

Cite as Det. No. 18-0294, 40 WTD 016 (2021)

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. 18-0294
)
...) Registration No. . . .
)

[1] RCW 82.04.070; RCW 82.04.080; WAC 458-20-203; WAC 458-20-111: GROSS INCOME OF THE BUSINESS – TRANSACTIONS BETWEEN RELATED ENTITIES – ADVANCES AND REIMBURSEMENTS. A transaction between two separate business entities is generally included in the gross income of the business unless the evidence demonstrates a true agency relationship existed between the entities for that transaction, and the transaction is a qualifying reimbursement.

[2] RCW 82.14.030; RCW 82.32.730; WAC 458-20-145: LOCAL SALES TAX – LOCATION OF TRANSACTIONS – SOURCING. Under sourcing rules for retail sales, when property is received at the seller's business location, the sale is sourced to that location; if it is not received at the seller's business location, the sale is sourced to the location where the purchaser receives the property.

[3] RCW 82.32.070; RCW 82.32.100; WAC 458-20-254: OBLIGATION TO MAINTAIN RECORDS – FAILURE TO PROVIDE RECORDS – AUTHORITY TO ESTIMATE. Generally, when a taxpayer fails to maintain sufficient business records as required by law, or provide them to the Department on request, the Department is permitted to make reasonable estimates to determine tax liability.

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.

Davis, T.R.O. – A Washington corporation (Taxpayer) petitions seeking correction of an audit assessment by the Department. In its petition, Taxpayer asserts that amounts it received from an affiliated business were not taxable income but were instead owner investment funds. Taxpayer argues that these amounts were previously taxed as income to the affiliated business and this represents a double tax on the same amounts. Taxpayer also contests the Department's coding of this income for local sales tax purposes, contending that, if it is recognizable as income, the related taxable activity should be coded to a different location. We deny Taxpayer's petition.¹

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

ISSUES

1. Under RCW 82.04.070, RCW 82.04.080, and WAC 458-20-111 (Rule 111), were deposits received by Taxpayer from an affiliated independent company properly included in Taxpayer's gross income from sales and subject to taxation?
2. Under RCW 82.14.030, RCW 82.32.730 and WAC 458-20-145 (Rule 145), in determining Taxpayer's local sales tax liability, was the Department's allocation of Taxpayer income to certain location tax codes correct?
3. Under RCW 82.32.070, RCW 82.32.100, and WAC 458-20-254 (Rule 254), did the Department have the authority to estimate Taxpayer's tax liability?

FINDINGS OF FACT

During the relevant period, . . . (Taxpayer) operated as a general contractor for the construction of residential housing as well as a contractor for a local school district. This company was wholly owned by a single individual (Owner). Taxpayer's business activities in Washington State during the relevant period included construction contracting for commercial, custom and speculative building projects.

In approximately November 2015, Owner formed another wholly owned affiliated business (Affiliate). Affiliate was established as a custom builder and speculative builder for constructing residential homes. Thus, three independent legal entities existed within the business structure applicable to this review during the relevant period. The first entity was Owner, the second entity was Taxpayer, and the third entity was Affiliate.²

In the course of Taxpayer's business during 2016, Affiliate made several payments by check to Taxpayer that were deposited in Taxpayer's business bank accounts (the Funds).

In August 2017, the Audit Division (Audit) of the Department of Revenue began an investigation of Taxpayer's records for the period from January 1, 2013, through March 31, 2017 (assessment period), to verify that Taxpayer's Washington State business activities were properly reported on its excise tax returns. The investigation was conducted at Taxpayer's office facility. The investigation included reconciliation of income taxable under the wholesaling business and occupation (B&O) tax, retailing B&O tax, and retail sales tax, by comparing amounts recorded in Taxpayer's business records with amounts reported on Taxpayer's excise tax returns. This reconciliation revealed discrepancies, and Audit made several adjustments to Taxpayer's tax liability, including classifying the Funds as sales income. Audit was unable to accurately determine where the Funds should be sourced to from Taxpayer's business records, for the purpose of calculating Taxpayer's local sales tax liability. Thus, using an estimation method derived from a

