BEFORE THE 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. 98-065
	)	
. . .	)	Registration No. . . .
	)	FY . . ./Audit No. . . .
	)	
	)	

[1] RULE 230; RULE 228; RCW 82.32.100; RCW 82.32.160; RCW 82.32.105: MOTION TO DISMISS; FAILURE TO PROMPTLY CONSIDER PETITION -- WAIVER OF INTEREST. RCW 82.32.100 does not address the period in which the Department must resolve a petition for correction of assessment. While RCW 82.32.160 does state that the Department should "promptly consider the petition and may grant or deny it," it does not require that the assessment be waived simply because the Department delayed in addressing the taxpayer's petition. However, where the delay in issuing a decision was for the sole convenience of the Department, the Department will waive interest for the period commencing one year after the taxpayer filed its petition through the payment due date.

[2] WITNESS CREDIBILITY. The following are among the important factors to be considered in evaluating witness credibility: (1) the opportunity and capacity of the witness to observe the act or event, (2) the character and reputation of the witness for truthfulness, (3) prior inconsistent statements or actions, (4) bias or lack thereof, (5) consistency with or contradiction by other evidence, (6) inherent improbability, and (7) demeanor of the witness. Citing Henry Bacon Building Materials, Inc. v. State, BTA Docket No. 89-27, 10 WTD 223 (1991).

[3] RULE 119; RCW 82.04.070: RETAILING B&O TAX -- RETAIL SALES TAX -- GROSS PROCEEDS OF SALES -- EMPLOYEE THEFT OF INVENTORY -- EMPLOYEE MEALS. Where liquor was stolen by the taxpayer's employees, such liquor cannot be used to impute income to the taxpayer. Liquor stolen by employees does not constitute "employee meals" because the taxpayer did not voluntarily give the liquor to the employees in exchange for their services.

[4] RULE 102; RCW 82.04.050: RETAIL SALES TAX -- RETAILING B&O TAX -- SALES FOR RESALE --INTERVENING USE --OWNER'S CONSUMPTION OF

INVENTORY. The consumption by the taxpayer's owner of products that were purchased for resale results in the taxpayer being liable for retail sales tax on the purchases. However, because the products are not sold by the taxpayer, no B&O tax is due on such amounts.

[5] RCW 82.32.090: EVASION PENALTY. The Department is authorized to impose an evasion penalty if "all or any part of the deficiency resulted from an intent to evade the tax." The imposition of the evasion penalty requires a showing of a tax liability which the taxpayer knows is due; and an attempt by the taxpayer to escape detection through deceit, fraud or other intentional wrongdoing. Citing Det. No. 94-007, 14 WTD 174 (1995). The fact that the taxpayer was a registered business does not prove that the taxpayer was aware that it had been underreporting its sales. The mere fact that sales tax trust funds were underreported does not support imposition of the evasion penalty.

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 taxpayer that operates a cafe protests the calculation of the assessment of retail sales tax and retailing B&O tax on its unreported beer and liquor sales. The taxpayer also protests the assessment of the evasion penalty.[1]

FACTS:

C. Pree, A.L.J. (successor to Krebs, A.L.J.) -- The taxpayer operates a cafe that sells food, liquor, and beer.

The taxpayer was audited for the period of January 1, 1990, through March 31, 1993. The audit was performed upon the recommendation of the Washington State Liquor Control Board ("WSLCB"). An analysis of the taxpayer's alcohol purchases by the WSLCB revealed that sales of alcohol reported on the WSLCB report were understated. The Audit Division's audit similarly revealed that the taxpayer's sales of alcohol were understated. The Audit Division's audit resulted in an assessment of retail sales tax of $ . . . , retailing business and occupation ("B&O") tax of $ . . . , service B&O tax of $ . . . , and interest of $ . . . . In addition, the Audit Division assessed an evasion penalty of $ . . . . The assessment totaled $ . . . .

The taxpayer filed a "motion to dismiss" because of the Department's "failure to prosecute and timely proceed in the processing of the appeal." The taxpayer cited RCW 82.32.100 and RCW 82.32.160 in support of its motion.

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

In February, 1995, the taxpayer paid the unprotested portion of the assessment ($ . . .), plus interest ($ . . .) for a total payment of $ . . . . The unprotested portion included the service B&O tax the Audit Division assessed on the taxpayer's pull tab and game commission income. According to the Audit Division, the taxpayer failed to report and pay tax to the Department on its pull tab income in one quarter. With respect to the taxpayer's unreported game income, the Audit Division reasoned that because the taxpayer was deemed to have granted the operator of the coin operated games a license to use its real property, the taxpayer is responsible for paying service B&O tax on its gross compensation.

