

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. 99-041
...	)	
	)	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 -- WILFULLNESS. The willful failure to pay or to cause retail sales taxes to be paid does not require an intent to defraud or bad motive. A responsible person with knowledge that a business is in financial trouble, but who fails to inquire whether funds are available to pay trust funds when due, may be held personally liable 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:

Chief executive officer and sole shareholder of liquidated corporation protests the assessment of personal liability for retail sales tax collected by the corporation but not remitted to the state.<sup>1</sup>

FACTS:

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

Mahan, A.L.J. – The taxpayer owns or has an interest in various corporate entities in the northwest. In 1995, he purchased all of the stock of a large boat dealership in Washington State. The taxpayer was the chief executive officer and sole shareholder of the boat dealership. The dealership employed a certified public accountant, as a chief financial officer (CFO), and an accountant as a controller. The controller had the primary responsibility for filing state tax returns and issuing checks for payment of the tax. The dealership's corporate secretary is the taxpayer's representative on appeal.

During 1996, the dealership had significant financial problems and ceased doing business in late 1996. Retail sales tax collected by the dealership during August through November of 1996 was not remitted to the State of Washington and returns for that period were not filed. In January 1997, the Department of Revenue (Department) estimated the amount of tax that was due and issued a warrant for unpaid taxes in the amount of \$ . . . . Subsequently, the dealership filed returns for the period at issue and showed a tax liability of \$ . . . . By letter dated October 8, 1997, the taxpayer was informed that he was personally liable for tax, interest, and penalties in the amount of \$ . . . . The taxpayer appealed the assessment of personal corporate officer liability.

The taxpayer contends that he was not involved in the day-to-day operations of the company, did not have actual knowledge of the non-payment of the tax and, therefore, can not be held personally liable for the tax. The taxpayer further contends that he had a policy of paying taxes on a priority basis and, therefore, any non-payment was not “willful” or intentional.

During 1995, 1996, and 1997, the taxpayer was also involved in protracted divorce proceedings. The operation and failure of the dealership was the subject of deposition testimony and affidavits in those proceedings. This testimony forms a substantial portion of the record on appeal here.

In testimony, the company's controller stated the dealership started being in arrears and debts were not being paid on a current basis in July or August of 1996.<sup>2</sup> He further testified that he prepared “cash position statements” showing past due state taxes, which he provided to the CFO.<sup>3</sup> He also faxed those statements to the taxpayer on a weekly basis.<sup>4</sup> The controller also had frequent conversations with the CFO regarding priorities in paying creditors, including the state, payroll, and boat financing companies.<sup>5</sup> With respect to such conversations, he stated:<sup>6</sup>

Q: You indicated . . . on a number of occasions that you would have powwows with [the CFO] and sometimes with [the taxpayer] regarding priorities and how to allocated dollars, am I correct?

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<sup>2</sup> Deposition dated May 9, 1997 at p. 13.

<sup>3</sup> Deposition dated May 9, 1997 at p. 6.

<sup>4</sup> Deposition dated May 9, 1997 at p. 14.

<sup>5</sup> Deposition dated May 9, 1997 at p. 13.

<sup>6</sup> Deposition dated May 9, 1997 at pp. 30-31.

A: That's correct. But I remember maybe one instance in which [the taxpayer] was part of the discussion as far as allocation of funds among our scarce resources.

\* \* \* \*

Q: Counsel asked you a question as to whether you ever got instructions from the taxpayer on how to pay bills. Wouldn't it be correct that you would not get that instruction from [the taxpayer], that would be part of the chain of command:

A: That would be part of the chain of command?

Q: If those instructions came, they would be from [the CFO] not [the taxpayer]?

A: Yes.

In testimony, although admitting that he received statements from the controller showing taxes as an accrued liability, the CFO denied being aware until November 1996 that taxes were unpaid.<sup>7</sup> He stated that he reviewed only the "income statements." Although further admitting that he received weekly cash disbursement and cash receipt statements, and had weekly discussions with the controller regarding bills that had to be paid, the CFO testified that he "can't remember" any specifics regarding unpaid taxes.<sup>8</sup> Although claiming a lack of knowledge regarding unpaid taxes, the CFO admitted:<sup>9</sup>

Q: You were aware that [the dealership] was in deteriorating financial condition, weren't you:

A: Yes.

Q: Didn't you consider it prudent to determine what of its liabilities were being paid in a timely fashion?

A: Yes.

