Cite as Det. No. 14-0268, 33 WTD 637 (2014)

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. 14-0268
. . .	)	Registration No. . . .

[1] RCW 82.32.090(7); WAC 458-20-228(5)(f): EVASION PENALTY – INTENT TO EVADE; MOTIVATION. A Taxpayer's difficult financial circumstances explain its motivation for tax evasion, but do not negate its intent to evade. With intentional evasion, there is no basis for waiving 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.

Munger, A.L.J. – The taxpayer, a building contractor on an active nonreporting status, collected retail sales tax from customers and did not remit it for several years. It appeals the 50% tax evasion penalty imposed on the amount of retail sales tax it collected but did not remit. Because the failure to remit these retail sales tax trust funds was intentional, we uphold the penalty.[1]

ISSUE

Whether, [under RCW 82.32.090(7) and WAC 458-20-228(5)(f)], the Taxpayer is liable for the 50% evasion penalty when it collected but did not remit retail sales tax for several years . . . .

FINDINGS OF FACT

[Taxpayer] is a building contractor. The Taxpayer was audited by the Department of Revenue (the Department) for the period of January 1, 2009, through June 30, 2013. As a result of the audit, a tax assessment was issued February 12, 2014, which included $. . . in retail sales tax, $. . . in retailing B&O tax, $. . . in use tax, and $. . . for the 50% evasion penalty. With credits, other penalties, and interest, the total assessment when issued was $. . . . The assessment remains unpaid.

The Taxpayer is appealing only the 50% evasion penalty of $. . . . During the audit period, the Taxpayer collected $. . . in retail sales tax from consumers. Sales tax was separately stated on

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

299 (almost all) of the invoices issued to Washington customers. The retail sales tax was generally collected at the correct rate.

Prior to the current audit period, on January 4, 2008, Mr. …, the Taxpayer's President, advised the Department that he only performed real estate development/speculative construction, and requested that his tax reporting account be put on a nonreporting status. The Department granted the request. The Taxpayer filed no excise tax returns during the audit period. However, during this period, the Taxpayer engaged in retail construction, and earned more than $. . . . The Taxpayer also did construction work in Oregon, not at issue here. After January 4, 2008, and until being contacted by the Department's Audit Division, in October of 2012, the Taxpayer did not reactivate his UBI account with the Department.[2]

The Taxpayer's owner explained that the company originally did speculative construction, but that after a 2007 condo project stalled, becoming a 2-3 year legal problem, the company began doing retail construction. During the 2009 through 2012 period, the company did charge and collect retail sales tax. During this period there were times when the company did not have a bookkeeper, and the business was struggling to keep afloat. The President describes that he was not trying to hide the problem, but that the company couldn't afford to pay the tax. As of the above hearing date, he hoped to be able to do so in another 90 days. The owner did not realize how serious the retail sale tax issue was until contacted by the Department.

ANALYSIS

RCW 82.32.090(7) mandates the imposition of the 50% evasion penalty when "…the department finds that all or any part of the [tax] deficiency resulted from an intent to evade the tax…" WAC 458-20-228(5)(f) [Rule 228], the Department's administrative rule regarding the evasion penalty states:

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[2] RCW 82.32.045(4) and WAC 458-20-101(3) allow the Department to relieve qualifying taxpayers from the requirement to file tax returns. Businesses assigned to this status are not required to file excise tax returns. Businesses retain their Unified Business Identifier (UBI number), and Department's tax registration number, and are considered to be actively doing business in Washington. To qualify for the "active nonreporting" status, all of the following criteria must be met:

- The Taxpayer's business activity does not require the collection of retail sales tax.
- The business is not required to collect or pay to the Department any other tax or fee which the Department is authorized to collect. This includes the retail sales tax.
- Gross proceeds of sales, gross income, or value of products for B&O tax classifications is less than $28,000 per year.

Persons placed on an active nonreporting status by the department are required to timely notify the department if their business activities do not meet any of the above conditions. These persons will be removed from an active nonreporting status, and must file tax returns and remit appropriate taxes to the department, beginning with the first period in which they do not qualify for an active nonreporting status. The present Taxpayer does not dispute that he did not qualify for the active, nonreporting status during the audit period, nor did it ever contact the Department to disclose its change in business activities to retailing.

(f) **Evasion.** If the department finds that all or any part of the deficiency resulted from an intent to evade the tax due, a penalty of fifty percent of the additional tax found to be due will be added. RCW 82.32.090(7). The evasion penalty is imposed when a taxpayer knows a tax liability is due but attempts to escape detection or payment of the tax liability through deceit, fraud, or other intentional wrongdoing. An intent to evade does not exist where a deficiency is the result of an honest mistake, miscommunication, or the lack of knowledge regarding proper accounting methods. The department has the burden of showing the existence of an intent to evade a tax liability through clear, cogent and convincing evidence.

RCW 82.08.050(2) addresses the additional special responsibilities applying to the collection of retail sales taxes:

(2) The tax required by this chapter, to be collected by the seller, is deemed to be held in trust by the seller until paid to the department. Any seller who appropriates or converts the tax collected to the seller's own use or to any use other than the payment of the tax to the extent that the money required to be collected is not available for payment on the due date as prescribed in this chapter is guilty of a gross misdemeanor.

