

Cite as Det. No. 04-0098, 23 WTD 331 (2004)

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. 04-0098
)	
. . .)	Registration No. . . .
)	Document No. . . .
)	Audit No. . . .
)	Docket No. . . .

- [1] RULE 228; RCW 82.32A.030, RCW 82.32.090, RCW 82.32.105: PENALTY – WAIVER – TAXPAYER RESPONSIBILITIES – ALLEGED DEPARTMENT FAILURE TO PROMPTLY CONTACT TAXPAYER WHO DID NOT FILE. Taxpayers are responsible for knowing their tax reporting obligations and for paying taxes in a timely manner. That a registered taxpayer might not have continued failing to file returns or failed to remit collected retail sales tax had the Department contacted the taxpayer when he first missed a filing deadline, and advised the taxpayer of the consequences of such failure, is not a basis for reducing the penalties incurred by the taxpayer’s failures.

- [2] RULE 228; RCW 82.32.105: PENALTY – WAIVER – FINANCIAL HARDSHIP. The fact that paying a penalty would create a financial hardship, or receiving a refund of a penalty would relieve a financial hardship, is not a basis for waiving, canceling, or reducing penalties.

- [3] RULE 228, RULE 230; RCW 82.32.090: EVASION PENALTY. Evidence that the taxpayer knew he had a tax liability and knew he was required to report and pay, but deliberately did not file tax returns because he intended to defer payment of the taxes until his financial situation improved, establishes intent to evade.

- [4] RULE 228, RULE 230; RCW 82.32.090: EVASION PENALTY. Even if a taxpayer intends to evade payment of taxes only on a temporary basis, the taxpayer is subject to the evasion penalty.

- [5] RULE 228, RULE 230; RCW 82.32.090: EVASION PENALTY. A taxpayer’s ignorance or mistake about the amount of penalty the taxpayer incurs by not

timely filing tax returns and remitting collected retail sales tax is not the sort of ignorance or mistake that overcomes a finding of intent to evade.

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.

Prusia, A.L.J. – A construction contractor who was newly in business and had registered with the Department of Revenue (DOR), engaged in retail activity and collected retail sales tax for three years without reporting the income or collected tax. He appeals the assessment of a 50% evasion penalty, 25% late return penalty, 5% assessment penalty, and interest. The taxpayer did not report or pay the taxes because he needed the money to pay bills and support his family, and because he understood that he could defer reporting and payment for three years and only incur a penalty of 25%. He faults DOR for not promptly contacting him and alerting him that the penalty could be higher, which he states would have stopped further delinquencies. He asks that the penalties and interest be cancelled because of these circumstances. He also asks that the penalties and interest be cancelled because he presently is financially unable to pay those amounts, because he was out of work for several months due to injuries. We are unable to cancel the late return penalty, assessment penalty, or interest under these circumstances. The evasion penalty was properly assessed, and is sustained. We deny the petition.¹

ISSUES

1. May DOR cancel the 25% late payment of return penalty assessed under the circumstances presented?
2. May DOR cancel the 5% assessment penalty under the circumstances presented?
3. May DOR cancel the interest added under the circumstances presented?
4. Has DOR shown by clear, cogent, and convincing evidence that the taxpayer intended to evade the retail sales tax payable?

FINDINGS OF FACT

. . . (the taxpayer) is a construction contractor. His business activities in Washington included framing and siding work on single family homes, primarily for speculative builders. He registered with DOR in March 2000, and was placed on quarterly reporting status. He filed the first excise tax return that was due, but had no income for that quarter. Throughout the subsequent twelve quarters (i.e., through June 2003), he had income from retail construction activity, and collected retail sales tax from his customers, but did not file tax returns or remit the collected retail sales tax.

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

In the third quarter of 2003, DOR's Audit Division examined the taxpayer's books and records for the period January 1, 1999 through June 30, 2003. The investigation found that the taxpayer had no income before registering in 2000, but thereafter had income and collected taxes as stated above. On September 24, 2003, the Audit Division issued assessment number . . . for additional retail sales tax and retailing Business and Occupation (B&O) tax for the audit period totaling \$. . . , plus a 50% evasion penalty on the collected retail sales tax of \$. . . , a 25% delinquency penalty of \$. . . , a 5% assessment penalty of \$. . . , and interest of \$ The taxpayer appeals the assessment of the penalties and interest.

