

Cite as Det. No. 98-121, 18 WTD 113 (1999)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

In the Matter of the Petition For Correction of	)	<u>D E T E R M I N A T I O N</u>
Assessment of	)	
	)	No. 98-121
	)	
...	)	Registration No. . . .
	)	YR . . . /Audit No. . . .
	)	
	)	

- [1] RULE 217; RCW 82.32.145: RETAIL SALES TAX -- INDIVIDUAL CORPORATE LIABILITY. In order for an individual to be liable for a corporation's failure to remit collected retail sales tax: 1) the retail sales tax must be a corporate liability; 2) the corporation must have been terminated, dissolved, or abandoned; 3) the taxpayer must have willfully failed to pay or to cause to be paid such retail sales tax; 4) the taxpayer must have supervision or control over the trust funds or be responsible for reporting and remitting the tax; and 5) there must be no reasonable means to collect the tax from the corporation.
- [2] RULE 217; RCW 82.32.145: RETAIL SALES TAX -- INDIVIDUAL CORPORATE LIABILITY -- CONTROL OR SUPERVISION. A taxpayer who has check signing authority and who has the discretion and responsibility to collect and remit trust funds to the Department is a responsible party under the statute.
- [3] RULE 217; RCW 82.32.145: RETAIL SALES TAX -- INDIVIDUAL CORPORATE LIABILITY -- WILLFUL FAILURE TO PAY -- GROSS NEGLIGENCE. Willfulness exists when a responsible person pays other creditors with a reckless disregard of whether trust funds have been paid to the state. Gross negligence is sufficient to show reckless disregard. Thus, the payment of other bills with knowledge that the business is in financial trouble, but failing to inquire whether funds are available to pay trust funds when due, creates liability as a matter of law.

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.

NATURE OF ACTION:

Corporate officers protest the assessment of individual liability for retail sales tax collected by the corporation but not remitted to the state.<sup>1</sup>

FACTS:

Mahan, A.L.J. -- [G], who is a party to this appeal, was the Vice President of . . . Leasing, Inc. and . . . Construction, Inc. [J], who is also a party to this appeal, was the Secretary/Treasurer of these two companies. [R], who is not a party to this appeal, was the president of both companies. . . . Leasing, Inc. was founded in 1993 and was in the business of purchasing construction equipment for lease to Construction, Inc. [G] and [J] each owned 23% of the shares of . . . Leasing, Inc., with the remaining shares owned by [R]. On June 24, 1996, [Construction, Inc.] filed for protection under Chapter 11 of the Bankruptcy Code. . . . Leasing, Inc. ceased doing business, and its Certificate of Registration was revoked on November 7, 1996.

. . . Leasing, Inc. last remitted collected retail sales tax to the state for the third quarter of 1995. The Department of Revenue (Department) audited . . . Leasing, Inc.'s records, which showed that, during the next four quarters, the company collected but did not remit \$ . . . in retail sales tax. As part of its audit, the Department subpoenaed various bank records in order to ascertain who might be liable for payment of these trust funds. These records showed that all three officers had check writing authority. The last two excise tax payments by . . . Leasing, Inc. were signed by [J]. The records also showed numerous checks issued to creditors during the period when retail sales tax was not remitted to the state. Each of the checks was signed by one of the officers. Numerous checks were signed by [J] and numerous checks were signed by [G].

Based on this information, the Department issued Trust Fund Accountability Assessments and warrants against each of the officers for the collected and unremitted trust funds, plus applicable penalties. [G] and [J] (hereafter collectively referred to as taxpayers) appealed these assessments.

The taxpayers do not dispute the amounts assessed or the evidence submitted by the Department in support of a prima facie case of responsible person trust fund liability under RCW 82.32.145. Rather, they contend that information about whether taxes had been paid was withheld from them by the president of the company and, therefore, they should not be considered responsible parties.

In support of this claim the taxpayers presented various documents (primarily copies of letters from the president of the company to the taxpayers), the testimony of the office manager for one year prior to [Construction, Inc.'s] bankruptcy, the testimony of the office manager for five years prior to [the present office manager], and a letter from the company's president. In essence the witnesses testified the company's president and the company's general manager made all financial decisions and the taxpayers were not informed of any financial problems until shortly

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<sup>1</sup> Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410

before the bankruptcy proceedings. As . . . the office manager stated in a subsequent letter to the Internal Revenue Service regarding federal trust fund liability:

During the course of my employment with [Construction, Inc] the primary function of [the taxpayers] was to manage their respective divisions, obtain work and run day to day personnel. It was with strict instruction by the president of the corporation that they be kept from the day to day financial affairs, bank statements, check registers, financial reports and statements of working capital. . . .[The taxpayers] only signed checks in the absence of the president.

In a similar letter to the IRS, the president of the company stated:

As majority shareholder, I exercised exclusive control of financial matters. Other people may have signed checks from time to time, but I made the decisions as to which bills would be paid and which bills would be postponed and paid later. I was aware that the company was experiencing financial difficulties, but I did not advise [the taxpayers] of the extent of the problems or that taxes had not been deposited.

The other documents submitted by the taxpayers also showed the president, as majority shareholder, completely controlled the company's financial affairs. They also showed that he signed checks for trust fund payments.

Based on this evidence, the taxpayers contend that they were not responsible parties. Alternatively, even if responsible parties, the taxpayers contend the president's control over management decision and his alleged failure to share financial information provides reasonable cause for the taxpayers' failure to pay collected retail sales tax. In support of this latter argument, the taxpayers cite to Finley v. United States, 123 F.3d 1342 (10th Cir. 1997).

