

Cite as Det. No. 14-0170, 34 WTD 030 (2015)

BEFORE THE APPEALS 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)
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No. 14-0170
Registration No. . . .

[1] RCW 82.04.470: B&O TAX – RETAIL SALES TAX – WHOLESALING – RETAILING – SUBSTANTIATION – RESELLER PERMIT – RESALE CERTIFICATE – FACTS AND CIRCUMSTANCES. A taxpayer objected to the reclassification of sales from wholesaling to retailing. Taxpayer did not provide required documentation to substantiate sales at wholesale. The Department denied Taxpayer's petition, finding that Audit properly reclassified the sales at issue to retailing.

[2] RULE 254; RCW 82.32.070; RCW 82.32.100: SUBSTANTIATION – GIFTS – BANK DEPOSITS. When a taxpayer fails to make records available for examination, the Audit Division is entitled to estimate a taxpayer's gross income through the use of bank deposits. When a taxpayer claims the discrepancy between the amounts reported on its excise tax returns and the amounts deposited with its bank was due to gifts from family members, the burden is on the taxpayer to provide records substantiating which deposits were made as gifts.

[3] RULE 228; RCW 82.32.105: SUBSTANTIAL UNDERPAYMENT PENALTY – WAIVER – LACK OF KNOWLEDGE. Penalties cannot be waived for lack of knowledge of a tax obligation.

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.

Anderson, A.L.J. – A contractor specializing in ceiling construction appeals an assessment of retail sales tax, retailing and wholesaling business and occupation (“B&O”) tax, penalties, and interest, on the basis that it worked as a sub-contractor on several jobs and has been unable to secure resale certificates and/or reseller permits because many general contractors have closed their businesses, monetary gifts from a relative were improperly assessed retailing B&O and retail sales tax, and it did its best in reporting and paying taxes. We deny the petition.¹

ISSUES

1. Pursuant to RCW 82.04.470, has Taxpayer shown that certain sales were wholesale sales?

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

2. Pursuant to RCW 82.32.070, has Taxpayer shown that certain bank deposits were gifts from a family member?
3. Pursuant to RCW 82.32.105, is good faith effort and lack of knowledge of tax liabilities sufficient grounds to waive or cancel a 5% assessment penalty?

FINDINGS OF FACT

[Taxpayer] is a contractor specializing in ceiling construction.

The Washington State Department of Revenue's (the "Department's") Audit Division ("Audit") reviewed Taxpayer's books and records for January 1, 2009 through December 31, 2012 (the "Audit Period"). On October 23, 2013, Audit issued Taxpayer an assessment in the amount of \$. . . comprised of \$. . . in retail sales tax, \$. . . in retailing B&O tax, \$. . . in wholesaling B&O tax, \$. . . in interest, and \$. . . in 5% assessment penalty.

Taxpayer appeals the assessment of retailing B&O tax, retail sales tax, and 5% assessment penalty. It asserts that it is a wholesale business and worked as a sub-contractor for general contractors and was not responsible for paying retail sales tax. Taxpayer also asserts that it could not get reseller certificates and/or reseller permits from some businesses because they were closed. Taxpayer states that it attempted to contact the . . . businesses to obtain resale certificates and/or reseller permits, but was unsuccessful: . . .

In addition, Taxpayer asserts that it deposited cash gifts from its co-owner's step-parent into its bank account and such amounts were improperly included in the measure of retailing B&O tax and retail sales tax. In support, Taxpayer provided a letter from [the step-parent] certifying ". . . that Cash gifts were given to [the owners] for their Business, [Taxpayer].". The letter lists the following cash gifts on the following dates: \$. . . – 5/28/2009; \$. . . – 8/4/2009; \$. . . – 12/13/2010; \$. . . – 1/4/2012; \$. . . – 2/24/2012; \$. . . – 10/22/2012.

Taxpayer also states that it would call the Department's Taxpayer Services toll free number for assistance in completing its tax returns; it did the best it could in reporting and paying its taxes and did not know it should have been reporting and paying taxes differently.

ANALYSIS

Retail Sales

Washington imposes the B&O tax "for the act or privilege of engaging in business activities" in this state. RCW 82.04.220. It is measured by the application of the B&O tax rate against the value of products, gross proceeds of sales, or gross income of the business, as the case may be. *Id.* The B&O tax rate varies by classification, e.g., the retailing B&O tax rate is 0.471 percent and the wholesaling B&O tax rate is 0.484 percent, and the classification is determined by taxpayers' business activities. RCW 82.04.250; RCW 82.04.270. The retailing B&O tax is levied upon all persons engaging in the business of making sales at retail in Washington State; the wholesaling B&O tax is levied upon all persons engaging in the business of making sales at wholesale in Washington State. RCW 82.04.250; RCW 82.04.270.