The undisputed portion of the assessment that the taxpayer paid also included a portion of the retail sales tax and retailing B&O tax that the Audit Division assessed with respect to the taxpayer's liquor and beer sales. While the taxpayer admits that such income was understated, the taxpayer contends that the Audit Division's assessment exaggerated the amount by which the taxpayer underreported this income.[2]

With respect to "well drinks," i.e., sales of liquor, the Audit Division calculated the amount of the taxpayer's unreported income by starting with the number of bottles the taxpayer purchased from the WSLCB. The Audit Division obtained these figures from WSLCB records. Using a WSLCB "drink conversion table," the Audit Division then calculated the number of drinks the taxpayer sold from each bottle. (The conversion table determines the number of drinks per bottle based on the quantity served per drink, then deducts an 8% "spillage & over-pour allowance" to determine the net drinks per container.) The Audit Division then multiplied the total number of drinks by the amount the taxpayer charged per drink. Based on testimony of the taxpayer's owner, the Audit Division assumed in its calculation of the assessment that each drink was sold for $1.75.

Similarly, the Audit Division calculated income from beer sales by first determining the number of cans of beer the taxpayer purchased for resale. The Audit Division used the taxpayer's invoices from its beer distributor and canceled checks to determine the total number of cans of beer the taxpayer purchased. The Audit Division divided the total invoice amount by the average cost per can of beer (as calculated on an Internal Revenue Service worksheet) to determine the number of cans purchased. The Audit Division then multiplied this number by the price the taxpayer charged for beer to determine the amount by which the taxpayer underreported its income. The Audit Division determined the price the taxpayer charged per can based on its conversation with the taxpayer. The taxpayer stated that it charged $1.50 per beer at the time of the audit (1994). The Audit Division used a sales price of $1.00 for 1990 and 1991 and $1.50 for 1992 and 1993.

The taxpayer did not provide cash register receipts as requested by the Audit Division. The taxpayer's owner stated that he had given the tapes to the WSLCB for its use in performing its audit of the taxpayer. The tapes were returned to him but he was unable to locate them because the room they had been stored in had been remodeled.

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[2] The Audit Division found nothing to indicate that the taxpayer had underreported its food sales. The Audit Division made this determination by comparing food purchases to food sales.

The taxpayer admits that it understated its income from beer and liquor sales, and it paid the unprotested portion of the assessment, based on its computation of the proper amount of its taxable income. During the hearing in this matter, the taxpayer explained that the difference between the income determined by the Audit Division and the amount the taxpayer now concedes to be due largely resulted from the actions of dishonest bartenders employed by the taxpayer. According to the taxpayer, one of its bartenders stole purchase records to conceal the fact that he was stealing money. This bartender, according to the taxpayer, also drank approximately a fifth of liquor per day from the taxpayer's inventory. Although no criminal charges were brought against this bartender, the taxpayer terminated him in June 1993. This bartender, as well as the other two bartenders employed by the taxpayer during the audit period, also gave drinks away and substantially over-poured drinks in exchange for tips from patrons.

The taxpayer agrees with the Audit Division with respect to the number of bottles of liquor and cans of beer it purchased. As noted above, the taxpayer explained that this amount was understated in its books of account because one of its bartenders stole the invoices for the liquor and beer purchases. Thus, when the taxpayer provided its bookkeeper the records to compute its taxable income, the taxpayer (unknowingly) did not provide the bookkeeper with all of the invoices. The bookkeeper used the taxpayer's purchase invoices and daily sales journals in preparing the taxpayer's returns. The taxpayer explained that there were also "problems internally in the recordkeeping" and that the taxpayer "did not adopt the best bookkeeping practices."