#### ISSUES:

1. May corporate officers, who had check signing authority, but were allegedly neither aware of the company's financial problems nor had reason to inquire about trust fund payments, be considered responsible persons?
2. Does a reasonable cause exception to responsible person liability exist under Washington law and, if so, have the taxpayers presented sufficient evidence to support such an exception?

#### DISCUSSION:

[1] In order for an individual to be personally liable for collected and unremitted retail sales tax: (1) the retail sales tax must be a corporate liability; (2) the corporation must have been terminated, dissolved, or abandoned; (3) the taxpayer must have willfully failed to pay or to cause to be paid such retail sales tax; (4) the taxpayer must have supervision or control over the trust funds or be responsible for reporting and remitting the tax; and (5) there must be no reasonable means to collect

the tax from the corporation. RCW 82.32.145; WAC 458-20-217(6) (Rule 217). A taxpayer may avoid liability if he or she can show that the failure to pay or to cause to be paid such taxes resulted from circumstances beyond the taxpayer's control. Id.

Here, it is undisputed that the tax was the liability of a corporation, which had been dissolved or abandoned, and there is no reasonable means to collect it from any corporate entity. With respect to responsibility for unremitted sales tax, RCW 82.32.145 identifies two types of individuals who may be held liable. A party may be liable as a result of control or supervision over collected funds or as a result of having responsibility for the filing of returns or payment of the trust funds, to wit:

Upon termination, dissolution, or abandonment of a corporate business, any officer or other person having control or supervision of retail sales tax funds collected and held in trust under RCW 82.08.050, or who is charged with the responsibility for the filing of returns or the payment of retail sales tax funds collected and held in trust under RCW 82.08.050, shall be personally liable for any unpaid taxes and interest and penalties on those taxes, if such officer or other person willfully fails to pay or to cause to be paid any taxes due from the corporation pursuant to chapter 82.08 RCW. For the purposes of this section, any retail sales taxes that have been paid but not collected shall be deductible from the retail sales taxes collected but not paid.

RCW 82.32.145(1) (Emphasis added.)

[2] Under the statutory scheme, a taxpayer who has the authority and the discretion to disburse funds for the benefit of creditors and who has check signing authority may be a responsible party. A corporate officer who has primary or secondary authority to file tax returns or to remit collected retail sales tax has been found to be a responsible party. See Det. No. 90-319, 10 WTD 319 (1990). Further, a corporate officer cannot be relieved of liability when a superior instructs the employee not to pay the taxes. Det. No. 95-101, 15 WTD 136 (1996).

In this case, the taxpayers had the authority to collect retail sales tax and the authority to sign checks for the payment of the sales tax. The taxpayers also appeared to have the authority and discretion to determine which corporate debts should be paid, based on the record of payments to creditors. Based on this evidence the Department presented a prima facie case of trust fund liability.

[3] We must then address whether corporate officers can overcome a prima facie case of liability by presenting evidence the officers had no knowledge of the company's financial problems and no reason to investigate whether trust funds had been paid. Such evidence goes to whether the taxpayers "willfully" failed to pay the trust funds to the state.

The federal courts have considered this issue in the context of a similarly worded provision under Section 6672 of the Internal Revenue Code, 26 U.S.C. § 6672. Because the federal and state trust fund statutes are intended to reach similar results, the Department may refer to cases under the federal statute for guidance in determining whether the taxpayer was a responsible party. See Sauve

v. K.C., Inc., 19 Wn. App. 659, 665, 577 P.2d 599 (1978), aff'd, 91 Wn.2d 698, 591 P.2d 1207 (1979).

In general, the willfulness requirement does not involve an intent to defraud or bad motive; indeed, "conduct motivated by a reasonable cause may nonetheless be willful." Davis v. United States, 961 F.2d 867, 871 (9th Cir.), cert. denied, 113 S.Ct. 969 (1992). Express knowledge of a default is also not necessary; willfulness exists when a responsible person pays other creditors with a reckless disregard of whether trust funds have been paid. Phillips v. United States, 73 F.3d 939 (9th Cir. 1996). Gross negligence is sufficient to show reckless disregard. Id. at 943. As recognized in Wright v. United States, 809 F.2d 425, 427 (7th Cir. 1987), "if a high degree of recklessness were required the purpose of the statute would be thwarted just by compartmentalizing responsibilities within a business (however small) and adopting a 'hear no evil--see no evil policy' . . ." Thus, courts have held that the payment of other bills with knowledge that the business is in financial trouble, but failing to inquire whether funds are available to pay trust funds when due, creates liability as a matter of law. See, e.g., Thomsen v. United States, 887 F.2d 12, 18-19 (1st Cir. 1989); but see Finley v. United States, 123 F.3d 1342 (10th Cir. 1997).

In this case, based on the evidence presented, we find that the taxpayers did not have knowledge that the business was in financial trouble when trust funds were unpaid and they signed checks to pay other creditors. We further find that, although the taxpayers on occasion signed checks to pay trust funds to the state, the company's president also signed such checks and the fact that the taxpayers were not presented with checks to sign during the period of delinquency, in and of itself, does not show a failure to inquire and gross negligence on the part of the taxpayers. Given the atypical management of the company and the specific instructions to the office manager not to share financial information with the taxpayers, we further find that the taxpayers were not grossly negligent in failing to inquire whether funds were available to pay the trust funds to the state. Accordingly, we find that the taxpayer did not willfully fail to pay trust funds to the state. Because of this conclusion, we do not address the taxpayers' alternative argument.

#### DECISION AND DISPOSITION:

The taxpayers' petition is granted. Nothing herein shall affect or alter the trust fund liability of the company's president.

Dated this 12<sup>th</sup> day of July 1998.