Cite as 3 WTD 409 (1987)

BEFORE THE INTERPRETATION AND APPEALS SECTION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment of)	D E T E R M I N A T I O N
)	No. 87-245
)	
)	Registration No. . . .
. . .)	Tax Assessment No. . . .
)	Warrant No. . . .

[1] **RCW 82.32.050:** EVASION PENALTY. To sustain a fifty percent penalty assessment, the Department must find that the taxpayer intentionally acted to avoid paying the tax with the knowledge or belief that he or she in fact owed it. Put another way, the word "intent" presupposes knowledge.

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.

TAXPAYER REPRESENTED BY: . . .

DATE OF HEARING: June 23, 1987

NATURE OF ACTION:

The taxpayer petitioned for cancellation of a fifty percent evasion penalty.

FACTS:

Normoyle, A.L.J. -- The taxpayer, a Washington corporation, is a retail seller in a county which borders Oregon. Concerned over a loss of customers to that state, which has no sales tax, the taxpayer advertised in the fall of 1984, and early 1985, that it would not charge sales tax to its customers, and that the tax would be paid by the corporation.

Washington law in effect at that time prohibited a seller from advertising that it would absorb the tax.[1] The Department of Revenue became aware of the advertising. A Department employee, first orally and later in writing, informed the taxpayer that the advertising was illegal. Both warnings referred specifically to RCW 82.08.120, the statute which, at that time, prohibited such advertising. The letter was dated February 20, 1985 and reads as follows, in pertinent part:

> Numerous complaints and a copy of an advertisement being circulated by you have been referred to this office. In this ad, you publicly state you will charge no sales tax on sales of your (product).
>
> In an article published . . . on November 22, 1984, your comments regarding this very issue prompted an oral warning from me citing the specific language contained in RCW 82.08.120. Enclosed is a copy of the article and the statute.
>
> This letter serves as a warning that should this practice not be discontinued immediately, the matter will be referred to the . . . Prosecuting Attorney's office for criminal action, in addition to administrative remedies per Chapter 82.32 RCW.
>
> Although we recognize there is a bill before the Washington Legislature that would abolish the statutory provisions against such advertising, that bill has not yet passed and until it does, RCW 82.08.120 is still in effect.

The taxpayer continued to advertise nonetheless, and its president was prosecuted for violation of RCW 82.08.120. He was fined $1,000, with $900 suspended.

It is important to note that the oral warning, the Department letter, and the criminal prosecution all related solely to the above advertising statute. Nothing in the audit file shows that the taxpayer was also advised that it might be violating RCW 82.08.050, which required the seller to collect the tax on the full sales price. As will be seen below, it was the failure to properly remit the correct tax, not violation of the advertising statute, which gave rise to the fifty percent evasion penalty at issue.

In 1986, the taxpayer was audited for the period of January 1, 1982, through June 30, 1986. The audit revealed that the taxpayer

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[1] The retail sales tax chapter, RCW 82.08, was amended in 1985, to allow such advertising and payment of the tax by the seller, under certain circumstances.

had underreported its retail sales. The problem arose because of the way that the taxpayer had computed and paid Retailing B&O and sales tax on those sales where the tax was paid by the taxpayer/seller. Using a $300 sale as an example, and assuming a tax rate of 7.3%, the total which should have been remitted to the state was $21.90. Instead, the taxpayer paid only $20.41, because it backed the tax out of the selling price, reasoning that the true selling price was the $300, less the tax paid by the taxpayer. To illustrate:

	$300.00	-- paid by customer
less	20.41	-- tax paid by seller
	$279.59	-- amount reported by seller as selling price

The net result, in this example, was that the taxpayer paid $1.49 less tax on each $300 sale than it should have ($21.90 - $21.41 = $1.49). By doing so, the taxpayer violated RCW 82.08.020 and .050, which require a seller to collect and remit the full amount of tax, based on the selling price. The selling price, as defined in the version of RCW 82.08.010 then in effect, meant the total paid by the buyer (here, $300), without deduction on account of taxes.

The Department assessed a fifty percent evasion penalty on the underreported retail sales up to April 15, 1985, when the advertising statute was amended.

The taxpayer argues that, while it violated the advertising law and the law requiring it to collect sales tax, it did not intentionally evade payment of the tax. Rather, it thought that its method of breaking the sale down into a net sale and a sales tax category was valid.

