

WAC 458-20-199 Accounting methods. (1) **Introduction.** In computing tax liability under the business and occupation tax and the retail sales tax, one of the following accounting methods must be used. This is true for all businesses, whether their activity involves the sale of tangible personal property or the rendering of services. (See WAC 458-20-197 for an explanation of when tax liability arises under the accrual method versus the cash receipts method.)

(2) **Method one, cash basis.** A taxpayer may file excise tax returns in each reporting period with figures based upon cash receipts only if the taxpayer's books of account are regularly kept on a cash receipts basis. (See RCW 82.04.090.) A taxpayer whose books of account recognize income at the time a sale is made or a service is rendered, regardless of when payment is received, is keeping its records on an accrual basis and must report and pay tax on the accrual basis. For those taxpayers who maintain formal accounting records, the department of revenue will generally look to the revenue accounts of the general ledger of the taxpayer and to the method of accounting used for reporting of federal income taxes to determine when the income is recognized. However, all records of the taxpayer will be considered by the department in determining whether the records are being kept on an accrual basis, particularly for those taxpayers who do not maintain formal records such as a general ledger.

The fact that a taxpayer makes sales "on account" and has records to identify the accounts receivable does not preclude the taxpayer from reporting on a cash receipts basis. Taxpayers can have accounts receivable and still report on the cash basis, provided the accounting records, such as the general ledger or federal income tax returns, do not record the sales on account as income until the cash is actually received. If a taxpayer keeps a general ledger on an accrual basis and federal income tax returns on a cash basis, the taxpayer may elect to report state tax returns on either the cash basis or the accrual basis. However, once a reporting basis is selected, the reporting basis may not be changed without authorization from the department unless the method for reporting federal taxes changes or the method used in keeping the records changes. A taxpayer who maintains its records throughout the year on a cash basis, including a general ledger, and elects to make a worksheet adjustment at year-end to report federal taxes on an accrual basis, will be permitted to report state taxes on a cash basis.

(3) **Method two, accrual basis.** A taxpayer who does not regularly keep books of account on a cash receipts basis must file returns with figures based on the accrual method. These taxpayers must report the gross proceeds from all cash sales made in the tax reporting period in which the sales are made, together with the total amount of charge sales during such period. The law does not require a taxpayer to use a particular accounting system. However, the taxpayer must report based on the system of accounting used by the business, regardless of the taxpayer's reasons for selecting a particular accounting system. It will be presumed that a taxpayer who is permitted under federal law or regulations to report its federal income taxes on a cash basis and does so is maintaining the records on a cash basis. A taxpayer who maintains a general ledger on an accrual basis and files federal tax returns on an accrual basis must also report state tax returns on an accrual basis.

(a) Taxpayers who make installment sales or leases of tangible personal property must use the accrual method when they compute their tax liability. (See RCW 82.08.090, WAC 458-20-198 and 458-20-211.)

(b) In the case of rentals or leases, the income is considered to have accrued to the seller in the tax reporting period in which the seller is entitled to receive the rental or lease payment.

(4) **Constructive receipt.** "Constructive receipt" means income that a cash basis taxpayer is entitled to receive, but will not receive because of an action taken by the taxpayer. Constructive receipts are taxable in the tax reporting period in which the taxpayer gives up the entitlement to actual future receipt of the income. The following examples show how this applies to a cash basis taxpayer.

(a) XYZ has \$10,000 in accounts receivable which XYZ expects to collect over the next six months. XYZ elects to sell these accounts receivable for eighty percent of their face value. Even though the taxpayer only receives \$8,000 from the sale of the accounts receivable, XYZ is taxable on the full \$10,000 because it has taken constructive receipt of the full \$10,000 by taking an action to give up entitlement to the \$2,000.

(b) XYZ has \$1,500 in accounts receivable from customers who are delinquent in making payment. XYZ turns these accounts receivable over to a collection agency with the understanding that the collection agency may keep half of whatever is collected. The collection agency over the next month collects \$500 and keeps \$250 of this amount for its services. XYZ is taxable on the full \$500 collected by the collection agency. XYZ has constructive receipt of this amount and the \$250 retained by the collection agency is a cost of doing business to the taxpayer.

(c) XYZ is involved in a bankruptcy proceeding. The receipt of cash from accounts receivable will be placed in an escrow account. These funds will be used to pay creditors and a portion of these amounts will be given to the taxpayer. The full amount of the accounts receivable collected and going into the escrow is taxable income to XYZ. XYZ has received the full benefit of the cash received from the accounts receivable through payment of XYZ's creditors.

[Statutory Authority: RCW 82.32.300. WSR 96-12-024, § 458-20-199, filed 5/30/96, effective 6/30/96; WSR 92-03-026, § 458-20-199, filed 1/8/92, effective 2/8/92; WSR 83-07-032 (Order ET 83-15), § 458-20-199, filed 3/15/83; Order ET 70-3, § 458-20-199 (Rule 199), filed 5/29/70, effective 7/1/70.]