\* \* \* \*

Q: Is it true that notwithstanding it being a prudent inquiry to make, you did not make the inquiry? Isn't that the case, sir?

A: That would be a fair statement.

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<sup>7</sup> Deposition dated May 9, 1997 at pp. 119-130.

<sup>8</sup> Deposition dated May 9, 1997 at pp. 123 and-147.

<sup>9</sup> Deposition dated May 9, 1997 at p. 121.

The CFO also stated that there was a policy to pay taxes as a priority.<sup>10</sup>

With respect to his involvement in the operation of the dealership, the taxpayer testified:<sup>11</sup>

My strength is not in knowing about engineering, telephones or boats. I go into a business and come to thoroughly know it. What I bring to the understanding I obtain about a subject is a knowledge of finance, accounting, marketing and innovation. This applies to any area or type of business.

The skills of an entrepreneur, which I am fortunate enough to possess, are creativity in, and knowledge about, financing, marketing, and accounting. The key to success in operating [the dealership] is not knowing about boats, but in creatively turning around a failing business, which we bought at a remarkably beneficial price.

Bank records subpoenaed by the Department show the taxpayer had check signing authority, but there is no evidence that he ever signed checks for payment of state taxes. The records also show that funds were deposited during the period of delinquency and that other creditors were paid during that period.

#### ISSUE:

Was the taxpayer a responsible party who willfully failed to pay trust funds to the state?

#### 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:

(1) 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

<sup>10</sup>Deposition dated May 9, 1997 at p. 123-124.

<sup>11</sup> Reply Declaration dated November 25, 1995.

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.

(Emphasis added.) See also Rule 217.

Rule 217 provides that the term “control or supervision” includes:

"Control or supervision of the collection of retail sales tax" shall mean the person who has the power and responsibility under corporate bylaws, job description or other proper delegation of authority (as established by written documentation or through a course of conduct) to collect, account and deposit the corporate revenue and to make payment of the retail sales tax to the department of revenue. The term means significant rather than exclusive control or supervision.

The rule further provides that those responsible for filing returns include:

"Responsibility for the filing of returns or the payment of the retail sales tax collected and held in trust" shall mean the person who has the authority and discretion to file state excise tax returns and to determine which corporate debts should be paid. The person who signs the state excise tax returns or signs checks on behalf of or for the corporation may be a responsible party if that person also has the authority and discretion to determine which corporate debts should be paid.

Under the statutory scheme, a taxpayer who has the authority and the discretion to disburse funds for the benefit of creditors may be a responsible party. A corporate officer who has authority to file tax returns or to remit collected retail sales tax may be a responsible party. See Det. No. 90-319, 10 WTD 319 (1990); Det. No. 95-101, 15 WTD 136 (1996).

In this case, the taxpayer, as CEO, had the authority and discretion to determine which corporate debts should be paid and to file tax returns. He also had significant control over collecting, accounting for, and depositing trust funds. Such activities were done through a chain of command, which he controlled. Accordingly, we find the taxpayer was a responsible party who may be liable should he have acted willfully. The taxpayer's reference to Pretzer v. Department of Rev., No. 46727 (Bd. of Tax Appeals 1996) for the proposition that the taxpayer had to be involved with day-to-day operations in order to be held liable is misplaced. Although the CEO under the facts of that case was involved in day-to-day operations, the case does not limit liability only to those who are responsible for payment of trust funds or control the collection of funds on a day-to-day basis. Only significant control, not day-to-day control, is required.

[2] We must then address 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. 1992), cert. denied, 113 S.Ct. 969 (1993). 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); see also Finley v. United States, 123 F.3d 1342 (10th Cir. 1997).

In this case, based on the evidence presented, we find the taxpayer was actively involved in the operation and management of the company, knew the company had cash flow problems and was in precarious financial condition during the period of delinquency, was routinely provided with accounting information showing taxes were unpaid, and trust funds were disbursed to other creditors while state taxes were unpaid. While there may have been a policy to pay taxes as a priority, that was not the practice when financial problems arose. Even if we were to find that the taxpayer was ignorant of the tax delinquency, as a result of gross negligence or otherwise, this would be a classic case of “hear no evil—see no evil”. At a minimum, the failure to inquire whether taxes had been paid while knowing the dealership was in financial trouble created liability as a matter of law. Accordingly, the Department’s assessment of personal corporate liability is sustained.

#### DECISION AND DISPOSITION:

Taxpayer's petition is denied.

Dated this 25<sup>th</sup> day of February, 1999.