all records maintained by an ordinary prudent business person, WAC 458-20-254(3)(c), which must be kept in a systematic manner that conforms to accepted accounting methods and procedures, WAC 458-20-254(3)(b). These records also must show gross receipts and sales from all sources, and must be supported by original source documents or records. WAC 458-20-254(3)(b)(i).

In the event a person fails to keep and preserve suitable records, then RCW 82.32.100 provides that “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(1).

Here, Taxpayer did not have records showing how much income the sole proprietorship earned from its business activities. Accordingly, the Department properly concluded Taxpayer did not have suitable records. Based on this conclusion, Audit was authorized under RCW 82.32.100(1) to estimate income in the manner it deemed best: through Taxpayer’s personal bank accounts.

Taxpayer protests that Audit included income from the bank accounts that Taxpayer claimed were completely unrelated to the business. Taxpayer provided Audit with a receipt book to show certain deposits into bank accounts were not related to the business, which Audit rejected.

The receipt book Taxpayer produced to substantiate its claim that some of the deposits in the bank accounts were unrelated to the business is flawed in several respects. First, these records are not preserved in a systematic manner, and seem to be randomly ordered. For example, on the fourth page of the receipt book Taxpayer faxed to Audit, the four receipts appearing on the page are dated in the following order: June 17, 2014; October 27, 2014; February 15, 2013; and August 29, 2013. The fact that the receipts are not in chronological order indicates the receipts were not created contemporaneously with the transactions they purport to record. . . . This does not satisfy WAC 458-20-254(3)(b)’s requirement to preserve records in a systematic manner; it appears no records were preserved at the time the transactions occurred.

Second, the receipt book does not conform to accepted accounting methods and procedures. According to Taxpayer, the number on each receipt matches the date. For example, a transaction dated June 30, 2014, would be numbered “63014,” while a transaction dated August 6, 2012, would

be numbered "80612." This does not conform to accepting accounting methods and procedures because this numbering system makes it appear as if the June 30, 2014, transaction occurred *before* the August 6, 2012, transaction. This creates a conflict with the dates, and makes it difficult to ascertain when these receipts were actually created.

Taxpayer is responsible for keeping accurate and complete business records. RCW 82.32.070(1); RCW 82.32A.030(3). Taxpayer failed to do so, which required Audit to look for facts and information elsewhere to base its assessment. RCW 82.32.100(1). Audit used Taxpayer's bank account, correctly disregarded the receipt book produced by Taxpayer, and assessed taxes based on facts and information obtained from Taxpayer's bank accounts pursuant to RCW 82.32.100(1).

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 12th day of July, 2016.