The taxpayer further explained that the Audit Division's calculation of its taxable income was erroneous because the Audit Division based its calculations on inflated prices. In an affidavit filed by the taxpayer's owner, the taxpayer claims that its drink prices were actually $1.50 for the period of January 1, 1990, through June 30, 1992, and $1.75 for the period of July 1, 1992, through March 31, 1993. (However, in calculating the payment of the unprotested portion of the assessment, the taxpayer's accountant erroneously used the figures of $1.50 for the period of January 1, 1990, through December 31, 1992, and $1.75 for the period of January 1, 1993, through March 31, 1993.) Further, the taxpayer's affidavit provides that the sale price of beer for the period of January 1, 1990, through June 30, 1992, was $1.00 per can or bottle. For the period of July 1, 1992, through March 31, 1993, the price was $1.50 per can or bottle. (Again, in calculating the payment of the unprotested portion of the assessment, the taxpayer's accountant used erroneous figures. Specifically, the accountant's statement provided that beer prices were $1.00 for the period of January 1, 1990, through December 31, 1991; $1.25 for the period of January 1, 1992, through June 30, 1992; and $1.50 for the period of July 1, 1992, through March 31, 1993.) The taxpayer recognizes that it owes the Department additional taxes based on the accountant's correction of his computational errors.

Finally, the taxpayer disputes the Audit Division's use of an 8% waste and over-pour percentage. Based on his more than thirty years of experience in the business, the taxpayer's owner stated in an affidavit that a 12% factor is more realistic for his business. (The taxpayer's accountant clarified that the owner meant an additional 12% factor, for a total factor of approximately 20%.) The taxpayer's owner based his statement on his comparisons of the number of bottles used by his bartenders to the number of drinks sold, as reflected by cash register receipts. Thus, the taxpayer determined that it sold only 16.06 drinks per bottle, rather than the 19.16 drinks assumed by the Department.

The taxpayer's accountant provided a detailed analysis of how he calculated the waste and over-pour factor of 20.8%. The accountant's calculation was comprised of the following four figures.

First, the accountant started with the 8% factor reflected in the WSLCB chart. The accountant characterized this figure as "assuming a very accurate pour rate by the establishment in question." The Audit Division noted that this percentage "is a standard not a minimum or maximum."

Second, the accountant added the amount estimated to have been stolen by the bartenders (at least 1/2 bottle per day during each five day work week), or 2.22%. In response to this argument, the Audit Division noted that the taxpayer has produced no documentation to substantiate the theft. Further, the Audit Division argues, the bartender's consumption of the alcohol could be considered employee meals, which are subject to the retailing B&O tax and retail sales tax.

Third, the accountant added 9.58% to reflect the amount the bartenders over-poured "on a consistent basis, in order to enhance their tips." The accountant assumed that the taxpayer served about 100,000 drinks per year, that the over-pour was no more than 7 milliliters, or only 1/4 ounce, and that this over-pour occurred no more than 60% of the time. The Audit Division noted that this figure appears to be duplicative of the 8% standard figure, but it would not dispute this figure, upon verification of the method used to arrive at the percentage.

Fourth, the accountant added 1% to reflect the amount the taxpayer's owner consumed from the inventory (1 bottle per week). The Audit Division responded that because the taxpayer is not a sole proprietorship, "the use of inventory by corporate officers would be a retail sale and retail sales tax due."

The taxpayer's 1995 payment of the unprotested portion of the assessment was based on the above changes to the Audit Division's calculations.

Based on the Audit Division's conclusion that "there has been a clear misrepresentation of material facts" by the taxpayer, the Audit Division assessed the evasion penalty. The Audit Division reasoned that the taxpayer had been registered and doing business in the state since 1986, and it had been collecting sales tax and reporting a portion of the tax collected to the state. The Audit Division concluded that this prior reporting is "clear evidence that the taxpayer has knowledge of its reporting responsibilities."

The Audit Division further reasoned that its assessment of the evasion penalty was warranted because of the taxpayer's underreporting of its taxes. The Audit Division noted that records provided by the WSLCB and the IRS "verify that gross income was significantly underreported." Specifically, the Audit Division found that the taxpayer's gross income in 1990 from beer and liquor sales was $219,628, but the taxpayer reported gross income on its returns of only $98,865. (The taxpayer concedes that its income from beer and liquor sales was $174,706 for 1990.) The Audit Division found that the taxpayer's gross income from beer and liquor sales in 1991 was $238,700, but the taxpayer reported gross income on its returns of only $119,842. (The taxpayer concedes that its income from beer and liquor sales was $191,483 for 1991.) For 1992, the Audit Division found that the taxpayer's gross income from beer and liquor sales was $263,711, but the taxpayer reported only $134,283 on its returns. (The taxpayer concedes that its gross income from beer and liquor sales for 1992 was $209,856.) Finally, for the first three months of 1993, the Audit Division found that the taxpayer's gross income from beer and liquor sales was $77,083, but the taxpayer reported only $36,443 on its returns. (The taxpayer concedes its income from beer and liquor sales for these three months was $68,744.) As noted above, the taxpayer paid tax on the unprotested portion of the assessment in February 1995.