² According to public records maintained by the Washington Secretary of State, neither Taxpayer nor Affiliate filed required annual reports in 2017. On January 1, 2018, both Taxpayer and Affiliate closed their Department of Revenue business accounts. Taxpayer (on May 3, 2018), and Affiliate (on April 3, 2018) were administratively dissolved by the Secretary of State for their 2017 failures to file. As of the date of this determination, neither entity had renewed its status with the Department or the Secretary of State.

review of Taxpayer records, Audit assigned the Fund amounts among the three tax code locations where the majority of Taxpayer's documented sourceable transactions took place.

In its hearing on review, Taxpayer stated that during the investigation, it provided to Audit several receipts and other accounting records documenting purchases Taxpayer made for services and property related to the business. Taxpayer argued that these records showed that the Funds were intended to reimburse Taxpayer for the purchases shown in the records and should not be included in Taxpayer's gross income.

Audit used the records to provide additional tax paid at source deductions for purchases in those cases where the records supported it, but ultimately determined that the records were not sufficient to support Taxpayer's primary argument.

Audit's adjustments were discussed with Taxpayer's accounting manager on August 25, 2017.

As a result of Audit's investigation, on October 6, 2017, the Department issued an assessment against Taxpayer for \$. . . , including retail sales tax of \$. . . , retailing B&O tax of \$. . . , wholesaling B&O tax credit of \$. . . , and interest of \$ No penalties were assessed. On November 2, 2017, Taxpayer timely petitioned for review.

In its petition, Taxpayer asserts that the Funds were not taxable income but were instead owner investment funds. Specifically, Taxpayer argues the Department improperly recognized and taxed \$. . .³ deposited into Taxpayer's account from Affiliate in calendar quarters two, three, and four, 2016, as business income from sales. Taxpayer represents that both businesses are owned by the same individual and Owner was merely transferring previously taxed funds between his two entities. Taxpayer argues that, because these amounts were already taxed as Affiliate's income, the assessment here represents a double tax.

Taxpayer also contests the allocation and coding of the Funds for local sales tax purposes. Taxpayer argues that, if the Funds are recognized as business income, Taxpayer should be charged local tax rates based on tax code [for Location A], and not tax codes [for Location B], because the related business activity took place in [Location A].

Except for the above points, Taxpayer stated that it does not object to Audit's calculations, classification of income, or adjustments to income, it accepts its tax liability, and agrees with the Department's assessment.

In a telephone hearing on December 19, 2017, Taxpayer more fully described its business operations. According to Taxpayer, when Affiliate began operations in 2016, Taxpayer, the older company, had available funds and established credit, which Affiliate lacked. Therefore, when Affiliate began its business, Owner used Taxpayer as paymaster for Affiliate's transactions on Affiliate's early building projects. Taxpayer states it used its own funds to pay for Affiliate's business expenses and documented the transactions it made for Affiliate by assigning each transaction to a specific Affiliate building project in Taxpayer's business records. These funds

³ . . .

were treated by the parties as if they had been loaned by Taxpayer to Affiliate, and when Affiliate developed sufficient income, Affiliate provided reimbursement in the form of several checks paid to Taxpayer during the last three quarters of 2016. Taxpayer acknowledged that it did not have any internal documents showing this loan arrangement or specifying the details of the transactions. However, in its hearing Taxpayer stated, “If you look at the records you can see that that’s what they were doing – keeping a tally of what [Affiliate] owed.”

In its hearing, Taxpayer also asserted that the Funds were paid in [Location A], Washington, at the location of the company’s offices, and during the relevant period, all of Affiliate’s building projects, where the benefit of Taxpayer’s purchases were received, were also located in [Location A].

