

Cite as Det. No. 16-0066, 35 WTD 540 (2016)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of) D E T E R M I N A T I O N
Assessment of) No. 16-0066
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...) Registration No. . . .
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RCW 82.32.090; WAC 458-20-228: RETAIL SALES TAX – EVASION PENALTY. A taxpayer that collected retail sales taxes and did not remit the taxes is liable for the evasion penalty. Additionally, the taxpayer attempted to escape detection by altering its QuickBooks records to make it appear that it did not collect retail sales taxes.

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.

M. Pree, A.L.J. – A Washington construction contractor disputes the evasion penalty assessed on retail sales taxes that the contractor collected and used to meet its payroll, but did not remit to the Department of Revenue (Department). The contractor modified its QuickBooks records prior to an audit so that the invoices showed wholesale sales without sales tax, rather than the separately stated retail sales tax originally billed. Because the taxpayer knew the tax was due and altered its records to escape detection, we deny the petition but remand the assessment to adjust the amount due.¹

ISSUE

Under RCW 82.32.090 and WAC 458-20-228 (Rule 228), did the contractor intend to evade payment of retail sales taxes when it collected the taxes but used them to meet its payroll, and, prior to an audit, it altered its QuickBooks records to escape detection by showing wholesale sales without sales tax, rather than the separately stated retail sales tax originally billed?

FINDINGS OF FACT

[Taxpayer] is a Washington corporation. The taxpayer is licensed as a general contractor performing construction services in Washington. The taxpayer used QuickBooks to account for its income and expenses. The taxpayer charged some customers retail sales tax, while others were not charged sales tax. After it issued invoices to its customers, which specified "Sales Tax Due," the taxpayer would routinely modify its QuickBooks records by reclassifying the dollar

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

amount of invoiced retail sales tax from “Sales Tax Due” to “Material Costs.” The taxpayer would subsequently collect the total amount originally invoiced (both invoiced job costs, as well as invoiced retail sales tax due). When the taxpayer reported its income on its combined monthly excise tax returns filed with the Department of Revenue, it did not report the sales tax initially charged and collected on the altered invoices, but instead reported the transactions as wholesale sales.

The Department’s Audit Division reviewed the taxpayer’s books and records for the period of January 1, 2010 through December 31, 2013 to verify that the taxpayer’s Washington business activities and transactions were properly reported on its excise tax returns. On May 29, 2015, the Audit Division issued Document No. . . . , which assessed \$. . . of additional taxes, including \$. . . of retail sales tax, a delinquent penalty of \$. . . , an evasion penalty of \$. . . , a 5% assessment penalty of \$. . . , and interest of \$ The assessment totaled \$. . . , which the taxpayer appealed.

The taxpayer primarily disputes the evasion penalty. The taxpayer contends that the Audit Division has not met its burden of proof to show that the taxpayer intended to avoid payment of tax through fraud. The Audit Division responds, that the pattern of invoice modification shown in the “Audit Trail Report” is clear evidence of an intent to evade. While the taxpayer may have initially billed many customers retail sales tax, the taxpayer explains it “modified” invoices in QuickBooks by removing the sales tax charges to “correct legitimate errors” based on new or updated information. For instance, the taxpayer claims that if it received a reseller’s permit after invoicing another contractor, but before payment, the taxpayer would re-categorize the bill from retail to wholesale without collecting the additional amounts labeled as “sales tax.” The taxpayer identified some of these changes, which occurred prior to its initial February 27, 2014, contact from the Audit Division.

The Audit Division did not subject all of the additional taxes due from the taxpayer to the evasion penalty. Rather the evasion penalty was imposed upon \$. . . on the invoices that the taxpayer modified from retail to wholesale sales during the audit period. Workpaper A-1 of the assessment shows that the taxpayer reported only \$. . . as retail sales.

In most cases where the taxpayer billed retail sales tax, but later changed its invoice, it would still collect the full amount from the original invoice that included sales tax. The taxpayer would then report the entire amount received (including the sales tax) as a wholesale sale. In a few instances, where prime contractors were billed sales tax erroneously, the taxpayer would make a corresponding adjustment and not collect the amounts billed as “sales tax” from its customers.

After being notified of the audit, the taxpayer further modified some of the invoices by changing the customer name from that of a home owner consumer to that of a contractor for whom the taxpayer had a reseller’s permit. The taxpayer argues those name changes were also proper. Because the modifications were so extensive, the Audit Division did not accept reseller permits for some contractors where the invoices were significantly modified.

When the examination was complete, the Audit Division met with the taxpayer’s former representative who acknowledged that the taxpayer had inappropriately altered the sales records.

The taxpayer stated that the retained sales tax was not kept for personal gain, but instead used to meet payroll. Many of the taxpayer's jobs may have involved the same contractors. The taxpayer identified 41 contractors for whom it alleged it provided the wholesale services, which appeared on numerous modified invoices.