In further support of its assessment of the evasion penalty, the Audit Division reasoned, since the taxpayer's business is a retail cash sales business, it is clear that sales tax trust funds were involved. The Audit Division noted that the taxpayer has "clearly collected sales tax trust funds from his customers and put them to his own use rather than submit them to the Department of Revenue."

The taxpayer urges that its underpayment was not due to an intent to evade. Instead, the taxpayer explained that, in addition to the problems caused by its dishonest bartenders, it maintained "sloppy and inadequate bookkeeping records." In addition, the owner explains that he suffered emotional strain due to his divorce in 1990, which led to him not overseeing the business as he should have. The owner also "consumed a substantial amount of alcohol from the inventory due to the mental anguish and emotional strain resulting from the divorce."

ISSUES:

1. Whether the Department's assessment should be "dismissed" due to the delay of the Appeals Division in responding to the taxpayer's petition for correction of assessment.

2. Whether the taxpayer proved that the liquor and beer prices used by the Audit Division in calculating the assessment were overstated.

3. Whether the taxpayer proved that its bartenders stole liquor and gave drinks away and over-poured drinks in exchange for tips. If the taxpayer proved these facts, whether these facts negate the taxpayer's receipt of "gross proceeds of sales" or a "selling price" to the extent of the theft.

4. Whether the consumption by the taxpayer's owner of products that were purchased for resale negates the taxpayer's liability for retail sales tax or use tax with respect to such products.

5. Whether the Audit Division proved that the taxpayer's underpayment of its taxes was due to an intent to evade.

DISCUSSION:

[1] Validity of Assessment. The first issue involves the taxpayer's motion to dismiss the assessment. The taxpayer based its motion to dismiss on RCW 82.32.100 and 82.32.160. RCW 82.32.100 generally prohibits the Department from issuing an assessment or issuing a correction of an assessment that results in an increased tax liability more than four years after the close of the tax year. See also WAC 458-20-230 (Rule 230). It does not address the period in which the Department must resolve a petition for correction of assessment.

RCW 82.32.160 does state that the Department should "promptly consider the petition and may grant or deny it." However, the statute does not require that the assessment be waived simply because the Department delayed in addressing the taxpayer's petition.

In Conversions & Surveys, Inc. v. Department of Revenue, 11 Wn. App. 127, 521 P.2d 1203 (1974), the Washington State Court of Appeals addressed both of the issues the taxpayer in this case raised. The court held that the Department's delay of over ten years in acting on a taxpayer's petition for correction of assessment did not negate the validity of the assessment. The case involved a foreign corporation that planned to cease doing business in Washington and sought permission to formally withdraw from the state. In 1959, as a prerequisite to withdrawal, the corporation filed an affidavit with the Department, requesting the Department to certify to the Secretary of State of Washington that the corporation had fully satisfied all of its Washington tax liability.

In response to the taxpayer's request, the Department audited the taxpayer for the period of 1956 through 1960. The assessment was issued in 1960, accompanied by a letter stating that the certificate would be issued upon payment of the assessment.

During 1961, the taxpayer made several requests for a hearing to the Department. In response, the Department promised the taxpayer that a hearing would be held "within the next two weeks." Later that year, the Department stated that the issues "should be resolved shortly" and the taxpayer would be notified of the Department's decision. In 1962, the taxpayer again inquired about its appeal, but this inquiry, according to the court, "elicited no more enlightening response." 11 Wn. App. at 129. The court continued, "For over 8 years thereafter (about 10 years since the assessment had been issued) the matter lay absolutely dormant." Id.

In 1970, in response to an inquiry from the taxpayer, the Department held a conference with the taxpayer. As a result of that conference, the Department requested further information from the taxpayer. The taxpayer provided the requested information, but also advised the Department that some of its key people had left its employ. Eight months after receipt of the additional information, and without a hearing, the Department issued a determination that denied the taxpayer's petition.

