Cite as Det. No. 94-007, 14 WTD 174 (1995).

BEFORE THE INTERPRETATION AND APPEALS DIVISION
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. 94-007
. . .	)	Registration No. . . .
	)	FY. . ./Audit No. . . .

[1] RULE 228; RCW 82.32.090: EVASION PENALTY -- COLLECTED BUT UNREMITTED SALES TAX. A taxpayer is liable for the evasion penalty where the evidence shows that he collected retail sales tax, did not remit the sales tax to the Department for a period of four years, and used the collected sales tax for his own purposes while filing tax returns with the Department under the classification of wholesaling.

[2] RULE 254; RCW 82.32.070: RECORD KEEPING -- CONSEQUENCES OF FAILURE TO KEEP RECORDS. Any person who fails to comply with the requirements of RCW 82.32.070 or of WAC 458-20-254 shall be forever barred from questioning, in any court action or proceedings, the correctness of any assessment of taxes made by the department based upon any period for which such books, records, and invoices have not been so kept and preserved.

[3] ETB 419.32.99: ESTOPPEL -- ORAL INSTRUCTIONS RELATING TO TAX LIABILITY. The department will not give consideration to claimed misinformation resulting from telephone conversations or personal consultations with a department employee. The taxpayer must show that the failure to report correctly was due to written, erroneous instructions from the Department.

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:

A sole proprietor appeals the assessment of the evasion penalty on sales tax collected but not remitted to the Department of Revenue (Department).[1]

FACTS:

Gray, A.L.J. -- The taxpayer is in the construction business. The Department's Audit Division audited the taxpayer for the period January 1, 1989 through December 31, 1992. The Audit Division concluded that the taxpayer should have reported under the classification "retailing" instead of "wholesaling," as was reported by the taxpayer. The Department allowed credit for the tax reported and paid under the classification "wholesaling" and assessed retailing business and occupation (B&O) tax. However, the Audit Division found that the taxpayer had charged and collected retail sales tax throughout the audit period, but had reported under the wholesaling classification and had not remitted the collected sales tax to the Department. The Department also assessed retail sales tax.

The Department also assessed an evasion penalty for intentionally not remitting the collected sales tax to the Department. The Department also assessed audit interest. The taxpayer appeals only the evasion penalty.

The Audit Division made two findings to support the evasion penalty:

1. The taxpayer charged and collected the retail sales tax from its customers during the entire audit period and did not remit those trust funds to the state.
2. The taxpayer reported all of its revenue receipts under the classification "wholesaling" while collecting the retail sales tax.

The taxpayer said that the evasion penalty (50% of the additional tax found to be due) is unreasonable and that there was no tax evasion. In the petition, the taxpayer wrote that "[w]e don't feel it was intentional tax evasion, but we are uneducated about the small business laws." The taxpayer's wife said she and the taxpayer began their business in 1988. During 1988 and 1989, the taxpayer did not keep financial books and records. Sometime in

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

1990, as a result of some problems with the Internal Revenue Service, the taxpayer began to keep some form of books and records. The taxpayer's wife kept the books and records, and she was helped by an assistant.

The taxpayer's wife said that the other person who assisted her with the books and records called the Department to ask how to fill out the quarterly reports and was informed that she should report the gross receipts on line 12 of the return (wholesaling). The taxpayer was unable to supply information with any degree of certainty about when events occurred. She did not know when the telephone call was made to the Department; she estimated that it was at least three years or more ago. No notes were made of the conversation. The assistant made a second phone call to the Department a year or two later, based upon a feeling that the reporting information was incorrect. This time, according to the taxpayer's wife, the assistant was told to report under the classification "retailing." The taxpayer began reporting under the retailing classification after the audit period, in 1993. The taxpayer said that he filed his returns based on his ignorance about small business laws and the information given to him by the Department.

The taxpayer argued that the amount of sales tax as stated in the assessment was incorrect because the Audit Division was not obtaining its information from books and records, but instead from bank statements. All income, from all sources, was placed in one bank account, and the Audit Division reached the wrong conclusion about some of the income, according to the taxpayer's wife.

The taxpayer's wife said that she and the taxpayer filed a petition in bankruptcy under chapter 13 on January 12, 1994.

ISSUES:

1. Whether the taxpayer intended to evade the tax.

2. Whether the taxpayer may contest the amount of the tax or the evasion penalty in the absence of books and records.

3. Whether the taxpayer may claim estoppel against the Department where the taxpayer alleges oral instructions only.

DISCUSSION:

[1] Chapter 82.32 RCW is the law governing the general administrative authority of the Department and defines the Department's authority with respect to the imposition and waiver

of penalties. Chapter 82.32 RCW is expressly made applicable to the administration of the sales tax by RCW 82.08.140. According to RCW 82.32.090, a 50% evasion penalty shall be added to a tax assessment if the Department finds that the deficiency resulted from an intent to evade the payment of the tax. The statute uses the word "shall." "Shall is presumed mandatory." Clark v. Pacificorp, 118 Wn.2d 167, 822 P.2d 162 (1991). The Department adopted WAC 458-20-228(4)(e) (Rule 228) which provides some further guidance on the evasion penalty.