In Det. No. 04-0098, 23 WTD 331 (2004) we further described this requirement for retail sales tax trust funds in this manner:

> A seller, as trustee of retail sales tax funds collected from purchasers, stands in a fiduciary relationship with the state. A trustee owes to the beneficiary of the trust the highest degree of good faith, diligence, loyalty, and integrity; a trustee must act solely in the beneficiary's interest.

With the trust fund requirements in mind, we turn to the standards for application of the evasion penalty. We have held that in order to sustain an assessment of the evasion penalty, the Department must first present evidence of each of the two elements of evasion. By statute, these are that the taxpayer knows a tax liability is due and the taxpayer attempts to escape detection through deceit, fraud, or other intentional wrongdoing.[3] The burden is on the Department to prove the existence of these elements. In order to meet this burden, the evasion must be shown by "clear, cogent, and convincing evidence." Rule 228(5)(f). Mere suspicion of intent to evade is not enough to meet this burden. Det. No. 90-314, 10 WTD (1990); Det. No. 04-0098, 23 WTD 331 (2004).

In upholding an assessment of the evasion penalty, we must find that the taxpayer acted with intent. For this purpose, DOR must show that the taxpayer acted with the specific purpose of escaping a tax liability which the taxpayer knew to exist. "The intent with which an act is done is a mental process, and as such generally remains hidden within the mind where it is conceived, and is rarely, if ever, susceptible of proof by direct evidence." However, intent may be inferred or gathered from the outward manifestations, by the words or acts of the person entertaining it, and the facts or circumstances surrounding [the alleged offense]." *State v. Gaul*, 88 Wash. 295,

[3] *See also* WAC 458-20-230(4).

152 P. 1029 (1915); *see also* Det. No. 99-049, 20 WTD 136 (2001), Det. No. 99-141, 19 WTD 638 (2000), and Det. No. 87-188, 3 WTD 219 (1987).

Intent to evade does not exist where a tax deficiency was due to an honest mistake, an unsuccessful attempt at legitimate tax avoidance, inefficiency, or ignorance of proper accounting methods. Even gross negligence will 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. *Id*.; Det. No. 92-133, 12 WTD 171 (1992); Det. No. 98-120, 18 WTD 132 (1999).

Although not controlling, the penalty is usually assessed where the taxpayer is or should be knowledgeable of tax laws, based on business or tax experience. Det. No. 87-273, 4 WTD 41 (1987). Business experience tends to undercut or negate the possibility that a taxpayer was unaware that it was required to report and pay taxes.

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.

In Det. No. 04-0098, 23 WTD 331 (2004) we considered circumstances similar to the ones in the present appeal:

> In Taxpayer's case, Taxpayer concedes he knew payment of a tax liability was due, and he deliberately did not file tax returns because he intended to defer payment of the taxes until his financial situation improved. We find these undisputed facts are clear, cogent and convincing evidence showing evasion. The law does not require DOR to prove that Taxpayer intended to forever evade payment. Even if a taxpayer intends to evade payment only on a temporary basis, the taxpayer is subject to the evasion penalty. Det. No. 91-173, 11 WTD 215 (1991).

In that case we also noted that the "Taxpayer's mistake or ignorance was not about whether he was required to report and pay taxes, but rather about the amount of the penalty he was incurring for his deliberate failure to report and pay."

In two other determinations we have also addressed the issue of distinguishing between a Taxpayer's intent as contrasted with motivation. In Det. No. 99-141, 19 WTD 638 (2000) we stated that "…the *motivation* for filing the false returns, *i.e.* financial difficulties brought on by poor health, is not a defense to the RCW 82.32.090(5) evasion penalty. [19 WTD 638 (emphasis added).] In Det. No. 97-134R, 18 WTD 163 (1998) we again stated that: "The expense of the taxpayer's drug addiction may have provided the motivation for the tax evasion, but no evidence has been provided that shows he was unable to form the intent to evade taxes." In this later

determination we upheld the evasion penalty, finding that: "Retail sales tax was routinely collected at the correct rate from customers" and that "Even more egregious is that the taxpayer did not remit the collected retail sales tax trust funds to the Department." Det. No. 97-134R, [18 WTD 163].

In the present case, the audit report correctly summarized the key facts demonstrating evasion as:

1. Taxpayer collected retail sales tax from his Washington customers throughout the audit period.
2. Retail sales tax is separately stated on all but one sales invoice.
3. The retail sales tax rate charged was the correct tax rate for of the each of the locations where work was performed.

Taken together, we find these facts demonstrate by clear, cogent and convincing evidence that the taxpayer had knowledge of its tax responsibility, but intentionally disregarded it by collecting and not remitting, even to the present date, the retail sales tax trust funds. Consequently we affirm the evasion penalty as it was applied to the collected retail sales tax.[4]

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 20th day of August, 2014.

[4] The evasion penalty was not applied to the B&O tax liability in this case.