The taxpayer argued that even if a tax liability initially existed, the Department should be enjoined from enforcing any tax assessment because (a) the assessment for additional tax was made more than four years after the close of the tax year in contravention of RCW 82.32.050, and (b) the unreasonable administrative delay denied the taxpayer due process of law and equal protection under the law. The Department, while admitting that the delay was unreasonable, argued that the delay did not deprive the taxpayer of due process or equal protection of law, at least not to the extent that the taxpayer suffered any prejudice.

With respect to the taxpayer's argument that the assessment was time-barred because it did not become final until more than four years had elapsed after the close of the tax year, the court reasoned that RCW 82.32.050 requires that the assessment be "made" within 4 years of the tax year. 11 Wn. App. at 133. The court further reasoned that the Department had authority to hold collection of the tax in abeyance once assessment has been made within the appropriate 4-year period. The court concluded that because the assessment was made within the four-year period provided by RCW 82.32.050, a partial summary judgment should have been issued in the Department's favor with respect to this issue.

The court then addressed the issues of whether the Department's delay in issuing a decision with respect to the taxpayer's petition was unreasonable and whether the delay was prejudicial to the taxpayer. The court determined that analysis of the taxpayer's constitutional arguments was unnecessary because "it appears that the taxpayer's real theory, although not specifically verbalized as such, is that the department is estopped, at this late date, from attempting to collect the additional tax which had been assessed in 1960." Id. at 135. The court concluded that the facts in the case did not require a conclusion, as a matter of law, that the Department was estopped from collecting the assessment. The court, therefore, denied the taxpayer's motion for summary judgment, but remanded the case to allow the taxpayer the opportunity to present facts to support an estoppel argument.

In short, the Department's delay in acting on the taxpayer's petition for correction of assessment in this case does not affect the validity of the assessment. Further, the taxpayer has neither raised nor proven any facts that would support an estoppel or other argument. As such, the taxpayer's petition is denied with respect to this issue.

However, because the delay in issuing this decision was for the sole convenience of the Department, we will waive interest on the portion of the assessment that is upheld in this decision for the period commencing one year after the taxpayer filed its petition through the payment due date as set forth in this decision. We base the waiver on RCW 82.32.105. That statute provides in pertinent part as follows:

> The department shall waive or cancel interest imposed under this chapter if:
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> . . .
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> The extension of a due date for payment of an assessment of deficiency was not at the request of the taxpayer and was for the sole convenience of the department.

[2] Liquor and Beer Prices. The next issue is whether the Audit Division overstated the prices the taxpayer charged on liquor and beer sales. In calculating the assessment, the Audit Division used prices it stated it received from the taxpayer's owner. However, the taxpayer's owner subsequently filed an affidavit that sets forth different prices. Thus, this issue turns, in part, on the taxpayer's credibility.

In Henry Bacon Building Materials, Inc. v. State, BTA Docket No. 89-27, 10 WTD 223 (1991), the Board of Tax Appeals set forth criteria that are helpful in evaluating the credibility of conflicting statements. The Board stated:

> We must resolve this conflicting testimony on the basis of our judgment of witness credibility. There are no fixed rules which serve as the test of credibility of a witness. Among the important factors which should be considered are: (1) the opportunity and capacity of the witness to observe the act or event, (2) the character and reputation of the witness for truthfulness, (3) prior inconsistent statements or actions, (4) bias or lack thereof, (5) consistency with or contradiction by other evidence, (6) inherent improbability, and (7) demeanor of the witness. See generally 81 Am. Jur. 2d Witnesses 662-669 (1976); In re Gallinger's Estate, 31 Wn.2d 823, 199 P.2d 575 (1948).

Although the taxpayer's owner has more reason than the auditor to be biased with respect to the prices of the drinks (because this amount has a direct impact on the amount of the assessment), we find that this factor is outweighed by other factors that lend credibility to the owner's statement.

First, we find that the owner had the best opportunity to observe the drink prices in his establishment during the audit period. While the Audit Division may have known the prices at the time of audit, it probably did not directly observe the prices during the preceding four-year period covered by the audit.

Second, we note that the Audit Division and the taxpayer are consistent in their statements as to the drink prices at the end of the audit period. The disagreement involves the prices during the earlier years of the audit period. This inconsistency is most likely the result of the either the taxpayer's owner misunderstanding that the Audit Division was requesting prices for the entire four year period or the Audit Division's misunderstanding that the taxpayer was giving prices that were in effect at the time of the question only. Thus, the taxpayer's statement to the Audit Division and its statement in the affidavit are most likely consistent statements.

