

Cite as Det. No. 15-0344, 35 WTD 497 (2016)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

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| 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. 15-0344 |
| |) | |
| ... |) | Registration No. ... |
| |) | |

[1] RCW 82.32.291; WAC 458-20-102(13) – RESELLER PERMIT – UNLAWFUL USE – PENALTY. The Department may not waive the reseller permit misuse penalty when the taxpayer was not aware that it improperly used its reseller permit.

[2] RCW 82.32.105(1) and WAC 458-20-228 (“Rule 228”) – WAIVER OR CANCELLATION OF PENALTIES OR INTEREST. A serious illness of a taxpayer or a member of the taxpayer’s immediate family, in certain circumstances, justifies the waiver of delinquent penalties under Rule 228(9)(a)(ii)(C). However, the taxpayer’s member’s wife’s long-term illness cannot excuse the taxpayer’s failure to report correctly over the period of three years during the audit period.

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.

Callahan, A.L.J. – A speculative and custom builder (“Taxpayer”) protests the assessment of the reseller permit misuse penalty with regard to items purchased for consumption by the business, arguing that it was not aware that it improperly used its permit. Taxpayer also asserts that its lack of knowledge of its retail sales tax liability and the serious illness of Taxpayer’s member’s family are circumstances beyond Taxpayer’s control for waiver of penalties and interest. We deny the petition.¹

ISSUES

1. Whether, under RCW 82.32.291 and WAC 458-20-102(13), the Department of Revenue (the “Department”) should waive the reseller permit misuse penalty when Taxpayer claims that it was unaware it was using the reseller permit improperly.

¹ Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

2. Whether, under RCW 82.32.105(1) and WAC 458-20-228, Taxpayer's lack of knowledge of the tax liability and the serious illness of Taxpayer's member's family are circumstances beyond Taxpayer's control for waiver of penalties and interest.

FINDINGS OF FACT

Taxpayer is engaged in the business of speculative and custom construction. Taxpayer registered with the [Department] on October 1, 2009. The Department issued a reseller permit to Taxpayer on January 20, 2010. The Department's Audit Division ("Audit") examined Taxpayer's books and records for the period of January 1, 2010 through December 31, 2013 ("audit period"). During the audit period, Taxpayer reported its income under the retailing business and occupation ("B&O") tax classification, and reported and remitted retail sales tax to the Department. For the custom construction activities, Audit identified retail sales tax deficiencies through a reconciliation of the amounts reported on Taxpayer's tax returns and the amounts recorded in Taxpayer's books and records.² The taxable differences identified were the result of various accounting errors, and due to Taxpayer incorrectly reporting some retailing income under the service and other activities B&O tax classification.³

For the speculative construction activities, Audit determined that Taxpayer did not pay retail sales tax on materials that it purchased and on charges made by Taxpayer's subcontractors.⁴ Taxpayer used its reseller permit to purchase materials, such as shower mirrors, lights, toilets, front fence, drywall and materials, electrical materials, plumbing materials, etc., used in speculative construction.⁵ Audit assessed use tax/deferred sales tax on those purchases.⁶ Audit assessed a misuse of reseller permit penalty on those purchases because Audit concluded that Taxpayer improperly used its reseller permit for consumable item purchases.⁷

On November 17, 2014, Audit issued an assessment against Taxpayer for \$. . . , which consisted of retail sales tax of \$. . . , use tax/deferred sales tax of \$. . . , a reseller permit misuse penalty of \$. . . , interest of \$. . . , and a 5% assessment penalty of \$ Taxpayer submitted a penalty and interest waiver request, dated December 4, 2014, to the Department's Taxpayer Account Administration (TAA) Division. Taxpayer argued in its request that it did not know that the assessment included the 5% assessment penalty and the interest, the reseller permit penalty is "extremely high and excessive," and it has been in compliance since it learned its tax obligations from the audit. While the request was pending, Taxpayer made a partial payment to the assessment in the amount of \$.....on December 15, 2014.

² Schedule 2, Audit report.

³ Audit did not make any adjustments to the service and other activities B&O tax Taxpayer reported because of the insignificant amount of deficiencies after the small business tax credit was taken into account. Schedule 2, Audit report.

⁴ Schedule 3, Workpaper A, Audit report.

⁵ Workpaper A, Audit report.

⁶ Schedule 3, Workpaper A, Audit report.