During the hearing, Taxpayer offered to provide records showing each of Affiliate’s building projects during the assessment period, and copies of Taxpayer accounting records showing that each relevant purchase was assigned to an Affiliate project, and then repaid by Affiliate. Taxpayer also stated it could provide documents showing the locations and dates of projects to support its claim that the only project Affiliate asked Taxpayer to pay for, and that Affiliate paid reimbursement on, was in [Location A] and not [Location B].

Following the hearing, Taxpayer provided additional accounting records and receipts, including several receipts for purchases; bank records indicating check deposits; spreadsheets containing an itemized list of transactions; and hand-written notes. Several of the original documents had additional hand-written notes added to them.⁴

In its accompanying letter, Taxpayer states the payments from Affiliate were “transfer[s] or short term loans of funds needed to cover . . . expenses [,] or loans that [Owner] made between his two companies.” Taxpayer further states, “[o]ur documentation and tracking . . . provides proof what each purchase was for, and further shows that the purchase would be ‘paid back/reimbursed.’” See Letter from Taxpayer to Department (January 9, 2018). In the same letter Taxpayer elaborates, “[w]e did a tremendous amount of ‘due diligence’ in keeping track of each receipt and cost to prove . . . what [Affiliate] would need to reimburse [Taxpayer] back for the funds they used.” See *Id.*

⁴ The records include: a copy of business check no. . . . for \$. . . from Affiliate to Taxpayer with the memo notation: “Reimbursement for Homes”; multiple personal checks drawn on Owner’s account made to third-party vendors in various amounts with memo notations identifying property lots or account numbers; a copy of cashier’s check no. . . . for \$. . . made out to Taxpayer with a “purchased by:” notation containing Affiliate’s name; business check no. . . . for \$. . . from Affiliate to Taxpayer with a blank memo notation; and business check no. . . . for \$. . . from Affiliate to Taxpayer with a blank memo notation. There is also a page from a QuickBooks spreadsheet showing multiple entries representing checks paid and deposits from different parties for various amounts and purposes, including: a deposit dated 06/03/2016 for \$. . . with the name field left blank; a deposit dated 06/15/2016 for \$. . . with the name field listing Affiliate; a deposit dated 07/06/2016 for \$. . . with the name field listing Affiliate and the memo field stating: “reimburse of . . .” [sic]; and a deposit dated 07/11/2016 for \$. . . with the name field left blank (apparently matching check no. . . . above). Numerous other receipts, purchase orders, invoices, copies of checks, and handwritten notations were provided as well. In some cases, a notation identifies a purpose, a vendor, or a property lot identification, but in many cases, there is no memo notation or other evidence to tie the transaction to a particular project, purchase, or entity.

In these additional records, however, Taxpayer did not provide any contracts or other records showing loan terms or details of the fund transfer arrangements between the two companies. Taxpayer did provide evidence showing one building project during the assessment period, which identified the property parcel but did not provide address information. The document was attached to a receipt for a payment made by Taxpayer, however, and no other information was provided to show which company was responsible for the project, or [who] was working on it.

ANALYSIS

Washington imposes a business and occupation (B&O) tax “for the act or privilege of engaging in business” in this state. RCW 82.04.220(1). The B&O tax measure and rate are determined by the type or nature of the business activity in which a person is engaged. Chapter 82.04 RCW. Washington also levies a retail sales tax on each retail sale in this state. RCW 82.08.020 and 82.04.050. Sales of tangible personal property or services falling within the definition of “sale at retail” or “retail sale” are subject to the retailing B&O tax classification, and the seller is required to collect retail sales tax from the buyer. RCW 82.04.250, RCW 82.08.020, and RCW 82.08.050.

When a taxpayer makes a “retail sale” as defined under RCW 82.04.050, the measure of the tax is the “gross proceeds of sales” of the business multiplied by the applicable tax rate. RCW 82.04.050(1). RCW 82.04.070 defines “gross proceeds of sales” as:

The value proceeding or accruing from the sale of tangible personal property, . . . and/or for other services rendered, without any deduction on account of the cost of the property sold, the cost of materials used, labor costs, interest, discount paid, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.