Third, as the Audit Division itself recognized, it is probable that the beer and drink prices increased during the audit period, as prices in general tend to increase over time. This probability is consistent with the taxpayer's statement in the affidavit.

Finally, we find that the demeanor of the taxpayer's owner lends credibility to his statements. He was forthright in his answers to questions, and he has admitted that he was responsible for not overseeing his business as well as he should have. Thus, based on our evaluation of the credibility of the witness, we find that the drink and beer prices set forth in the owner's affidavit were the correct prices during the audit period.

[3] Liquor Stolen by Bartender. The next issue is whether, in calculating its income, the taxpayer properly excluded the amounts that it contends were stolen by one of its bartenders and the amounts that the bartenders gave away to customers or intentionally over-poured in exchange for tips.

First, we must determine whether these amounts were actually stolen or given away by the bartenders. Again, we recognize that the taxpayer has reason to be biased on this issue because the stolen amounts and amounts that were given away may be excluded from the calculation of income upon which the assessment is based. However, based on other factors, we find the statements of the taxpayer's owner on this issue to be credible. First, the owner had the opportunity to observe its employees and the amounts of liquor that were missing from inventory. Second, because of difficulties in the owner's personal life, he was not overseeing his business as carefully as he should have, which would give this bartenders opportunity to steal the liquor and to give it away. Third, with respect to the bartender that stole liquor, the owner took actions that were consistent with his belief that the bartender was stealing liquor. While the owner did not file criminal charges against the offending bartender, the owner did terminate the bartender upon the owner's discovery of the theft. As such, we find that the taxpayer has proven that the bartender stole liquor.

Having determined that one bartender did, in fact, steal liquor from the taxpayer and that the bartenders gave away the liquor in exchange for tips, we must next address how the stolen amounts affect the calculation of the taxpayer's income. Essentially, as explained above, the Audit Division's method in calculating the taxpayer's income was to determine the total number of bottles purchased, multiply this figure by the number of drinks per bottle, and then multiply the result by the price per drink. The taxpayer argues that the stolen liquor must be subtracted from the total number of drinks per bottle. Basically, according to the taxpayer, because the stolen liquor was not available for sale to customers, it cannot be included in the taxpayer's income.

We agree. We note that this is not a case where a taxpayer's employee steals money from the taxpayer after the taxpayer has earned the income. Instead, this is a case where the employee has stolen inventory, which prevents the taxpayer from earning income from the inventory. As such, there can be no "gross proceeds of sales" or "selling price"[3] from this inventory upon which to base retailing B&O or retail sales tax. Similarly, the liquor that was intentionally over-poured and given away as free drinks to the customers in exchange for tips did not give rise to gross proceeds of sales or result in a selling price.

Because of the bartenders' theft of liquor and over-pouring and giving away drinks, we find that the taxpayer is entitled to an over-pour allowance in excess of the industry standard of 8% reflected on the WSLCB chart. Further, we find the taxpayer's calculations of the amounts stolen and given away to be credible. Thus, we find that the taxpayer properly excluded these amounts from the calculation of income.

The Audit Division argues that the theft by the bartenders of liquor could be considered "employee meals." Meals provided to employees free of charge by their employers are subject to retailing

[3] The retailing B&O tax is measured by "gross proceeds of sales." See RCW 82.04.250. RCW 82.04.070 defines "gross proceeds of sales" as "the value proceeding or accruing from the sale of tangible personal property and/or for services rendered." The retail sales tax is measured by the "selling price." RCW 82.08.020. The "selling price" is defined in RCW 82.08.010 as " the consideration . . . expressed in the terms of money paid or delivered by a buyer to a seller."

B&O tax and retail sales tax. WAC 458-20-119 (Rule 119). The theory underlying this result is that the employer provides the meals to the employees in exchange for the services provided by the employee; in effect, the employee pays for the meal with its services. See WAC 458-20-124 (Rule 124)("Meals provided to employees are presumed to be in exchange for services received from the employee and are retail sales and also subject to the retailing tax.") Although we note that there is a real question whether liquor could be considered an "employee meal," we need not decide this issue. Because the employee stole this liquor, the liquor was not "provided to employees . . . in exchange for services received," i.e., the taxpayer did not voluntarily give the liquor to the bartender in exchange for the bartender's services. As such, the stolen liquor is not taxable to the taxpayer as an employee meal.