To bolster its argument that it didn't intentionally evade payment of taxes, the taxpayer points to the fact that it had been audited at regular intervals (1978 and 1982), and that it "would be very stupid" to subject itself to additional taxes or penalties, "knowing that we face an audit every 4 years."

ISSUE:

The narrow issue is whether the facts support a finding that the taxpayer intentionally evaded payment of taxes by incorrectly computing the selling price on those sales where it paid the tax.

DISCUSSION:

The Department assessed the fifty percent penalty under authority of RCW 82.32.050, which reads as follows, in pertinent part:

> If the department finds that all or any part of the deficiency resulted from an intent to evade the tax

> payable hereunder, a further penalty of fifty percent of the additional tax found to be due shall be added.

Our task, then, is to decide whether the evidence is sufficient to sustain a finding that the taxpayer intended to evade payment of Retailing B&O and retail sales tax. We are not guided by any appellate court decisions on point. There have been, however, many appeals to the Department concerning this issue. By administrative rule (WAC 458-20-100(12)), we are directed to:

> . . . make such determination as may appear to [the Administrative Law Judge] just and lawful and in accordance with the rules, principles and precedents established by the department of revenue
> . . .

Prior Department Determinations establish the following principles in cases involving a claim of tax evasion:

1. The tax evasion statute is not part of the criminal code. Therefore, the burden of proof is a preponderance of the evidence.

2. The purpose of the statute is to allow the Department to exercise its discretion where it has found facts sufficient to penalize a taxpayer for activity which is a gross deviation from the spirit of our tax laws.

3. Merely failing to meet one's tax obligations is not the same as intention to evade the tax.

4. To sustain a fifty percent penalty assessment, the Department must find that the taxpayer intentionally acted to avoid paying the tax with the knowledge or belief that he or she in fact owed it. Put another way, the word "intent" presupposes knowledge.

5. Intent may be inferred from a taxpayer's conduct; that is, an inference of intent to evade can arise solely from the facts of the case. The taxpayer, once such an inference is established, then shoulders the burden of rebutting that inference.

6. Although not controlling, the Department gives considerable weight to the fact that a taxpayer had been previously warned that a particular activity was taxable, and chose to not heed those warnings.

7. Although not controlling, the penalty is usually assessed where the taxpayer is or should be knowledgeable of tax laws, based on business or tax experience.

It is understandable that the Audit Section felt that the evasion penalty should be assessed. The taxpayer intentionally continued the illegal advertising and absorption of sales tax, even after two

warnings. It does not follow, however, that the failure to properly compute and pay tax on the true selling price was done with the specific intention of evading payment of the full tax.

This is not the first case involving "backing out" of the sales tax, when the tax is absorbed by the seller. No other Determination has been found which has sustained an evasion penalty on that basis alone. We conclude that the facts here, as they relate to the underreporting of tax, do not support a finding, by a preponderance of evidence, of intentional tax evasion. While there is ample evidence showing an intent to violate the statute prohibiting advertising and the statute requiring the seller to collect sales tax, there is simply no evidence showing that the taxpayer intended to evade taxation by its incorrect computation and payment of sales and B&O taxes.

We base our decision on these facts:

1. There is no evidence to show that the taxpayer knew, prior to April 15, 1985, that its computation method was incorrect.

2. The taxpayer had not been warned, prior to that time, that the result of its computation was that less taxes were paid than should have been. As noted earlier, the warnings from the Department referred only to violation of the advertising statute, not to violation of the duty to pay tax on the full "selling price," without deduction. We do not imply that the Department must warn a taxpayer before an evasion penalty is assessed. We simply emphasize that this taxpayer was not warned that the specific activity which resulted in the assessment, i.e., the "backing out" of the tax, was incorrect. Thus, principle no. 6 above does not apply.

3. It would indeed have been stupid to intentionally underreport and underpay taxes, in the face of an audit every four years. This is especially true where the taxpayer knew that the Department was seeking prosecution of the advertising violation and, naturally, was aware of the taxpayer's activities.

The taxpayer was required to pay statutory interest on the underreported sales. Thus, the taxpayer was not allowed free use of the money it should have properly paid to the state. The taxpayer was also prosecuted for illegally advertising. Thus, it was punished by the court, albeit lightly, for this statutory violation. As egregious as its behavior was in continuing to illegally advertise, we cannot sustain an evasion penalty on these facts, because the advertising is not what gave rise to the penalty assessment.

DECISION AND DISPOSITION:

The petition for correction of Warrant No. . . . is granted. The penalty assessment of $ . . . shall be cancelled.

DATED this 20th day of July 1987.