Here, Taxpayer, a building contractor, made both retail and wholesale purchases in the course of its business activities, received both retail and wholesale sales income for construction services and construction related sales of goods, maintained receipts and other business records of these transactions, including taxes paid, and does not object to Audit’s classification of the purchases or the tax assessed on these transactions. Taxpayer instead objects to Audit’s reclassification of the Funds as sales income.

Funds Received by Taxpayer

Taxpayer argues that the Funds should be excluded from its gross income because they are essentially 1:1 reimbursements for business loans Taxpayer made to Affiliate. In its letter to the Department dated January 9, 2018, Taxpayer states these amounts were “transfer[s] or short term loans of funds needed to cover . . . expenses [,] or loans that [Owner] made between his two companies.”

Tax Treatment of Separate Entities

Because the legal relationship between the two parties, Taxpayer (a Washington corporation), and Affiliate (a Washington LLC), is critical to determining the outcome of the case, we first turn to a

discussion of the tax treatment of separate, but related, legal persons or entities. During the assessment period, Taxpayer and Affiliate were separate legal entities. The question of whether transactions between entities are taxable is not new. As Excise Tax Advisory (“ETA”) 3134.2009 states:

The Department has addressed the question of transactions between related entities on many occasions. In an effort to simplify the information available to taxpayers, the Department has consolidated these excise tax advisories into a single document.

WAC 458-20-203 (Rule 203) states, in part:

Each separately organized corporation is a "person" within the meaning of the law
....

Each corporation shall file a separate return and include therein the tax liability accruing to such corporation. . . . [T]he law makes no provision for . . . the elimination of intercompany transactions from the measure of tax.

The principles of Rule 203 apply to all business organizations including, but not limited to, limited liability companies (LLC), limited partnerships, and joint ventures. *See also* WAC 458-20-170(2)(f).

While intra-company transactions are not taxable (*See* WAC 458-20-201), business transactions between different persons are subject to taxation unless there is a specific deduction or exemption. The fact that entities are related does not change the fact that they are separate persons for tax purposes. Rule 203; *Washington Sav-Mor Oil Co. v. Tax Comm.*, 58 Wn.2d 518 (1961).

As stated above, the law makes no provision for consolidating tax returns or eliminating transactions between different entities from taxation. Rule 203; Det. No. 86-309, 2 WTD 83 (1986). Thus, generally transactions between separate entities are taxable. Det. No. 16-0158, 36 WTD 038 (2017).

Under the RCW 82.04.070 and RCW 82.04.080 definitions of “gross proceeds of sales” and “gross income of the business,” no deductions are provided for costs of doing business, such as “the cost of tangible property sold, the cost of materials used, labor costs, interest, discount, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.” RCW 82.04.080(1). *See also* RCW 82.04.070.

[N]o charge which represents . . . payment on the purchase price of an article or a cost of doing or obtaining business, even though such charge is made as a separate item, will be construed as an advance or reimbursement. Money so received constitutes a part of gross sales or gross income of the business

Rule 111.

RCW 82.04.080(1) more fully defines “gross income of the business:”

“Gross income of the business” means the value proceeding or accruing by reason of the transaction of the business engaged in and includes gross proceeds of sales, compensation for the rendition of services, gains realized from trading in stocks, bonds, or other evidences of indebtedness, interest, discount, rents, royalties, fees, commissions, dividends, and other emoluments however designated, all without any deduction on account of the cost of tangible property sold, the cost of materials used, labor costs, interest, discount, delivery costs, taxes, or any other expense whatsoever paid or accrued and without any deduction on account of losses.