[4] Liquor Consumed by the Taxpayer's Owner. The next issue is whether the consumption by the taxpayer's owner of products that were purchased for resale negates the taxpayer's liability for tax with respect to such products. The taxpayer did not pay retail sales tax when it purchased the liquor because it purchased the liquor for resale to its customers. However, RCW 82.04.050 defines the term "retail sale" to include:

> every sale of tangible personal property . . . other than a sale to a person who (a) purchases for the purpose of resale as tangible personal property in the regular course of business without intervening use by such person, . . .

(Emphasis added.) In accordance with the above statute, a person who purchases tangible personal property for resale in the regular course of business without intervening use need not pay sales tax. However, no such exemption exists for a purchaser who uses the item. WAC 458-20-102 (Rule 102) specifically addresses this situation. The rule provides:

> If the buyer gives a resale certificate for all purchases and thereafter consumes some of the articles purchased, the buyer must set up in his or her books of account the value of the article used and remit to the department of revenue the applicable deferred sales tax. The deferred sales tax liability should be reported under the use tax classification on the buyer's excise tax return.

Thus, because the taxpayer's owner used the liquor, the taxpayer is liable for "deferred" sales tax on the liquor. This situation stands in contrast to the situation where the taxpayer's employees stole the liquor. In that situation, the taxpayer did not take any action to convert the liquor to its own use. Instead, the action was taken by the taxpayer's employees, without the consent of the taxpayer.

However, as noted above, because this liquor was not sold by the taxpayer, no B&O tax or retail sales tax is due on such amounts, and these amounts should be excluded from the "drinks per bottle" calculation used to determine the number of drinks the taxpayer sold. Instead, as set forth above, the taxpayer is liable for deferred sales tax, based on the cost of the liquor.

[5] Evasion Penalty. RCW 82.32.090 authorizes the Department to impose an evasion penalty if "all or any part of the deficiency resulted from an intent to evade the tax payable hereunder." The

amount of the penalty is fifty percent of the additional tax found to be due. RCW 82.32.090. In Det. No. 94-007, 14 WTD 174 (1995), we explained the evasion penalty as follows:

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

Thus, the issue is whether the Audit Division presented sufficient evidence for us to find that the taxpayer "acted with the specific purpose of escaping a tax liability which the taxpayer knew to exist." The Audit Division argues that the taxpayer was aware of its tax liability because it had been registered with the Department since 1986. While we agree that the taxpayer was aware of its reporting obligations to the state, the fact that the taxpayer was a registered business does not prove that the taxpayer was aware that it had been underreporting its liquor and beer sales. Further, we note that the fact that the taxpayer was registered and was properly reporting its food sales and game income in all but one quarter reflects that the taxpayer did not act with "the specific purpose of escaping a tax liability which the taxpayer knew to exist." As discussed above, we found the taxpayer's testimony regarding the acts of its bartenders to be credible, and we find nothing in the record to support the proposition that the taxpayer was aware of its underreporting.

The Audit Division also argues that because the taxpayer's business is a retail cash sales business, it is clear that sales tax trust funds were involved. The Audit Division noted that the taxpayer has "clearly collected sales tax trust funds from his customers and put them to his own use rather than submit them to the Department of Revenue." While it is true that sales tax trust funds were involved and that the taxpayer underreported these taxes, these two facts do not support imposition of the evasion penalty. This case stands in sharp contrast to Sunrise Fiberglass Engineering, Inc. v. State, BTA Docket No. 41913, 13 WTD 203 (1993). The issue in that case was not whether the evasion penalty should be assessed, but was instead whether the Department proved that the taxpayer fraudulently underreported its taxes such that the statute of limitations for the assessment of taxes would be tolled. The BTA held that the statute was tolled. In contrast to the taxpayer here, who appears to have inadvertently underpaid its taxes, the taxpayer in Sunrise underpaid its taxes pursuant to a systematic scheme. Specifically, the taxpayer properly accounted for and reported sales taxes collected on the first three or four invoices each month. Thereafter, however, the taxpayer reported the amounts received under the "manufacturing" B&O tax classification, thus representing that the sales were made out-of-state and not subject to sales tax.

In short, we find that the Audit Division has not met its burden of proving by clear, cogent, and convincing evidence that the taxpayer underpaid its taxes with an intent to evade.

DECISION AND DISPOSITION:

The taxpayer's petition is granted in part and denied in part. The taxpayer's file is remanded to the Audit Division for adjustment consistent with this decision.

Dated this 27th day of April, 1998.