

Cite as Det. No. 97-168, 17 WTD 142 (1998)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

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. 97-168
)	
...)	Registration No. . . .
)	Trust Fund Accountability Assessment
)	

[1] RULE 217; RCW 82.32.237: RETAIL SALES TAX -- CORPORATE OFFICER'S PERSONAL LIABILITY FOR TRUST FUNDS -- COLLECTED BUT UNREMITTED RETAIL SALES TAX -- WILLFUL FAILURE. Neither the purported levying of accounts by the Internal Revenue Service nor increasing costs of doing business are sufficient grounds for finding that a corporate officer's failure to remit collected sales tax was not willful.

[2] RULE 217; RCW 82.32.237; RCW 26.16.030: RETAIL SALES TAX -- CORPORATE OFFICER'S PERSONAL LIABILITY FOR TRUST FUNDS -- COLLECTED BUT UNREMITTED RETAIL SALES TAX -- HUSBAND AND WIFE -- COMMUNITY PROPERTY AGREEMENTS -- SEPARATE PROPERTY. A community property agreement between husband and wife does not prevent the Department from collecting collected but unremitted retail sales tax from the community where the liability arose from the operation of a corporation that was the husband's separate property.

NATURE OF ACTION:

Husband and wife appeal trust fund accountability assessment on the basis that the wife is not liable for husband's actions and that the corporate officer husband's failure to remit the collected retail sales tax trust funds was not willful.¹

FACTS:

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

Munger, A.L.J. -- The taxpayers are husband and wife.² Prior to their marriage, the husband was the owner and operator of a corporation. He continued as the sole owner and operator of the corporation during the parties' marriage. During the marriage, the corporation incurred substantial unpaid excise tax debts and the Department of Revenue (the Department) had filed three tax warrants in the taxpayers' county against the corporation. The corporation's registration with the Department was revoked in 1996 for non-payment of the tax warrants. We note that the husband now describes himself as the "Authorized Representative" of a new corporation with his son as the only listed officer and which also has failed to remit collected retail sales taxes now overdue.

In September 1996, the Department notified the taxpayers that per WAC 458-20-217 (Rule 217) it was establishing that the husband and the marital community of the taxpayers were personally liable for collected but unremitted retail sales tax trust funds owing by the corporation. It is undisputed that the trust funds in question were under the husband's sole control and that the wife had no involvement in her husband's corporation. The husband appeals the Department's finding of personal liability for the corporate tax debts and both parties assert that regardless of the husband's potential personal tax liability, the wife should not be held personally liable for her husband's corporate tax debts.

The husband contends that under Rule 217(6)(d), his failure to remit his corporation's collected retail sales taxes to the Department was not willful.³ He contends that the failure to remit was caused by an economic downturn due to a significant increase in the price of logs that was no fault of his own. The husband also states that other government agencies such as the Internal Revenue Service (IRS) and the Washington Employment Security Agency levied his bank accounts before he could remit the collected retail sales taxes, thereby making his failure to remit unintentional.

The tax warrants cover a period of 21 months from January 1993 through May 1996. No documentation has been provided that would show that each time the corporation attempted to remit the retail sales tax trust funds, it was unable to do so because of a recent levy on its accounts. The Department indicates that the payments simply were never made, and there were no bounced checks that could have been an indication that the funds had suddenly become unavailable because of a levy by another agency. The Department also notes that payments they did receive from him were from the husband's personal accounts rather than corporate ones.

² The wife subsequently indicated that she will seek a divorce from her husband. The issues herein, however, are based on events during their marriage and a subsequent divorce would have no effect on the outcome of this determination as it relates to liability during the marriage. The effect of possible divorce or separation is addressed later.

³ The husband does not dispute the other requirements of Rule 217(6) needed for the Department to find personal liability for collected retail sales taxes.

The taxpayers entered into a prenuptial agreement on August 12, 1991 and were married on August 17, 1991. The prenuptial agreement listed the parties' separate property acquired prior to the date of marriage and stated that neither was to gain an interest in the other's separate property. The corporation was listed as one of the husband's separate properties. Additionally, the agreement stated their intent to separately manage their own property and that any of the husband's debts entered into in his name only were to be considered his separate debts. This section of the agreement included a hold harmless clause in favor of the wife. The parties assert that this agreement prevents the Department from collecting any of the husband's tax debts from the income or separate assets of the wife.

ISSUES:

1. Are financial hardship and a levied bank account defenses to a finding of corporate officer personal liability for the failure to remit collected retail sales tax trust funds?
2. May the trust fund accountability tax debts incurred by a corporate officer husband be collected from his wife?

DISCUSSION:

[1] WAC 458-20-217(6)(d) (Rule 217(6)(d)), which implements RCW 82.32.237, authorizes a finding that a corporate officer may be personally liable for collected but unremitted retail sales tax trust funds. Rule 217(6)(g) and (h) are the portions of that rule dealing with the corporate officer's intent.

(d) REQUIREMENTS FOR ASSESSMENT: Before the department may assess trust fund accountability for retail sales tax held in trust, the statute requires that the underlying retail sales tax liability be that of a corporation. Second, there must also be a termination, dissolution or abandonment of the corporation. Third, the person against whom personal liability is sought willfully failed to pay or to cause to be paid retail sales tax collected and held in trust. Fourth, the person against whom personal liability is sought is a person who has control or supervision over the trust funds or is responsible for reporting or remitting the retail sales tax. Finally, there must be no reasonable means to collect the tax directly from the corporation.

...