Thus, in general, all income a business bills to customers, even “at cost” or on a “1:1 basis,” is included in gross income and subject to tax. The fact that Taxpayer did not make a profit from these transactions is not material because the definition of gross income applies without any deduction on account of losses or lack of profit. [See] RCW 82.04.080(1); *see also Budget Rent-A-Car of Wash-Or, Inc., v. Dep’t of Revenue*, 81 Wn.2d 171, 500 P.2d 764 (1972) (“Whether a profit is realized on the transactions is immaterial, for the tax is on the gross revenues received in the course of doing business.”); *Time Oil [Co. v. State]*, 79 Wn.2d at [143,] 147[, 483 P.2d 628 (1971)] (Court upheld B&O tax on exchanges of fuel where the parties only saved transportation and storage costs, but did not make a profit); *Young Men’s Christian Ass’n v. State*, 62 Wn.2d 504, 383 P.2d 497 (1963); *City of Seattle v. State*, 59 Wn.2d 150, 367 P.2d 123 (1961).

Here, however, Taxpayer argues that the Funds were merely reimbursement for business loans, with Taxpayer acting in the capacity of Affiliate’s agent making necessary business purchases for Affiliate’s business activities to assist Affiliate until it was able to raise sufficient funds to repay the amounts. Therefore, we next examine the exclusion of reimbursements from gross income.

Excludable Reimbursements

The Department recognizes that not all payments received are taxable income. Payments may also be reimbursements for expenses advanced for a client, which “pass through” a business solely in the business’s capacity as an agent for the customer or client. Such amounts are not taxable to the business and are excluded from the business’s gross income. WAC 458-20-111 (Rule 111) sets forth the criteria for excluding advances and reimbursements. Rule 111 defines the terms “advance” and “reimbursement” and limits the application of these terms to “only when the customer or client alone is liable for the payment of the fees or costs and when the taxpayer making the payment has no personal liability therefor, either primarily or secondarily, other than as agent for the customer or client.” *See Washington Imaging Services, LLC v. Dep’t of Revenue*, 171 Wn.2d 548, 560, 252 P.3d 885 (2011) (“The concept is that ‘amounts that merely “pass through” a business in its capacity as an agent cannot be attributed to the business activities of the agent’ and therefore ‘such amounts are not taxable.’”); *City of Tacoma v. Wm. Rogers Co.*, 148 Wn.2d 169, 60 P.3d 79 (2002); *Rho Co. v. Dep’t of Revenue*, 113 Wn.2d 561, 782 P.2d 986 (1989).

Payments that meet the requirements of Rule 111 are not attributed to the business activities of the taxpayer and may be excluded from the measure of tax. Under Rule 111, for a payment to be considered an advance or reimbursement, it must meet three basic requirements: 1) be a customary

reimbursement for advances made to pay costs or fees for the client; 2) involve goods or services that the taxpayer does not or cannot render; and 3) not involve an obligation the taxpayer is liable for, except as the agent of the client. *See Rule 111; see also Washington Imaging Services, LLC*, 171 Wn.2d at 561-562. A payment must meet all of these requirements to be excludable from gross income. *Christensen, O'Connor, Garrison & Havelka v. Dep't of Revenue*, 97 Wn.2d 764, 769, 649 P.2d 839 (1982) (establishing the “*Christensen* test”).

The Washington State Supreme Court has ruled that to satisfy the “agent of the client” test a true agency relationship between the client or customer and the taxpayer is required. “The existence of that agency relationship is not controlled by how the parties described themselves” and “standard agency definitions should be used in analyzing the existence of the agency relationship.” *Washington Imaging Services, LLC*, 171 Wn.2d at 561-562 (emphasis added); *William Rogers Co.*, 148 Wn.2d at 177-78. The taxpayer must establish that its use of the funds to pay a third party is solely as an agent of the customer. If this condition is satisfied, the taxpayer must also establish that it received the funds as the agent of the customer. *Id. See also Det. No. 05-0139, 26 WTD 6 (2007); Rho*, 113 Wn.2d at 573; *William Rogers*, 148 Wn.2d at 178.