⁷ Audit Standards and Procedures Supplemental Instructions; Audit report, p.3. Schedule 4, Audit report. Audit identified some items that Taxpayer purchased from an out-of-state vendor without paying use tax. Audit assessed use tax/deferred sales tax on those purchases, but it did not assess a misuse of reseller permit penalty on those purchases.

On December 17, 2014, TAA denied Taxpayer's penalty and interest waiver request pursuant to RCW 82.32.105 and WAC 458-20-228 ("Rule 228"). On January 15, 2015, the Department's Appeals Division received Taxpayer's petition for correction of an assessment. Taxpayer does not dispute the taxes assessed, but argues that the Department should waive the interest and penalties in the assessment. Taxpayer argues that it was not aware that it improperly used its permit for speculative building purchases because it was under the assumption that the home buyers would pay the retail sales tax at closing. Taxpayer has not presented any evidence, such as purchase and sale agreements between itself and the home buyers, showing retail sales tax was collected at closing. Taxpayer also asserts that its business operation was affected by Taxpayer's member's wife's illness. Taxpayer represented at the hearing that its member's wife was diagnosed with cancer in 2010.

ANALYSIS

Retail Sales Tax on Speculative Builders:

All sales of tangible personal property within the RCW 82.04.050 definition of "retail sale" in the state of Washington are subject to retail sales tax, unless an exemption applies. RCW 82.08.020; RCW 82.04.050. A person engaged in the business of constructing homes for consumers is a prime contractor. WAC 458-20-170(1)(a) ("Rule 170"). Prime contractors are taxable under the retailing classification on the full contract price. RCW 82.04.050(2)(b); Rule 170(3)(a). Sales to prime contractors of materials, which become part of the structure being built, are sales for resale and are not subject to the retail sales tax. RCW 82.04.050(1)(b); Rule 170(4)(c).

A person engaged in the business of constructing homes on land it owns is a "speculative builder." Rule 170(2)(a). "Speculative builders are required to pay retail sales tax on all materials purchased by them and all charges made by their subcontractors." Rule 170(2)(e). This is because the speculative builder is the consumer of the materials purchased and charges made by the builder's subcontractors. Det. No. 13-0076, 32 WTD 238 (2011); Det. No. 08-0197, 28 WTD 076 (2009).

Here, it is not in dispute that Taxpayer is [both] a speculative builder and a custom builder. Therefore, when acting as a speculative builder, Taxpayer must pay retail sales tax on all materials purchased and all charges made by its subcontractors as the consumer of the purchases. RCW 82.08.020; Rule 170(2)(e). Taxpayer is not disputing it owes retail sales tax, but argues that the Department should waive the misuse of reseller permit penalty because it was unaware it was using the reseller permit improperly. Taxpayer also argues that the Department should waive the 5% assessment penalty and the interest because its business operation was affected by Taxpayer's member's wife's illness, and it has been in compliance since it learned its tax obligations from the audit. We will first address the misuse of reseller permit penalty.

Misuse of Reseller Permit Penalty:

[Purchases of tangible personal property for resale in the regular course of business without intervening use are excluded from the definition of "retail sale" in] RCW 82.04.050(1)(a). A buyer may use a reseller permit only when making wholesale purchases. RCW 82.04.060; WAC 458-20-102(6) ("Rule 102(6)"); RCW 82.04.470]. In addition, RCW 82.08.130 allows a

taxpayer[that] is normally engaged in both consuming and reselling certain types of personal property to use a reseller permit or other documentation authorized under RCW 82.04.470 for the [personal] property purchases when it cannot determine whether the [personal] property will be consumed at the time of the purchase.⁸

In the present case, Taxpayer may not use its reseller permit when it [purchases construction] materials and services from its subcontractors for use in its speculative construction [projects] because Taxpayer is the consumer [of those materials and construction services]. RCW 82.08.020; Rule 170(2)(e); Rule 102(6). Even if Taxpayer purchases materials and does not know at the time whether they will be used for speculative or custom construction, and it qualifies for purchasing for dual use, once [the materials have been] used [in] a speculative [construction project], it has a limited time [of 120 days] in which to report deferred sales/use tax on the purchases. Rule 102(12)(a). *See* Det. No. 07-0178, 27 WTD 26 (2008).

