

Cite as Det No. 10-0125, 29 WTD 90 (2010)

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. 10-0125  
... )  
 ) Registration No. ....  
 ) Document No. . . . /Audit No. . . .  
 )  
 ) Docket No. ....  
)

- [1] Rule 228; RCW 82.32.090: EVASION PENALTY – INTENT TO EVADE. An owner and operator of two prior businesses that collected and remitted retail sales tax had the requisite knowledge of taxpayer's tax reporting requirements to impose the 50% evasion penalty.
- [2] Rule 228; RCW 82.32.090: EVASION PENALTY – INTENT TO EVADE. A medical condition that the owner claims compounded his lack of knowledge is not a defense to the 50% penalty when he continued to earn income from business operations, collect retail sales tax from customers, and use the funds to pay other bills.

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.

Jensen, A.L.J. – An outdoor lighting company protests the imposition of the evasion penalty on retail sales tax that the company collected, but did not remit to the Department of Revenue (Department). The taxpayer's owner claims that he did not willfully fail to remit the collected retail sales tax under WAC 458-20-228(5)(f)(ii) (Rule 228) because he did not know how to remit the taxes and had difficulty filling out the combined excise tax returns because of his [medical condition]. We uphold the evasion penalty.

## ISSUE

Did the taxpayer willfully fail to remit collected retail sales taxes sufficient to uphold an evasion penalty under Rule 228(5)(f)?<sup>1</sup>

## FINDINGS OF FACT

[Taxpayer] is a Washington based company that provides outdoor lighting for residential and commercial customers. . . . Taxpayer started business in . . . 2006. From 2006 through the end of 2008, Taxpayer collected retail sales tax from its customers, but did not remit those taxes to the Department. Taxpayer filed combined excise tax returns throughout this period indicating that it did not collect any retail sales taxes and did not have an excise tax liability.

The Department's Audit Division (Audit) reviewed Taxpayer's records for the period of November 1, 2006, through December 31, 2008. In reviewing Taxpayer's invoices, Audit discovered that Taxpayer had collected retail sales taxes from its customers, which it did not remit to the Department. Audit also noticed that Taxpayer had filed its combined excise tax returns indicating that it did not have any business activity.

Audit issued an assessment on April 2, 2009, in the amount of \$. . . . This amount included \$. . . in retail sales tax, \$. . . in retailing business and occupation (B&O) tax, \$. . . in wholesaling B&O tax, a small business tax credit of \$. . . , \$. . . in delinquent penalties, \$. . . in the evasion penalty, \$. . . in a five percent assessment penalty, and \$. . . in interest. Taxpayer appeals the imposition of the evasion penalty, arguing that it failed to remit collected retail sales tax because of [its owner's (Owner's)] unintentional misunderstanding regarding his obligation to remit the taxes, compounded by his medical problems.

Taxpayer first claims that [Owner] lacked knowledge of how to remit collected retail sales taxes. Taxpayer claims that while [Owner] has experience with running his own electrician business, in those prior businesses, he did not play a significant part in remitting collected retail sales taxes or filing excise tax returns with the Department.

[Owner] first started an electrician business in the late 1980's. This business was named . . . and did business as . . . (Company #1). Company #1 was a sole proprietorship. The Department's records show that Company #1 began reporting taxes to the state in the third quarter of 1990. Company #1 reported and remitted retail sales tax on all the returns filed with the Department. The returns were all signed by [the same individual that owns and operates Taxpayer].

Company #1 mostly performed electric work as a subcontractor. [Taxpayer] claims that the nature of work began to change from subcontracting to electrical work for residential customers.

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

The record is not clear when this transition happened, but when it did, [Owner] closed down Company #1 and formed a corporation named . . . (Company #2). Department records confirm that Company #2 continued to report retail sales to the Department and submit collected retail sales taxes. Company #2's returns were also all signed by [Owner].

[Owner] hired a bookkeeper to help prepare Company #1's federal and state tax returns. The bookkeeper did this work for Company #1 from its inception through the late 1990's. [Owner] and the bookkeeper claim that bookkeeper would review the paperwork, prepare tax returns, and compile financial statements. Both also allege that when these items were completed the bookkeeper would present the necessary forms and checks to [Owner] for signature. [Owner] claims that he was not aware of whether tax payments were specifically being made to the Department, but was aware that bookkeeper was preparing state tax returns for Company #1.