“An agency relationship generally arises when two parties consent that one shall act under the control of the other.” *Rho*, 113 Wn.2d at 570; see Restatement (Third) of Agency § 1.01 (2006) (“[a]gency is the fiduciary relationship that arises when one person (a ‘principal’) manifests assent to another person (an ‘agent’) that the agent shall act on the principal’s behalf and subject to the principal’s control, and the agent manifests assent or otherwise consents so to act”). Consent may be implied. *Rho*, 113 Wn.2d at 570. The requirement that the principal must exercise control over the agent, *Nordstrom Credit, Inc. v. Dep't of Revenue*, 120 Wn.2d 935, 941, 845 P.2d 1331 (1993), means that there must be facts or circumstances that “establish that one person is acting at the instance of and in some material degree under the direction and control of the other.” *Matsumura v. Eilert*, 74 Wn.2d 362, 368-69, 444 P.2d 806 (1968); *see also Washington Imaging Services, LLC*, 171 Wn.2d at 562

Here, Taxpayer challenges Audit’s inclusion of the Funds in its gross sales income. Taxpayer states that instead they were excludable reimbursements Taxpayer received for purchases Taxpayer made on Affiliate’s behalf. However, Taxpayer has not shown that the transactions meet the requirements of the Rule. Taxpayer provided receipts, invoices, and other ordinary accounting records documenting the original transactions, and these were considered by Audit in its investigation. However, Taxpayer has not provided a contract, loan document, or other evidence that Taxpayer acted under Affiliate’s direction, or that Affiliate was solely liable for payment of each related transaction Taxpayer made.⁵ Without this evidence, it is impossible for the

⁵ Taxpayer has admitted that no such documents exist, but argues that the Department should be able to see by looking at the receipts and accounting records what the parties intended. However, this is not sufficient here. A review of the receipts and spreadsheets do not demonstrate Affiliate was solely liable for each Taxpayer purchase, or that Taxpayer was acting solely under Affiliate’s direction. In addition, absent evidence, there is nothing demonstrating that the Funds were related to the transactions. On their face, the records seem to demonstrate arms-length purchases from outside vendors, made in the ordinary course of the business that both Taxpayer and Affiliate were engaged in. Thus, for example, based solely on the evidence in the record, it is also possible that the entities were actively participating on the same projects to some degree, and choosing to allocate purchases or expenses between them. It is also possible that, in making the payments to Taxpayer, the entities were attempting to rebalance funds in some manner according to a business strategy. Other reasonable possibilities consistent with the evidence exist. As discussed above, it is

Department, relying solely on spreadsheet notations and transaction receipts, to determine if the Rule's requirements are met for an individual transaction. Determining whether an agency relationship existed requires knowledge of the specific terms of a transaction, and no such evidence is in the record here.

As discussed above, the evidence in the record is insufficient to allow the Department to review each of Taxpayer's claimed transactions to determine if it meets the legal requirements for reimbursement exclusion. Therefore, Taxpayer has not shown that it is entitled to exclusion. As a result, we find that, based on the evidence currently in the record, the amounts paid by Affiliate to Taxpayer were properly included in Taxpayer's gross income.

Local Sales Tax

Taxpayer also objected to Audit's assignment of location codes to the amounts paid by Affiliate for collection of local sales tax. RCW 82.14.030 authorizes counties and cities to levy local sales and use taxes, to be collected along with the state's sales and use taxes. RCW 82.32.730 implements sourcing rules under the streamlined sales and use tax agreement, and Rule 145 is the administrative rule regarding local sales and use tax.

Rule 145 provides that the sourcing rules provided "apply in a descending order of priority. This means the seller should first determine if [Rule 1] applies. If it does apply, then the seller must source the sale under Rule 1." Rule 145(2)(a). If a sourcing rule does not apply, the seller must proceed down the list in order of priority until the appropriate sourcing is determined. Thus, the default is that, when the property or service is received by a purchaser at the seller's business location, the sale is sourced to that location. RCW 82.32.730(1)(a); Rule 145(2)(a)(i) ("Rule 1").

RCW 82.32.730(1)(b) and Rule 145(2)(a)(ii) ("Rule 2") also explain that, for transactions defined as retail sales under RCW 82.04.050, when tangible personal property is not received by the purchaser at the seller's business location, it is sourced to the location where the purchaser receives the property.