The taxpayer did not report or remit the taxes during the audit period because he needed the money to pay his bills and support his family of seven. The taxpayer states he looked at some Internal Revenue Service information when he started his business, and understood that he could delay paying taxes for up to three years and would incur a maximum penalty of 25%. His income was zero initially, and the business grew very slowly. He decided to defer reporting and paying taxes and incur the 25% penalty, with the expectation that as his earnings increased, he would be able to pay the past due taxes and the 25% penalty. He states he did not intend to evade paying the taxes, he just could not afford to pay them at the time they were due. He provided the Audit Division with all the information he had on his income and retail sales tax collected when he was audited, and did not try to hide anything.

The taxpayer states that if DOR had personally contacted him sooner about his failure to file returns, and let him know that the consequences of his failure were much greater than he assumed, he would have avoided further delinquencies. He states that DOR's inaction accounts for most of the penalty dollars, because his income and taxes owed were very small before 2002-2003.²

The taxpayer states he currently is not financially able to pay both the taxes due and the other components of the assessment. He broke two ribs and injured his shoulder, and because of the injuries was unable to work between September and December 2003. He states that paying the full amount of the assessment would require him to sell everything and go out of business.

ANALYSIS

² The petition states (spelling or typo errors are Taxpayer's): "I was sent notices and final notices for taxes since I opened my business in 2000 until 2003. But in that time period no one contacted us until July 2003. In that time period I don't understand that if I was doing something wrong why wasn't I contacted sooner then this could of be resolved a long time ago. I was lead to believe I had three years to pay my taxes with only a maximum penalty of 25%."

The taxpayer engaged in business in Washington as a prime contractor during the audit period. His work for speculative builders was subject to B&O tax at the retailing rate, and he was required to collect retail sales tax on the full contract price. Rule 170.³

The retail sales tax is imposed on the buyer, and the seller is required to collect the tax on each taxable sale. The collected tax is deemed to be held in trust by the seller until paid to DOR. RCW 82.08.050.

Persons who engage in taxable activity in Washington have the responsibility to register with DOR, and to accurately report and timely pay taxes. RCW 82.32.030; RCW 82.32A.030(1) and (2). For taxpayers who are on a quarterly reporting schedule, the due date for payment of taxes, including retail sales tax, falls on the last day of the month following the close of the quarter. RCW 82.32.045; WAC 458-20-228 (Rule 228).

If a taxpayer fails to timely file excise tax returns, DOR is required to assess a late payment of return penalty. RCW 82.32.090(1). The amount of the penalty varies depending upon how long a return is delinquent. For tax returns that are filed after July 1, 2003, late payment penalties start at 5% of the amount of the tax, increasing to a maximum of 25% if the tax has remained unpaid after the last day of the second month following the due date. RCW 82.32.090(1) and Chapter 13, Laws of 2003, 1st Sp. Sess.

Beginning July 1, 2003, DOR is required to add a 5% penalty to all billings and assessments. RCW 82.32.090(2) and Chapter 13, Laws of 2003, 1st Sp. Sess.

When a taxpayer fails to timely pay taxes due on a return, the Department also is required to add interest on the tax due. RCW 82.32.050.

If DOR finds that all or any part of the tax deficiency resulted from an intent to evade the tax payable, it must add a further penalty of 50% of the tax found due. RCW 82.32.090.

Delinquency penalty, assessment penalty, and interest

We will first discuss the 25% delinquency penalty, the 5% assessment penalty, and the interest added to the taxes due. We will discuss the evasion penalty separately.

³ Washington imposes a B&O tax “for the act or privilege of engaging in business” in the State of Washington. RCW 82.04.220. The measure of the B&O tax is the gross income of the business; the rate of the tax depends upon the activity engaged in by the taxpayer. RCW 82.04.220.

RCW 82.08.020 imposes a retail sales tax on each retail sale in this state. The seller is required to collect the tax from the buyer and remit the collected tax to DOR. RCW 82.08.050. The term “retail sale” includes the constructing, repairing, or improving of new or existing buildings on real property of or for consumers. RCW 82.04.050(2)(a); WAC 458-20-170 (Rule 170). Rule 170 explains that prime contractors, who are persons performing construction for consumers, are making retail sales. The retail sales tax is measured by the full contract price.