Company #1 later hired an office manager who took over the bookkeeper's responsibilities, including filing combined excise tax returns to the Department. Office manager continued to perform this function for Company #2. [Taxpayer] claims that, just as with the former bookkeeper, office manager prepared and filed the returns. Office manager would present the returns and accompanying checks to [Owner] for his signature.

Taxpayer indicates that the Department did not audit Company #1 or Company #2 and did not make any inquiries regarding its state taxes during the period it was in operation. However, Department records show Company #2 failed to remit all of its taxes at the end of 2005, which started various attempts by the Department to contact [Owner] and receive payment for the taxes owed. From early 2006 through early 2007, the Department had numerous conversations with Company #2's office manager who tried to work with the Department to pay the taxes the company owed. The Department's correspondence records also indicate many attempts to contact [Owner] directly regarding the tax deficiency. These attempts to contact [the owner] included a field visit to [Owner's] personal residence. [Owner] was not home that day, and Department employees left a card for [Owner] to contact them by noon the next day. There is no record indicating that [Owner] called the employees following this visit or that he ever spoke with the Department regarding Company #2's tax liabilities.

After various attempts to obtain payment from Company #2, the Department issued a tax warrant against the company in June of 2006. During the subsequent collection process, the Department continued to try to contact [Owner] and the company's office manager. In a conversation with the office manager on March 16, 2007, the office manager told the Department that both [Owner] and she were under the impression that Company #2's deficient taxes had been paid. The office manager also indicated that she would discuss the issue with [Owner, who] eventually closed Company #2 in August of 2006 with the outstanding warrant unpaid. After Company #2 closed, [Owner] created Taxpayer. Taxpayer claims that Company #2's office manager did not ever work for Taxpayer. [Owner] hired an accountant to prepare Taxpayer's federal tax returns. This accountant asserts that he prepares the returns based upon information supplied to him by [Owner] and [Owner's] assistant. However, [Owner] apparently did not ask this accountant to also help prepare Taxpayer's excise tax returns until the 1<sup>st</sup> quarter of 2009. [Owner] testified that he did not hire anyone to prepare Taxpayer's state excise tax returns and that there was no

expectation that this accountant would complete Taxpayer's excise tax returns before he asked the accountant to do so in early 2009.

[Owner] essentially ran Taxpayer. When [Owner] performed the underlying services, he would bill Taxpayer's customers and specifically itemize and collect retail sales taxes. According to [Owner], he generally asked his customers what their combined state and local sales tax rate was when he collected those taxes. [Owner] would then personally fill out Taxpayer's combined excise tax returns, indicating that Taxpayer had no business activity. [Owner] also testified that once collected, the retail sales taxes went into the same bank account as Taxpayer's other income and that the funds were ultimately used to pay Taxpayer's other bills.

[Owner] claims that he was unaware of how to properly fill out the excise tax returns and that he felt that the Department would contact him if they had any problems with his returns. He testified that the fact the Department accepted the returns gave him the impression that his method of reporting was appropriate. [Owner] also claims that he thought the Department would send another form to remit collected retail sales taxes.

There is no record of any attempt by [Owner] to contact the Department to inquire regarding how to report collected retail sales taxes. Department records show that [Owner] called once in September of 2007 to file a no business return with the Department for two months. Audit claims that when contacted about the audit, [Owner] admitted that he had business activity during the audit period and was aware of the unremitted retail sales taxes that he had been collecting on Taxpayer's behalf.

[Owner] also asserts that his misunderstanding was compounded by his medical condition. Taxpayer provides a letter from his doctor, explaining [Owner's] diagnosis in June of 2009. In this letter, the doctor also explains that it would be difficult for someone like [Owner] to understand things that would be readily apparent to others.

## ANALYSIS

Washington law requires the Department to add a fifty percent evasion penalty when it finds that any part of a deficiency "resulted from an intent to evade the tax." RCW 82.32.090(6). "Evasion involves a situation where the taxpayer knows a tax liability is due and the taxpayer attempts to escape detection through deceit, fraud, or other intentional wrongdoing." WAC 458-20-230(4) (Rule 230). The Department has consistently held that in order to sustain an assessment of the evasion penalty, it must present evidence of these two elements now found in Rule 230. Det. No. 04-0098, 23 WTD 331 (2004); Det. No. 97-238, 18 WTD 215 (1999). To meet this burden, the Department must show intent to evade "by clear, cogent, and convincing evidence which is objective and credible." Rule 230(4). The mere suspicion of intent to evade is not enough to meet this burden. Det. No. 90-314, 10 WTD (1990).