Rule 145 explains the seller's responsibility as follows (in pertinent part):

The department assigns location codes to identify the specific taxing locations that receive the local taxes. These location codes are used on tax returns to accurately identify the correct taxing location and tax rate.

Sellers and their agents are responsible for determining the appropriate tax rate for all of their retail sales taxable in Washington. Sellers and their agents are also responsible for collecting from their purchasers the correct amount of tax due upon each sale and remitting that tax to the department.

Rule 145(1).

Taxpayer's responsibility to provide sufficient evidence to the Department to justify each tax preference claim, in this case by showing that each element of Rule 111 was met for a particular transaction.

RCW 82.32A.030 provides that taxpayers have certain responsibilities under chapter 82.32 RCW. These responsibilities include keeping accurate and complete business records, filing accurate returns, and ensuring the accuracy of the information entered on tax returns. RCW 82.32A.030(3), (4), and (5).

Here, Audit determined during its investigation that Taxpayer's records were insufficient to properly determine a sourcing location to classify the Funds for local tax purposes. Therefore, Audit was required to estimate. Audit reviewed Taxpayer's accounting records and proportionally allocated the funds between the three locations representing the highest dollar amounts of Taxpayer's other recorded transactions, according to the percentage from each location. These locations were all in [Location B]. Audit states this is "the most equitable method with respect to the municipalities and efficiencies of conducting an audit." *See* Audit Response Memorandum (November 29, 2017).

Taxpayer argues that Audit's sourcing is incorrect because all business was done in [Location A]. In its hearing on review, Taxpayer stated the transfer of the funds was made in [Location A] because both companies were located in [Location A] and all houses under construction at that time were in [Location A]. During its hearing on review, Taxpayer stated it would provide records showing the location of all projects under construction during the assessment period, but these records were not provided. The evidence and records available do not provide sufficient information to allow Audit to properly source each transaction under the above rules. Therefore, Audit was required to estimate.

Because Audit's decision to estimate was based on its determination that Taxpayer's records were insufficient, we next turn to a discussion of Taxpayer's obligation to maintain records. Generally, when a taxpayer fails to maintain sufficient business records as required by law, or provide them to the Department upon request, the Department, relying on the information available, is permitted to make reasonable estimates to determine tax liability. *See* RCW 82.32.100(1), (2).

Recordkeeping Requirements

RCW 82.32.070 requires every person liable for payment of excise taxes to keep and preserve suitable records in order to determine the amount of any tax for which the taxpayer may be liable. This includes records that will demonstrate the amount of gross receipts and sales from all sources; the amount of all deductions, exemptions, credits, and refunds claimed; and the payment of retail sales tax or use tax. Rule 254(3)(b). A taxpayer must also keep its federal and state tax returns, and all documents and data used in the preparation of such returns. Rule 254(3)(c).

Taxpayers are also subject to recordkeeping requirements provided in RCW 82.32.070(1) and Rule 254. Rule 254 states that the records must include the normal records maintained by an ordinary prudent businessperson. Rule 254(3)(c). Rule 254 provides a lengthy list of such records, including general ledgers, sales journals, cash receipts journals, purchase journals, bills, invoices and all work papers used in the preparation of tax returns. *Id.* Rule 254 specifically provides that a taxpayer must keep records that demonstrate the amounts of all deductions through supporting records necessary to substantiate the deduction. Rule 254(3)(b)(ii).

Taxpayers are under a duty to maintain records that shall be open for examination by the Department according to specific requirements. *See* RCW 82.32.070(1); Rule 254. If a person fails to keep and preserve suitable records, then the Department may proceed to estimate tax liability according to RCW 82.32.100(1).