The taxpayer failed to timely file returns for twelve quarters, beginning with the third quarter of 2000. No returns for those quarters were filed before July 1, 2003, and therefore the penalties prescribed by Chapter 13, Laws of 2003, 1st Sp. Sess. applied -- DOR was required to impose a late return penalty of 25% and a 5% assessment penalty. DOR also was required to add interest on the overdue taxes.

In limited circumstances, DOR can waive or cancel delinquency penalties and interest. However, DOR is an administrative agency, and its authority to waive or cancel penalties and interest is limited to the authority the Legislature has granted. DOR is given no discretionary authority to waive or cancel penalties or interest. Det. No. 98-85, 17 WTD 417 (1998); Det. No. 99-285, 19 WTD 492 (2000).

DOR's authority to cancel penalties is set out in RCW 82.32.105.⁴ Subsection 1 authorizes DOR to waive any penalties imposed under Chapter 82.32 if the failure of the taxpayer to pay the full amount due by the due date "was the result of circumstances beyond the control of the taxpayer." This provision would apply to both the late payment penalty imposed under RCW 82.32.090(1) and the assessment penalty imposed under RCW 82.32.090(2). RCW 82.32.105(2) provides that if the circumstances do not qualify for waiver under subsection 1, DOR may waive a penalty imposed under RCW 82.32.090(1) (late payment penalty) if the taxpayer has been registered and has a good payment history.

Taxpayer had no payment history, so good payment history is not a possible basis for relief. RCW 82.32.105 does not define what the term "circumstances beyond the control of the taxpayer" means, but DOR has explained, and given examples of the term, in WAC 458-20-228 (Rule 228), subsection (9). The rule sets out seven circumstances that may be considered "beyond the control of the taxpayer."⁵ The rule also lists circumstances that are generally not considered to be beyond the control of the taxpayer.⁶

The taxpayer states four reasons for not timely filing or paying taxes for the twelve quarters. The first is that he could not afford to pay the taxes. Rule 228 specifically lists "financial hardship" as a circumstance that is generally **not** considered beyond the control of the taxpayer, and will **not**

⁴ RCW 82.32A.020(2) is another limited source. It gives taxpayers the right to have penalties waived where they have detrimentally relied on specific, official written advice from DOR to them. This circumstance is covered by RCW 82.32.105(1), as interpreted by DOR in WAC 458-20-228.

⁵ The seven are (short-hand descriptions): inadvertently mailing the return to another agency; erroneous written information given by a DOR officer or employee; death or serious illness of the taxpayer or a member of the immediate family or of the tax preparer or the preparer's immediate family; unavoidable absence of the taxpayer or key employee prior to the filing date; destruction of the taxpayer's place of business or records; fraud, embezzlement, theft, or conversion by an employee or contracted person that the taxpayer could not immediately detect or prevent; and the taxpayer had timely requested forms from DOR but DOR had not provided them in sufficient time for the return to be paid before the due date.

⁶ These circumstances include "financial hardship" and "a misunderstanding or lack of knowledge of a tax liability."

qualify for waiver or cancellation of penalty. We conclude that the taxpayer's financial hardship is not a basis for us to cancel the late payment penalties.

The second reason given is that the taxpayer was unaware that he was potentially incurring penalties exceeding 25%, and had he known the penalties might be larger, he would not have deferred paying the taxes. Rule 228 specifically lists "a misunderstanding or lack of knowledge of a tax liability" as a circumstance that is generally **not** considered beyond the control of the taxpayer, and will **not** qualify for waiver or cancellation of penalty. We conclude that the taxpayer's lack of knowledge of the consequences of his failure to report and pay taxes is not a basis for us to cancel the late payment penalties.