The auditor asked the taxpayer to provide copies of checks it deposited into its bank account to show: 1) who paid the taxpayer for its services, and 2) whether the sales tax originally invoiced was collected. In response, the taxpayer provided additional records.

The Audit Division has reviewed the records, and agrees that the assessment should be adjusted for the few documented instances where the taxpayer has provided sufficient records to show it made a wholesale sale and did not collect retail sales tax on the transaction. The Audit Division will limit the evasion penalty to those instances where the taxpayer collected retail sales tax and the invoices were modified in such a manner as to intentionally misrepresent retail transactions as tax exempt wholesale sales (e.g. the sales tax was relabeled as materials).

ANALYSIS

Under RCW 82.32.090(7), "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 must be added." Rule 228(5)(f) further explains:

The evasion penalty is imposed when a taxpayer knows a tax liability is due but attempts to escape detection or payment of the tax liability through deceit, fraud, or other intentional wrongdoing. An intent to evade does not exist where a deficiency is the result of an honest mistake, miscommunication, or the lack of knowledge regarding proper accounting methods. The department has the burden of showing the existence of an intent to evade a tax liability through clear, cogent and convincing evidence.

This knowledge and responsibility is clear when collected retail sales tax is not remitted, because sellers collecting the tax have a special responsibility. Sellers must collect sales tax for the state, more specifically, for the Department. In imposing this collection duty on sellers, the legislature said, in part, in RCW 82.08.050:

The tax required by this chapter, to be collected by the seller, shall be deemed to be held in trust by the seller until paid to the department, and any seller who appropriates or converts the tax collected to his or her own use or to any use other than the payment of the tax to the extent that the money required to be collected is not available for payment on the due date as prescribed in this chapter shall be guilty of a gross misdemeanor.

In other words, taxpayers have a fiduciary duty under RCW 82.08.050 to remit sales tax to the Department because they have collected it on behalf of the state. Because the taxpayer billed and collected the sales tax, the taxpayer knew the tax was due. By altering the QuickBooks records prior to Audit Division's examination, the taxpayer attempted to escape detection through deceit.

Rule 228(5)(f)(ii) offers as two examples of actions that establish an intent to evade a tax liability:

- (B) The willful failure of a seller to remit retail sales taxes collected from customers to the department; and
- (C) The alteration of a purchase invoice or misrepresentation of the price paid for property (e.g., a used vehicle) to reduce the amount of tax owing.

These examples match the taxpayer's actions. The taxpayer knew it was liable for the sales tax in question because it collected the tax pursuant to its own invoices, and remitted other collected sales taxes to the Department. It attempted to escape payment or detection of the tax liability by altering its QuickBooks to eliminate the record of the tax it collected from its customers, which it did not remit to the Department. The taxpayer's actions match the quoted examples in Rule 228(5)(f)(ii), which evince an attempt to evade paying the sales taxes it collected, but did not remit.

The taxpayer admitted to the Audit Division that it retained the collected tax to meet its payroll obligations. Utilizing collected retail sales tax for a taxpayer's own business purpose provides a basis to sustain a 50% evasion penalty. *See, e.g.*, Det. No. 91-173, 11 WTD 215, 217 (1991); Det. No. 02-0115, 23, 25 WTD 21 (2004).

We conclude that there is clear, cogent, and convincing evidence that the taxpayer willfully failed to remit the collected retail sales taxes to the Department and acted with intent to evade payment of same. *See* Det. No. 04-0120, 24 WTD 247 (2005); Det. No. 98-039, 19 WTD 101 (2000). We affirm the evasion penalty.

Once the Department has clearly established the elements of evasion, a burden of production is imposed on the taxpayer to produce evidence of honest mistake, miscommunication, ignorance of law, lack of knowledge, or some other fact which tends to rebut the Department's evidence. Det. No. 04-0098, 23 WTD 331 (2004). That determination goes on to explain that:

Mere subjective and self-serving statements by the taxpayer regarding intent, without more, are insufficient to meet this burden of production. Any evidence [presented by the taxpayer must be weighed against that presented by [the Department]. Because the burden placed on the taxpayer is one of production only, the burden of proof as to evasion still rests with [the Department]. The evidence of evasion presented by [the Department] when viewed alone, or along with the taxpayer's evidence, must weigh heavily in favor of upholding the assessment.

Id. at 338.

The objective evidence in this case supports imposition of the evasion penalty. The taxpayer knowingly collected retail sales tax from its customers and then tried to hide that fact by later modifying its invoices. [The Taxpayer offered] no evidence that these actions were due to honest mistake, miscommunication, or lack of knowledge.

DECISION AND DISPOSITION

We deny the taxpayer's petition in part and grant it in part. We remand the assessment for adjustment where the taxpayer has [shown with sufficient evidence that a transaction] was a wholesale sale and that it did not collect retail sales tax on the sale.

Dated this 12th day of February, 2016.