When a taxpayer improperly uses its reseller permit, the taxpayer is subject to the reseller permit misuse penalty imposed under RCW 82.32.291(1), which provides:

(1) Except as otherwise provided in this section, if any buyer improperly uses a reseller permit number, reseller permit, or other documentation authorized under RCW 82.04.470 to purchase items or services at retail without payment of sales tax that was legally due on the purchase, the department must assess against that buyer a penalty of fifty percent of the tax due, in addition to all other taxes, penalties, and interest due, on the improperly purchased item or service.

RCW 82.32.291(1). The penalty is fifty percent of the tax due. *Id.*

RCW 82.32.291(3) defines “improper use” as:

A buyer that purchases items or services at retail without payment of sales tax legally due on the purchase is deemed to have improperly used a reseller permit number, reseller permit, or other documentation authorized under RCW 82.04.470 to purchase the items or services without payment of sales tax and is subject to the penalty in subsection (1) of this section if the buyer:

(a) Furnished to the seller a reseller permit number, a reseller permit or copy of a reseller permit, or other documentation authorized under RCW 82.04.470 to avoid payment of sales tax legally due on the purchase; or

⁸ RCW 82.08.130(1), in relevant part provides:

(1) If a buyer normally is engaged in both consuming and reselling certain types of personal property, the retail sale of which is taxable under this chapter, and the buyer is not able to determine at the time of purchase whether the particular property acquired will be consumed or resold, the buyer may use a reseller permit ... for the entire purchase if the buyer principally resells the property according to the general nature of the buyer's business. The buyer must account for the value of any articles purchased with a reseller permit ... that is used by the buyer and remit the deferred sales tax on the property to the department.

(b) Made the purchase from a seller that had previously used electronic means to verify the validity of the buyer's reseller permit with the department and, as a result, did not require the buyer to provide a copy of its reseller permit or furnish other documentation authorized under RCW 82.04.470 to document the wholesale nature of the purchase. In such cases, the buyer bears the burden of proving that it did not improperly use its reseller permit to make the purchase without payment of sales tax.

Here, Taxpayer admits that it improperly used its reseller permit to purchase items at retail without payment of sale tax that was legally due on the purchases, but argues that the Department should waive the misuse penalty because it was not aware that it improperly used its permit.

RCW 82.32.291(2) addresses circumstances where the Department can waive the penalty:

(2) The department must waive the penalty imposed under subsection (1) of this section if it finds that the use of the ... reseller permit, ... was due to circumstances beyond the taxpayer's control or if the ... reseller permit, ... was properly used for purchases for dual purposes. The department must define by rule what circumstances are considered to be beyond the taxpayer's control.

RCW 82.32.291(2) (emphasis added).

Rule 102(13) addresses penalty waivers, and repeats the statutory standard that the Department will waive the penalty where the use was due to circumstances beyond the control of the buyer. Rule 102(13) in pertinent part states:

(13) **Waiver of penalty for misuse of reseller permits.** The department will waive the penalty imposed for misuse of reseller permits upon finding that the use of the . . . reseller permit . . . to purchase items or services by a person not entitled to use the reseller permit for that purpose was due to circumstances beyond the control of the buyer or if the . . . reseller permit . . . was properly used for purchases for dual purposes and the buyer made a good faith effort to report deferred sales tax. . . . The penalty also will not be waived merely because the buyer was not aware of either the proper use of the reseller permit or the penalty. In all cases the burden of proving the facts is upon the buyer.

WAC 458-20-102(13) (emphasis added).⁹

Even if Taxpayer was acting in good faith when it made the error of using its reseller permit when it should not have, we cannot waive the penalty solely because Taxpayer was unaware of its improper use in this case. RCW 82.32.291(2); Rule 102(13); Det. No. 14-0404, 34 WTD 337 (2015).¹⁰ Because . . . Taxpayer has not shown that the misuse was due to circumstances beyond

⁹ Taxpayer did not properly use the reseller permit for dual purposes. Even if Taxpayer did, it did not make a good faith effort to remit its deferred sales tax liability. Rule 102(12)(a)(i). See Det. No. 07-0178, 27 WTD 26 (2008).