Here, Taxpayer admits there are no records available to show that Taxpayer loaned or advanced money to Affiliate, or that Taxpayer acted on Affiliate's behalf when making the purchases it asserts are the basis for Affiliate's payment of the Funds.⁶ No location or specific transaction or purchase is given. There is thus no way to reasonably determine the location where Affiliate received the property or service for which the Funds were paid. Thus, the record suggests that Taxpayer has failed to keep and preserve the normal records maintained by an ordinary prudent businessperson. Taxpayer has failed to document the deductions it claims, and does not maintain records detailing the terms of its business relationship with Affiliate regarding the purchase transactions or the Funds at issue.

This lack of proper documentation indicates that, here, Taxpayer's records for the assessment period were not complete or reliable, and therefore are not "suitable records as may be necessary to determine the amount of any tax for which [Taxpayer] may be liable." RCW 82.32.070(1).

Department's Authority to Estimate Tax

In general, where a taxpayer fails to make available for examination the records required by RCW 82.32.070 and Rule 254, the Department is authorized to estimate a taxpayer's tax liability based on available documents. RCW 82.32.100(1), (2).

RCW 82.32.100 provides, in part, that "[i]f any person fails or refuses to make any return or to make available for examination the records required by this chapter, 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). *See also* Det. No. 16-0218, 36 WTD 063 (2017). Once the Department obtains the facts and information needed, the Department "shall proceed to determine and assess against such person the tax and any applicable penalties or interest due." RCW 82.32.100(2).

In this case, having concluded that Taxpayer's records were not suitable, Audit relied on the provisions of RCW 82.32.100(1) and proceeded to estimate in order to properly determine Taxpayer's tax liability. Under RCW 82.32.100(1), Audit was authorized to estimate in the manner it deemed best. This statutory provision affords the Department wide discretion in the methodology employed to calculate a reasonable estimate of tax. *See, e.g.*, Det. No. 15-0350, 35 WTD 291 (2015) ("We have previously noted and affirmed the Department's authority to assess taxes based

⁶ Such records might include an agency agreement, paymaster agreement, promissory note, or other similar document. In the records Taxpayer provided on review, and which both it and Audit stated were provided during the investigation, there are records showing payments by Owner, Affiliate, and Taxpayer. There are invoices, receipts, purchase orders, and other records showing purchases of property and services made by both Affiliate and by Taxpayer. Some of these identify specific projects, but most do not contain any identifying information tying them to a particular project. In particular, of the several records that show deposit of the Funds, only two contain notations: "Reimbursement for Homes"; and "reimburse of . . ." [sic].

on a reasonable estimate.”) (citing Det. No. 14-0106, 33 WTD 402 (2014); Det. No. 13-0302R, 33 WTD 572 (2014); Det. No. 03-0279, 23 WTD (2004); Det. No. 97-134R, 18 WTD 163 (1999)).

Therefore, because Taxpayer was unable to provide suitable records for Audit to properly determine its tax liability, we find that Audit’s decision to use Taxpayer’s other accounting records to determine the locations where the majority of Taxpayer’s services and property were usually delivered, and Audit’s proportional allocation of the Funds among the three primary tax code locations based on Taxpayer’s documented income from these locations, was reasonable under the circumstances, and we affirm Audit’s allocation.

Conclusions

Because Taxpayer and Affiliate are separate entities, transactions between them are taxable unless an exclusion or deduction exists. Because Taxpayer has not provided detailed records sufficient to document the individual transactions that it seeks to exclude from gross income, it is impossible for the Department to determine whether a true agency relationship existed in each case. Thus, Taxpayer has not demonstrated it is eligible for the reimbursement exclusion, and we find Audit properly classified the payments as gross sales income.

Next, similarly, because Taxpayer has not provided detailed records sufficient to document the location where services were provided or property was received, the Department was unable to properly assign tax codes to determine the proper amount of local sales tax to assess. Therefore, the Department was required to estimate in the manner it deemed best to create a reasonable estimate of the tax due. We find the Department’s method of estimation to be reasonable in this case and affirm its allocation of income to [Location B] tax codes. We therefore affirm the assessment.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 2nd day of November 2018.