To demonstrate intent to evade tax, Audit relies heavily on Rule 228. That rule provides:

(ii) **What actions may establish an intent to evade?** The following is a nonexclusive list of actions that are generally considered to establish an intent to evade a tax liability. This list should only be used as a general guide. A determination of whether an intent to evade exists may be ascertained only after a review of all the facts and circumstances.

...

(B) *The willful failure of a seller to remit retail sales taxes collected from customers to the department;....*

Rule 228(5)(f)(ii) (emphasis added).

RCW 82.08.050 imposes a statutory duty on sellers of tangible personal property and retail services to collect and remit retail sales tax. A taxpayer must remit collected retail sales taxes to the Department, even in situations where the taxpayer was not legally required to collect retail sales tax. *Kitsap-Mason Dairymen's Ass'n v. Tax Comm'n*, 77 Wn.2d 812, 467 P.2d 312, (1970) (en banc). "Inherent in RCW 82.08 is the fact that taxes collected in the name of the state are not [the] property of the seller." *Id.* at 817, 316. The Department has consistently held that "utilizing retail sales tax for a taxpayer's own business purpose provides a basis to sustain a 50% evasion penalty." Det. No. 02-0115, 23 WTD 21 (2004); Det. No. 91-173, 11 WTD 215 (1991).

In this case, Taxpayer collected retail sales tax from its customers during the audit period. Taxpayer's invoices set forth a cost for its services, and then separately itemized a charge for sales tax . . . . [Owner] filled out all of Taxpayer's invoices. These documents demonstrate that [Owner] knew that he was collecting retail sales tax from his customers.

Taxpayer also did not remit the collected tax to the Department. Instead, Taxpayer filed its excise tax returns indicating that it did not have any business activities to report. [Owner] personally filled out all of these returns with full knowledge that Taxpayer was engaging in business and that he had collected retail sales tax on Taxpayer's behalf.

Once the Department has clearly established the elements of evasion, a burden of production is imposed on 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).

Taxpayer claims that . . . , its owner and operator, was unfamiliar with how to remit the collected taxes to the Department and felt that the Department would contact him regarding how to remit the collected taxes. Taxpayer alleges that this lack of knowledge was compounded by [the owner's] medical condition.

[1] The objective evidence in this case supports imposition of the evasion penalty. Taxpayer provides testimony from [Owner], as well as letters from his doctor, a former bookkeeper, a former office manager, and [Owner's] accountant. While this evidence shows that [Owner] did not personally fill out excise tax returns submitted by entities he owned and operated prior to Taxpayer, they also show that [Owner] has been in the business long enough to understand how to collect and remit retail sales taxes to the Department.

There is no question that [Owner] possessed the sophistication necessary to collect retail sales taxes from his customers. However, prior to creating Taxpayer, [Owner] relied on others to submit the collected taxes to the Department. Even though these other individuals completed returns for [Owner], it was [Owner] that ultimately signed the returns and checks necessary to remit taxes to the Department. [Owner] knew that these individuals were responsible for not just filing the combined excise tax returns, but also for remitting payment along with those returns.

[2] When Taxpayer was formed, [Owner] attempted to do this work on his own. Even assuming that this task was overwhelming for [Owner] in light of his medical condition, he possessed a sufficient understanding that he needed to remit the taxes that he had collected to the State. [Owner] knew that Taxpayer was earning income from its business operations. He also knew that he had collected taxes from his customers. Nevertheless, [Owner] used those collected taxes to pay other bills. Had [Owner] been waiting for the Department to provide him with further instructions regarding the collected retail sales taxes, he would not have diverted those funds for other business purposes.

Even the facts surrounding the closure of Company #2 show that [Owner] understood that he needed to report and pay his taxes to the state. The Department maintained records of every attempt to contact [Owner] in relation to his activities with Company #2. These records show that the Department attempted for over a year to contact [Owner], even going to his personal residence. Even though [Owner] never personally returned these calls, the communications with Company #2's office manager indicate that [Owner] both directed her to speak with the Department and that she communicated the tax issues with [Owner]. These records show that [Owner] knew the consequences of not reporting taxes to the Department.

Based upon this evidence, we find that the Department has met its burden by clear, cogent, and convincing evidence that [Owner] both knew that the retail sales taxes that he collected on Taxpayer's behalf were due and attempted to avoid the tax liability by intentionally keeping the funds for other business uses. Therefore, we uphold the evasion penalty against Taxpayer.

#### DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 21st day of April 2010.