

Cite as Det. No. 14-0106, 33 WTD 402 (2014)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition for Refund of	)	<u>D E T E R M I N A T I O N</u>
	)	
...	)	No. 14-0106
	)	
	)	Registration No. . . .
	)	

[1] RULE 254; RCW 82.32.070, RCW 82.32.100: BUSINESS AND OCCUPATION TAX – RECORDS RETENTION – ESTIMATE OF TAX – BANK DEPOSITS. Taxpayer did not provide the Department with records sufficient to determine whether some deposits into Taxpayer’s business bank account originated from nontaxable sources. Without adequate records for review, the Department concluded the deposits represented taxable income.

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.

Valentine, A.L.J. – [Taxpayer] asks for a refund of tax, interest, and penalties paid following the Department of Revenue’s (Department) audit of Taxpayer’s business records and state excise tax returns.<sup>1</sup> Taxpayer’s petition for refund is denied.<sup>2</sup>

ISSUES

Pursuant to RCW 82.32.070, RCW 82.32.100, and WAC 458-20-254 (Rule 254), when a taxpayer makes deposits into a business bank account, but does not provide specific documentation to show that certain deposits are non-business related, should those deposits be included in an estimate of Taxpayer’s gross income for business and occupation (B&O) tax purposes?

FINDINGS OF FACT

Taxpayer is a hair salon specializing in haircuts and hair coloring. During the audit period of January 1, 2009, through December 31, 2012, Taxpayer did not offer any tangible personal

<sup>1</sup> See below for an itemization of the assessment.

<sup>2</sup> Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

products for sale to customers. Records provided for the audit were limited to bank statements and federal income tax returns.

The Department's Audit Division (Audit) assessed Taxpayer a total of \$. . . <sup>3</sup> This amount includes \$. . . for reversal of a small business credit, \$. . . in service and other activities B&O tax, \$. . . for use tax/deferred sales tax,<sup>4</sup> \$. . . in interest, and a 5% assessment penalty of \$. . . . Audit reviewed bank statement deposits and compared the deposits to amounts reported on Taxpayer's state excise tax returns. Audit also compared the deposits to amounts reported on Taxpayer's federal income tax returns. Audit found significant discrepancies in both income reconciliations, namely, that deposits into Taxpayer's business bank account totaled sums higher than those reported on Taxpayer's state excise tax returns and federal income tax returns.

Taxpayer paid the assessment in full and asks for a refund. Taxpayer contends that funds from non-business sources are included in amounts Audit treats as gross income of the business.<sup>5</sup>

Audit asserts that Taxpayer has not provided sufficient documentation, such as copies of checks or other source documents, to show that the deposits in question originated from sources other than Taxpayer's hair salon business.

The deposits in question are labeled as ATM deposits on Taxpayer's business bank account statements. Taxpayer provided copies of annual W-2 Wage and Tax Statements showing employment earnings (unrelated to the hair salon) for 2009 and 2010 (there were no wages deposited for 2011 and 2012). Taxpayer, however, does not provide documentation related to any of the individual ATM deposits at issue.

#### ANALYSIS

Taxpayer and Audit agree that Taxpayer's proper B&O tax reporting classification is service and other activities. *See* WAC 458-20-224; WAC 458-20-138. The issue in this case is the amount of gross income on which Taxpayer owes B&O tax.

RCW 82.32.070 and Rule 254 require every taxpayer who is liable for a tax or fee imposed by the State of Washington to keep, for five years, and make available to the Department, adequate records by which the Department can determine the correct tax liability. The records to be preserved and presented include those business records that an ordinary, prudent business person would keep, such as "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." Rule 254(3)(c).

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<sup>3</sup> The original amount assessed was \$. . . , but Audit issued a credit of \$. . . for sales tax paid on the purchase of a capital asset and issued a post assessment adjustment showing a total assessment of \$. . . .

<sup>4</sup> Taxpayer does not offer any argument or evidence related to the remaining assessment of \$. . . for use tax/deferred sales tax. Thus, we uphold this portion of the assessment without additional discussion or analysis.

<sup>5</sup> Specifically, Taxpayer contends that side-job wages earned by its owner and owner's spouse were deposited into Taxpayer's business bank account.

In cases where taxpayers fail or refuse to provide the Department access to necessary business records, RCW 82.32.100 authorizes the Department to “proceed, in such manner as it may deem best to obtain facts and information on which to base its estimate of the tax.”

Taxpayer provided bank statements and federal income tax information, but Taxpayer did not provide specific documentation to show, with any certainty, that some deposits to its business bank account came from sources other than Taxpayer’s business.<sup>6</sup> Thus, the Department has no basis on which to exclude these deposits from Taxpayer’s gross income for B&O tax purposes.

In summation, the Department is authorized to estimate a taxpayer’s tax liability based on the best information available when the taxpayer does not provide adequate business records. “The burden of maintaining proper records rests with the taxpayer.” Det. No. 01-193, 21 WTD 264 (2002). In this case, in the absence of any documentation to the contrary, we conclude that Taxpayer’s total deposits into its business bank account provided the most reliable data by which Audit could ascertain Taxpayer’s gross business income and resulting B&O tax liability.

#### DECISION AND DISPOSITION

Taxpayer’s petition for refund is denied.

Dated this 25th day of March 2014.

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<sup>6</sup> As we said in Det No. 12-0277, 32 WTD 194 (2013), “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.)”