BEFORE THE INTERPRETATIONS 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. 97-141
. . .	)	Registration No. . . .
	)	FY . . . /Audit No. . . .

[1] RULE 254 -- RCW 82.32.070 -- B&O TAX -- SALES TAX -- USE TAX -- RECORD-KEEPING REQUIREMENTS. A person doing business in Washington is required to maintain records adequate to establish his or her state excise tax liability. One who fails to do so may not successfully object to an ensuing tax assessment.

[2] RULE 228: RCW 82.32.090 -- EVASION PENALTY -- FAILURE TO FILE RETURNS -- ATTORNEY. An attorney who stopped filing state tax returns based on a casual conversation at a banking seminar is not liable for the penalty for tax evasion.

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:

Protest of the excise tax and evasion penalty assessed against an attorney.[1]

FACTS:

Dressel, A.L.J. -- The taxpayer is an attorney. His books and records were examined by the Department of Revenue (Department) for the period November 1, 1991 through June 30, 1995. As a result a tax assessment was issued. Based on additional records furnished to the Audit

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

Division of the Department (Audit), the assessment was reduced in a post assessment adjustment. The taxpayer appeals.

According to Department records, the taxpayer's registration number was originally issued in September, 1981. Sometime after that, it was deactivated. It was reactivated with a beginning business date of January, 1992. Audit states in its original audit report, however, that the taxpayer actually did conduct business activity in the last quarter of 1991. Audit further states that the taxpayer filed a tax return for the first quarter of 1992 but none after that to the date of the audit. The original audit was completed in October, 1995.

In addition to assessing sales, use, and business and occupation (B&O) taxes, Audit imposed the penalty for tax evasion. In doing so, it relied on the fact that the taxpayer neglected to file tax returns for the last quarter of 1991 and for the second quarter of 1992 through the second quarter of 1995. The taxpayer's explanation of this action, or lack thereof, as stated at the hearing of this matter, was that some private accountants and/or attorneys at a banking seminar he was attending told him, in an informal discussion, he was not required to file tax returns, if his monthly income was under $6,000. Further, he explained, he just started his private law practice in late 1991. Prior to that, he had come from a job as a salaried attorney where he was considered an employee and not required to file state tax returns. Before that he had worked as an attorney in Illinois and Ohio, states which have income taxes, so he was not familiar with Washington's B&O tax. The taxpayer stated that his original registration back in 1981 had nothing to do with his work as a lawyer but, rather, was established to report the income he received from his brother for the lease of a truck that was located in Washington.

Initially, the taxpayer raised some other objections to the tax assessment. For one thing, he objected to Audit's use of his bank statements to fix his tax liability. He believed that the income used by Audit to measure his taxes included filing fees and process serving charges that he thought were the obligations of clients and should have been excluded from his measure of tax. Further, use tax was imposed on certain office equipment, including a computer. The taxpayer objected to that because, he said, he paid sales tax on that equipment at the time of purchase. In addition, at the hearing, he mentioned he advanced $2,000.00 for certain client expenses. We believe that was his estimate of the above-referenced filing fees and process serving charges that were, according to the taxpayer, erroneously included in his measure of tax.

ISSUES:

1. May a tax assessment be based on a taxpayer's bank statements, in lieu of other books and records?

2. Were client costs, such as filing fees and process serving charges, included in the measure of an attorney's B&O tax?

3. If such costs were included in the measure of tax, should they be deducted?

4. Does this attorney taxpayer have adequate documentation to establish that sales/use tax was paid on office equipment?

5. By failing to file returns, did an attorney manifest an intent to evade the payment of state excise taxes?

DISCUSSION:

[1] The first four issues stated above relate to the keeping of the taxpayer's books of account. Per RCW 82.32.070, a taxpayer must maintain for inspection books and records adequate for establishing his or her state tax liability. One who fails to do so cannot thereafter question a subsequent tax assessment by the Department for that period for which adequate records were not kept. I*d*.[2] The post assessment adjustment, or amended assessment, issued by the Department, as referred to previously, actually came *after* the appeal was filed in this case. In the amended assessment, Audit adjusted down the taxpayer's liability for tax on filing fees, based on check registers furnished by the taxpayer, and also gave the taxpayer credit for sales tax on the computer, based on an invoice that was furnished. Inasmuch as Audit gave credit for the filing fees, we need not decide that legal issue. Otherwise, Audit made the adjustments in the amended assessment that were appropriate, based on the few additional records that were provided. No additional records have been submitted to us. Without such records and in accordance with RCW 82.32.070, we will not make further factual adjustments to the audit. In the event that the taxpayer discovers additional records not already presented, it may forward them to Audit for possible credit, subject to the applicable statute of limitations.

On issues one through four, all of which relate to the presence or absence of adequate documentation, the taxpayer's petition is denied.

The last issue is the evasion penalty. The authority for it is RCW 82.32.090(5)[3] which reads: "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 shall be added." Further, we stated in *Det. No. 90-314*, 10 WTD 111 (1990) at 113:

> 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:
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> 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.

[2] See also WAC 458-20-254.
[3] Restated in WAC 458-20-228.

> 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.

Clear, cogent, and convincing evidence is that which establishes the fact in issue as "highly probable" or "positive and unequivocal." *Colonial Imports, Inc. v. Carlton Northwest, Inc.*, 121 Wn.2d 726, 735, 853 P.2d 913 (1993).

[2] The taxpayer states he quit filing returns because of the advice he received from persons with whom he was attending a seminar. We asked him at the hearing if he ever attempted to verify that advice by calling the Department. He said he did not. While it is somewhat difficult for us to believe that an attorney, whose business it is to pay attention to legal details and fine print for his clients, would not verify advice given in a casual conversation, the taxpayer's explanation is not so improbable that we can ignore it. It is conceivable that one might take the word of fellow professionals who, presumably, had practiced in this state longer than the taxpayer. It is also conceivable that the taxpayer misconstrued their advice by thinking that the threshold taxable amount they discussed applied to a reporting period other than the one the taxpayer was assigned. With these possibilities, we cannot say that it was "highly probable" or "positive or unequivocal" that the taxpayer intended to evade payment of Washington state excise tax. This is especially so in light of the fact that the only evidence of evasion presented by the Department is the fact that the taxpayer filed one tax return at the beginning of the audit period and then stopped filing. This sole fact does not constitute clear, cogent, and convincing evidence of tax evasion.

On issue number five, tax evasion, the taxpayer's petition is granted.

DECISION AND DISPOSITION:

The taxpayer's petition is denied in part and granted in part. Audit will delete the evasion penalty and issue an amended assessment, due for payment by the date stated thereon.

DATED this 23rd day of July 1997.