The Department considers tax evasion to be a specific type of fraudulent behavior. The imposition of the evasion penalty requires a showing of the following:

1. a tax liability which the taxpayer knows is due; and

2. an attempt by the taxpayer to escape detection through deceit, fraud or other intentional wrongdoing.

In order to sustain an assessment of the evasion penalty, the Department must first present evidence of each of the foregoing elements. The burden is on the Department to prove the existence of these elements by clear, cogent and convincing evidence. In order to meet this burden, the Department must present objective and credible evidence that clearly demonstrates intent to evade a known tax liability. Mere suspicion of intent to evade is not enough to meet this burden.

In upholding an assessment of the evasion penalty we must find that the taxpayer acted with intent. For this purpose, the Department must show that the taxpayer acted with the specific purpose of escaping a tax liability which the taxpayer knew to exist. Although the subjective intent of a person is difficult to ascertain, it may be determined from objective facts such as the actions or statements of the taxpayer. However, intent to evade does not exist where a deficiency was due to an honest mistake, an unsuccessful attempt at legitimate tax avoidance, inefficiency, or ignorance of proper accounting methods. Even gross negligence does not rise to the level of intent to evade. There must be proof of a deliberate attempt on the part of the taxpayer to evade a tax liability.

Once the Department has clearly demonstrated the existence of each of the elements of evasion, a burden of production is imposed on the taxpayer to come forward with evidence of honest mistake, ignorance of the law, negligence, or some other fact which tends to rebut the Department's evidence. 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. See, Determination No. 90-314, 10 WTD 111 (1990).

In this case, the Department has shown that the taxpayer reported, during the entire audit period, under the wholesaling classification, but that the taxpayer collected sales tax during the same period and diverted the sales tax to the taxpayer's own use. The taxpayer claims that the failure to remit the collected sales tax to the Department, and the diversion of the collected sales tax for spending by the taxpayer, was due to negligence. The taxpayer supports that argument by pointing to the virtual absence of bookkeeping for the first two years of business and a general lack of knowledge about "small business tax laws." We disagree and conclude that the Department has shown there was an intent to evade payment of the tax. It is perhaps a truism that "ignorance of the laws" is no excuse, but the taxpayer cannot rely upon ignorance of the tax laws to avoid the evasion penalty here.

The taxpayer knew enough to collect the sales tax for four years and enjoyed the benefits of the sales tax by spending it himself. The taxpayer never contacted the Department, either by telephone or in writing, to inquire when he should remit the sales tax or to inquire why the Department supposedly told the assistant to report under the wholesaling classification when the taxpayer knew that he was making retail sales and collecting the sales tax. This activity went on from at least 1989 through 1992. The assistant did not appear to report first-hand her contacts with the Department. We conclude that the taxpayer attempted to avoid detection by reporting under the wholesaling classification. This activity constitutes more than "negligence" or even "gross negligence." The evasion penalty is affirmed.

[2] The taxpayer also cannot complain about the amounts assessed as collected retail sales tax. The Audit Division did the best that it could using the materials that were available to it. RCW 82.32.070 requires every person liable for any fee or tax imposed by chapters 82.04 through 82.27 RCW to "keep and preserve, for a period of five years, suitable records as may be necessary to determine the amount of any tax for which he may be liable." The Department adopted WAC 458-20-254 (Rule 254) which elaborates on the requirement to keep books and records. RCW 82.32.070 expressly states:

> Any person who fails to comply with the requirements of this section shall be forever barred from questioning, in any

> court action or proceedings, the correctness of any assessment of taxes made by the department of revenue based upon any period for which such books, records, and invoices have not been so kept and preserved.

The taxpayer's petition was limited to the evasion penalty; however, to the extent that the taxpayer also questions the amount of tax and penalty due, the petition is also denied.

[3] Finally, the taxpayer claims the Department is estopped from imposing the tax because, supposedly, someone in the Department instructed the taxpayer to report under the wholesaling classification. ETB 419.32.99 is an excise tax bulletin that addresses the issue of oral instructions relating to tax liability.

> The department of Revenue gives consideration, to the extent of discretion vested in it by law, where it can be shown that failure of a taxpayer to report correctly was due to written instructions from the department or any of its authorized agents. The department cannot give consideration to claimed misinformation resulting from telephone conversations or personal consultations with a department employee.
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> There are three reasons for this ruling:
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> (1) There is no record of the facts which might have been presented to the agent for his consideration.
>
> (2) There is no record of instructions or information imparted by the agent, which may have been erroneous or incomplete.
>
> (3) There is no evidence that such instructions were completely understood or followed by the taxpayer.

ETB 419.32.99 applies here. We have no way of knowing what facts were presented to the Department, who spoke for the Department, what the Department's response was, or whether it was understood by the assistant. There is no basis for estoppel in this case. The petition is denied on this issue as well.

DECISION AND DISPOSITION:

The taxpayer's petition is denied. Because of the automatic stay provision of the Bankruptcy Code (11 U.S.C. § 362), the taxpayer is not required to pay immediately. The Department will file its claim with the Bankruptcy Court for tax, audit interest, and the

evasion penalty plus additional interest through the date of filing of the bankruptcy.

DATED this 20th day of January, 1994.