In addition, Washington imposes retail sales tax on sales in this state of tangible personal property and sales of services defined as retailing, unless the property or services are purchased for resale or otherwise exempt. RCW 82.08.020; *See*, RCW 82.04.050. It is measured by the

application of the retail sales tax rate to the selling price of each retail sale. RCW 82.08.020(1). It is the seller's responsibility to collect retail sales tax from the buyer, and if the seller fails to do so, the seller is personally liable for the amount of tax unless the seller maintains proper records of exempt transactions and provides them to the Department when requested. RCW 82.08.050.

"Retail sale" is defined by statute. RCW 82.04.050. As relevant here, "retail sale" or "sale at retail" specifically includes the sale of or charge made for labor and services rendered with respect to "[t]he constructing, repairing, decorating, or improving of new or existing buildings or other structures under, upon, or above real property of or for consumers, . . ." RCW 82.04.050(2)(b).

Similarly, "wholesale sale" is also defined by statute. RCW 82.04.060. As relevant here, "wholesale sale" includes "Any charge made for labor and services rendered for persons who are not consumers, in respect to real or personal property, if such charge is expressly defined as a retail sale by RCW 82.04.050 when rendered to or for consumers." RCW 82.04.060(2).

The burden of proving that a sale is wholesale rather than retail is on the seller. RCW 82.04.470. The seller may meet this burden as follows:

- By taking from the buyer, at the time of sale or a reasonable time after the sale as provided by rule of the department, a copy of a reseller permit (formerly resale certificate) issued to the buyer by the department under RCW 82.32.780 or 82.32.783. RCW 82.04.470.²
- In lieu of a copy of a reseller permit (formerly resale certificate) issued by the Department, a seller may accept a properly completed uniform exemption certificate approved by the streamlined sales and use tax agreement governing board or any other exemption certificate as may be authorized by the Department and properly completed by the buyer. RCW 82.04.470(2)(a).
- If the seller has not obtained an appropriate reseller permit (formerly resale certificate) or other acceptable documentary evidence, the seller may sustain the burden of proof through facts and circumstances that the property was sold for resale in the regular course of the buyer's business without intervening use by the buyer. WAC 458-20-102(7)(h).³ The Department will consider all evidence presented, including the circumstances of the sales transactions themselves, when determining whether the seller has met its burden of proof. Id. Facts and circumstances that should be considered include, but are not necessarily limited to: (i) The nature of the buyer's business – the items being purchased at wholesale must be consistent with the buyer's business; (ii) The nature of the items sold – the items sold must be of a type that would normally be purchased at wholesale by the buyer; and (iii) Additional documentation – such as, purchase orders and shipping instructions. Id.

And, the burden of maintaining proper records rests with the taxpayer. RCW 82.32.070 provides in pertinent part:

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 may be liable,

² Beginning January 1, 2010 (during the Audit Period), buyers are required to obtain reseller permits from the Department; resale certificates are no longer to be used. RCW 82.32.780.

³ WAC 458-20-102A(5)(a) provides similar rules with respect to resale certificates.

which records include copies of all federal income tax and state tax returns and reports made by him. All his books, records, and invoices shall be open for examination at any time by the department.

RCW 82.32.070(1).

Thus, a seller is liable for the retail sales tax due on any retail sale unless it has the documentation to show that the sale was exempt or otherwise not subject to retail sales tax. Det. No. 01-193, 21 WTD 264 (2002). It is the seller's burden to maintain records to support the exempt nature of its transactions. *Id.*; RCW 82.32.070(1).

Here, Taxpayer has not provided reseller permits or resale certificates, or any additional records or evidence regarding the facts and circumstances surrounding these sales of construction services. Further, we note that some of these listed businesses do not appear to be closed nor general contractors, i.e., . . . and . . . ; it is unclear why these businesses would potentially provide Taxpayer with a reseller permit or resale certificate. Accordingly, in the absence of evidence showing these sales to be wholesale, we must sustain Audit's determination that they are retail sales and the assessment of retailing B&O tax and retail sales tax.

Gifts

As stated above, RCW 82.32.070(1) imposes a duty of each taxpayer to keep complete and accurate records for which the department may determine the liability for such taxpayer. WAC 458-20-254 defines the requirements for the maintenance and retention of books, records, and other sources of information, and requires the records to include "the normal records maintained by an ordinary prudent business person."

Where a taxpayer fails to make available for examination the records required by RCW 82.32.070 and WAC 458-20-254, the Department is authorized to estimate a taxpayer's tax liability based on available documents. RCW 82.32.100 provides, in part:

- (1) If 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; and to this end the department may examine the records of any such person as provided in RCW 82.32.110.