¹⁰ It has also been longstanding law that penalty waivers for late payment of taxes are also not granted when the basis for the waiver is the Taxpayer's claim that it was unaware of its tax obligations. WAC 458-20-

its control, [as required by statute and administrative rule,] we deny the misuse of reseller permit penalty waiver request.¹¹

Substantial Underpayment (5% assessment) penalty and interest waiver:

RCW 82.32.090(2) requires the Department to add a five percent substantial underpayment penalty on all assessments in which the taxpayer has paid less than eighty percent of the tax that the Department determines to be due. The Department may assess a total substantial underpayment penalty of fifteen percent of the amount of the tax if the Department has not received the payment of the tax by the due date specified in the notice. *Id.*

RCW 82.32.105 provides that penalties may be waived under certain circumstances. Under RCW 82.32.105(1), the Department can waive penalties where the failure to pay tax less than that properly due was the “result of circumstances beyond the control of the taxpayer.” *See* Det. No. 06-0155, 26 WTD 73 (2007). The Department is authorized to issue rules regarding the waiver of penalties. RCW 82.32.105(4). It has done that in Rule 228. Taxpayers bear the burden of establishing that the circumstances went beyond their control and directly caused the late payment. Rule 228(9)(a)(i). A misunderstanding or lack of knowledge of tax liability is an example of a circumstance that is not generally considered to be beyond the control of the taxpayer and will not qualify for a waiver or cancellation of penalties. Rule 228(9)(a)(iii)(B). Taxpayer’s assumption that the buyers would pay the retail sales tax is not a circumstance beyond its control under the rule. *See* Det. No. 14-0170, 34 WTD 030 (2014).

A serious illness of a taxpayer or a member of the taxpayer’s immediate family, in certain circumstances, justifies the waiver of delinquent penalties under Rule 228(9)(ii)(C). *See* Det. No. 15-0062, 34 WTD 419 (2015). However, this waiver is not “intended to have an indefinite application.” Rule 228(9)(a)(2)(C); *See also* 34 WTD 419; Det. No. 87-41, 4 WTD 197 (1986). “A death or serious illness which denies a taxpayer reasonable time or opportunity to obtain an extension or to otherwise arrange timely filing and payment is a circumstance eligible for penalty waiver.” Rule 228(9)(a)(2)(C). Here, Taxpayer’s member’s wife’s long-term illness cannot excuse Taxpayer’s failure to report correctly over the period of three years during the audit period.

RCW 82.32.105(2) authorizes the Department to waive late return payment penalty imposed under RCW 82.32.090(1) when a taxpayer has timely and accurately reported and paid its taxes due for the previous twenty-four months. RCW 82.32.105(2) is not applicable here because the penalty at issue is imposed under [the substantial underpayment provision of RCW 82.32.090(2), not under] RCW 82.32.090(1).

While the Department has implemented programs to inform and assist taxpayers, the ultimate responsibilities for knowing their tax obligations rest upon the taxpayers. Chapter 82.32A RCW. Because of the nature of Washington’s tax system, the taxpayer has the burden of becoming

228(9)(a)(iii)(B). *See* Det. No. 14-0170, 34 WTD 030 (2015); Det. No. 13-0306, 34 WTD 001 (2014); and Det. No. 14-0155, 33 WTD 496 (2014).

¹¹ Taxpayer also argues that the misuse of reseller permit penalty is “excessive.” The fifty percent penalty of the tax due is authorized under RCW 82.32.291(1). As an administrative agency, we do not have the authority to determine whether the penalty is excessive.

informed about tax liability, and it is the taxpayer who bears the consequences of a failure to be correctly informed. Det. No. 01-165R, 22 WTD 11 (2003). We conclude that there are no circumstances in this case that permit the Department to waive the substantial underpayment (5% assessment) penalty and under RCW 82.32.105 and Rule 228.

With respect to the interest waiver request, RCW 82.32.105(3) and Rule 228(10) provide that the Department shall waive or cancel interest only if: (a) the failure to timely pay the tax was the direct result of written instructions given the taxpayer by the department; or (b) the extension of a due date for payment of an assessment of deficiency was not at the request of the taxpayer and was for the sole convenience of the department. Det. No. 93-004, 12 WTD 553 (1993). Here, the Department gave Taxpayer neither written instructions nor an extension of the due date for payment of the taxes assessed. Under these circumstances, we have no authority to waive the interest that was charged.

Therefore, we sustain the imposition of the penalties and interest in the assessment and affirm the assessment in its entirety. We deny Taxpayer's petition.

DECISION AND DISPOSITION

We deny Taxpayer's petition.

Dated this 15th day of December, 2015.