(g) WILLFULLY FAILS TO PAY OR TO CAUSE TO BE PAID: The statute defines the term "willfully fails to pay or to cause to be paid" as an intentional, conscious and voluntary course of action. The failure to pay over such tax must be the result of a willful failure to pay or to cause to be paid to the state any retail sales tax COLLECTED on retail sales by the corporation as opposed to retail sales tax due on the corporation's consumable items.

For example, if the treasurer knows that the retail sales tax must be remitted to the state on the twenty-fifth day of the following month, but rather than holding the funds for payment on the twenty-fifth, uses such funds to pay for any other obligation such as the payroll or additional inventory, such act is an intentional, conscious and voluntary course of action. If there are insufficient funds on the twenty-fifth day of the following month to pay over to the state, the treasurer will have willfully failed to pay or to cause to be paid retail sales tax held in trust.

(h) CIRCUMSTANCES BEYOND THE CONTROL: Any person, who shall otherwise meet the requirements for personal liability, shall not be personally liable if the failure to pay or to cause to be paid is the result of circumstances beyond the control of such person and that person has exercised good faith in collecting and attempting to hold the funds in trust. The following examples are provided for illustrative purposes only and they do not, in any way, limit the scope of the circumstances which may be beyond the control of the person against whom liability is sought. Each case will be determined in accordance with its particular facts and circumstances.

(i) Immediately prior to timely payment of the retail sales tax, unknown to the person against whom personal liability is sought, the Internal Revenue Service levies and seizes the money. Such occurrence is beyond the control of the person against whom personal liability is sought.

(Emphasis added.)

The husband has provided no documentation that the IRS levied accounts containing the retail sales tax trust funds immediately prior to the due dates every month or quarter for 21 months worth of taxes due during almost a three and one half year period. Even assuming the husband's (or the corporation's) accounts had been levied against at least once, that would have put him on notice to more carefully protect the trust funds for the future after the first levy and after continuing to fail to pay IRS and Employment Security debts.

The increasing cost of logs used in the husband's business may explain his motivation in not remitting collected retail sales tax trust funds. It does not, however, justify his actions. Rule 217(6)(g) specifically states that spending the trust funds on other debts is not a defense to a Departmental finding of personal liability.

[2] RCW 26.16.120 is the statute authorizing community property agreements:

Agreements as to status. Nothing contained in any of the provisions of this chapter or in any law of this state, shall prevent the husband and wife from jointly entering into any agreement concerning the status or disposition of the whole or any portion of the community property, then owned by them or afterwards to be acquired, to take effect upon the death of either. But such agreement may be made at any time by the husband and wife by the execution of an instrument in writing under their hands and

seals, and to be witnessed, acknowledged and certified in the same manner as deeds to real estate are required to be, under the laws of the state, and the same may at any time thereafter be altered or amended in the same manner: **PROVIDED, HOWEVER, that such agreement shall not derogate from the right of creditors,** nor be construed to curtail the powers of the superior court to set aside or cancel such agreement for fraud or under some other recognized head of equity jurisdiction, at the suit of either party.

(Emphasis added.)

This statute makes it clear that while a husband and wife may make agreements between themselves regarding their property, such agreements have no effect on third party creditors. The Department, as a third party creditor, is unaffected by the pre-nuptial agreement. We must then analyze the wife's liability under traditional community property law analysis.

The taxpayers assert that the tax debt is a separate one because it was originally (and still is) a debt of the corporation which is the husband's separate property. The liability of the husband, however, was incurred through his actions and employment during the marriage, and as such it is a community debt. RCW 26.16.030.

Although not specifically articulated in the context of a tort, the taxpayers also object to the wife's incurring liability due to her husband's actions with the sales tax trust funds. In Washington community property law, the non-offending spouse is not liable for the tortfeasor spouse's actions. Sandgren v. West, 9 Wn. 2d 494, 115 P. 2d 724 (1941). However, if the tortious act ". . . results or is intended to result in a benefit to the community . . .," such as the tort being committed during the course of income generating employment, then the community, including the non-offending spouse's income is liable. LaFramboise v. Schmidt, 42 Wn. 2d 198, 200, 254 P. 2d 485 (1953) and Farman v. Farman, 25 Wn. App. 896, 611 P.2d 1314 (1980). The husband's employment at the corporation was a benefit to the community and the trust fund violation occurred as part of that work. Consequently, the taxpayers' community, including the wife's income is liable for the taxes.

The community property agreement, while not binding on the Department as a creditor, does raise another critical issue. It is long standing community property law that the community debts incurred by one spouse only may not be collected against the separate property of the other spouse. Sweet, Dempster & Co. v. Dillon, 13 Wn. 521, 43 P. 637 (1896) and Cunningham v. Zane, 139 Wn. 176, 245 P. 913 (1926). In the present case, it is undisputed the wife was not involved in the husband's conversion of the sales tax trust funds. Consequently, none of her separate property may be used by the Department as a source for collecting the tax debt. In the event of a separation or the dissolution of the taxpayers' marriage, the wife's income and property purchased with that income would also become her separate property and would likewise be unavailable for satisfaction of the tax debt. RCW 26.16.140.

DECISION AND DISPOSITION:

The petition is granted in part and denied in part. The Department's finding of individual and community liability for the husband's sales tax trust fund violations is upheld. The community property of the taxpayers' marriage, including the wife's income, is liable for payment of the tax debt as well as the income and separate property of the husband. The separate property of the wife from the Community property agreement and any of her income earned after any future separation or divorce are unavailable to the Department for satisfaction of the tax debt.

Dated this 28th day of August, 1997.