In the present case, the auditor found that the deposits in the bank account exceeded the amounts reported on the excise tax returns. The auditor discussed this discrepancy with Taxpayer prior to issuing the assessment and gave Taxpayer an opportunity to provide additional records to explain the discrepancy. Taxpayer argued that the bank deposits included proceeds from a loan or gift from a family member, but did not provide any supporting records to substantiate its argument. Because records were not available to explain the discrepancy between the deposits in the bank account and the amounts reported on the excise tax returns, Audit was justified in using the bank deposits to estimate gross income. RCW 82.32.100(1).

Starting with bank deposit records and requiring a taxpayer to identify and document all non-income deposits is an accurate method for reconciling taxable income with reported income. *See* Det. No. 10-0167, 30 WTD 89 (2011); *See also Parks v. C. I. R.* 94 T.C. 654, 658 (Tax Court, 1990) (Bank deposits are *prima facie* evidence of the receipt of income.) The Department's auditor is required to determine the amount of any tax for which a taxpayer may be liable. The

auditor is the person who has the opportunity to look at the taxpayer's various records. A Department auditor is particularly qualified by training and experience to determine which records are suitable for determining the amount of tax due. We generally will not second-guess the auditor's decision as to which records should be used for determining whether the taxpayer has correctly and completely reported.

On appeal, Taxpayer provided a letter from [the step-parent] certifying that several gifts had been made to [the owners] for their business (Taxpayer). We find this letter to be vague in that it does not state who gave these alleged gifts, and conclude it is insufficient to prove the cash deposits were gifts. In order to grant Taxpayer's petition with respect to this assertion, we would need additional records substantiating the gifts, such as the gifter's bank statements showing the withdrawal of the cash gifts or Taxpayer's deposit records.

Penalties

RCW 82.32.090(2) provides for the assessment of a substantial underpayment penalty when the Department determines that any tax has been substantially underpaid. A substantial underpayment of tax occurs when the underpayment of tax is at least \$1,000 and a taxpayer has paid less than 80% of the amount of tax determined to be due for all types of taxes included in, and for the entire period of time covered by, the Department's examination. RCW 82.32.090(2).

Here, the Department assessed Taxpayer \$. . . in total tax and Taxpayer had paid \$. . . in total tax, for the Audit Period; the Department correctly assessed the substantial underpayment penalty.⁴ Taxpayer requests waiver or cancellation of the 5% substantial underpayment penalty on the basis that it made a good faith attempt to report and pay taxes during the Audit Period and did not know it should have been reporting and paying taxes differently.

RCW 82.32.105 provides when the Department may waive or cancel penalties, and provides, in pertinent part:

- (1) If the department of revenue finds that the payment by a taxpayer of a tax less than that properly due or the failure of a taxpayer to pay any tax by the due date was the result of circumstances beyond the control of the taxpayer, the department of revenue shall waive or cancel any penalties imposed under this chapter with respect to such tax.

(Emphasis added.)

"Circumstances beyond the control of the taxpayer" is defined in WAC 458-20-228(9), which states:

The circumstances beyond the control of the taxpayer must actually cause the late payment. Circumstances beyond the control of the taxpayer are generally those which are immediate, unexpected, or in the nature of an emergency. Such circumstances result in the taxpayer not having reasonable time or opportunity to obtain an extension of the due date or otherwise timely file and pay.

WAC 458-20-228(9) goes on to provide a non-exclusive list of circumstances that generally will and will not be considered circumstances beyond the control of the taxpayer. As relevant here, a misunderstanding or lack of knowledge of a tax liability is generally not considered a

⁴ \$. . . exceeds \$1,000 and Taxpayer paid less than 80% of the total tax due (\$. . .).

circumstance beyond the control of the taxpayer and will not qualify for a waiver of the penalty. WAC 458-20-228(9)(a)(iii)(B). Det. No. 01-096, 22 WTD 126 (2003) (“‘Lack of knowledge’ is not a ‘circumstance beyond the control of the taxpayer’ because the law, regulations, and Department publications explaining all tax laws are publicly available . . .”). And, we note that neither RCW 82.32.105 nor WAC 458-20-228 permits good faith effort to be the basis in waiving penalties. *See* Det. No. 99-042, 19 WTD 784 (2000).

Further, RCW 82.32A.030(a) places upon taxpayers the responsibility to “[k]now their tax reporting obligations, and when they are uncertain about their obligations, seeks instructions from the department of revenue.” The Department has a Taxpayer Information and Education Division and field offices throughout the state to answer any questions pertaining to tax liabilities. It would be inconsistent with this statutory scheme to waive penalties on taxes properly due where Taxpayer misunderstood the law and failed to seek instruction from the Department. *See also* WAC 458-20-228. Accordingly, we sustain the assessment of substantial underpayment penalties.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 22nd day of May, 2014.