[1] The third reason given relates to penalties incurred after the first quarter. The taxpayer contends he would not have been delinquent for future quarters if DOR had promptly contacted him after he first failed to file quarterly returns. This is not a circumstance that Rule 228 lists as one that is generally considered to be beyond the control of the taxpayer. Moreover, treating it as a circumstance that excuses late payment of taxes would be incompatible with Washington's tax system. RCW 82.32A.005 states, in pertinent part:

The legislature further finds that the Washington tax system is based largely on voluntary compliance and that taxpayers have an obligation to inform themselves about applicable tax laws. The legislature also finds that the rights of the taxpayers and their attendant responsibilities are best implemented where the department of revenue provides accurate tax information, instructions, forms, administrative policies, and procedures to assist taxpayers to voluntarily comply

Consistent with this legislative finding, RCW 82.32A.030 places on taxpayers the obligations to "[f]ile accurate returns and pay taxes in a timely manner," and to "[k]now their tax reporting obligations, and when they are uncertain about their obligations, seek instructions from the department of revenue." RCW 82.32A.020(5) gives taxpayer the right to receive, "upon request," clear and current tax instructions, rules, procedures, forms, and other tax information. DOR is not required to personally contact every taxpayer who fails to file a return to make sure the taxpayer understands the consequences of that failure.

Knowing the consequences is the taxpayer's responsibility. Also, if the taxpayer had at least filed a return reporting his income, DOR would have given him the information regarding penalties for nonpayment that he now argues would have made a difference. We conclude that the cause of the taxpayer's delinquencies was the taxpayer's own failure to meet his responsibilities. The circumstance argued by the taxpayer is not a basis for waiving or canceling delinquency penalties.

[2] Finally, the taxpayer requests cancellation of the penalties for the reason that paying the penalties would be a financial hardship. He states it would force him to go out of business. DOR has consistently held that the fact that paying a penalty would create a financial hardship, or receiving a refund of a penalty would relieve a financial hardship, is not a basis for waiving,

canceling, or refunding penalties. Det. No. 94-16, 14 WTD 184 (1994); Det. No. 90-340, 11 WTD 81 (1990); Det. No. 87-348, 4 WTD 281 (1987); *see also* Det. No. 87-300, 4 WTD 101 (1987). However, it is a circumstance DOR's Compliance Division, in the exercise of its discretion, may take into account in deciding whether to accept installment payments of a tax debt.

Turning to the request for cancellation of the interest, the Department's authority to waive or cancel interest is set out in RCW 82.32.105(3).⁷ That statute authorizes DOR to waive or cancel interest only in the following circumstances:

- (a) The failure to timely pay the tax was the direct result of written instructions given the taxpayer by the department; or
- (b) 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.

We find that neither RCW 82.32.105(3) circumstance is present in this case.

In sum, DOR does not have the authority to cancel the 25% late payment penalty, the 5% assessment penalty, or the interest assessed in this case, and taxpayer's petition for cancellation of those penalties and interest must be denied.

Evasion penalty

"Evasion involves a situation where the taxpayer knows a tax liability is due and the taxpayer attempts to evade detection through deceit, fraud, or other intentional wrongdoing." WAC 458-20-230(4) (Rule 230).

We have held that in order to sustain an assessment of the evasion penalty, DOR must first present evidence of each of the two elements set out in Rule 230. The burden is on DOR to prove the existence of these elements. In order to meet this burden, "[t]he evasion must be shown by clear, cogent, and convincing evidence, which is objective and creditable." Rule 230(4). Mere suspicion of intent to evade is not enough to meet this burden. Det. No. 90-314, 10 WTD (1990).⁸

⁷ A Department rule, WAC 458-20-228 (Rule 228), repeats the RCW 82.32.105(3) provisions. RCW 82.32A.020(2) also provides limited authority, but simply repeats the authority provided in RCW 82.32.105(3)(a). RCW 82.32A.020(2) provides that the taxpayers of the state have "[t]he right to rely on specific, official written advice and written tax reporting instructions from the department of revenue to that taxpayer, and to have interest, penalties, and in some instances, tax deficiency assessments waived where the taxpayer has so relied to their proven detriment."

⁸ The Board of Tax Appeals has said that in the case of the retail sales tax, a prima facie showing of fiduciary fraud, and hence a prima facie showing of tax evasion, is made simply by showing that the seller has collected and failed to turn over the funds to DOR. 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. Unexcused failure to timely turn over trust funds actually collected by a seller on behalf of the state is a breach of the seller's fiduciary duty, and amounts as a matter of law to fraud on the state. *Sunrise Fiberglass Engineering v. Dept. of Revenue*, BTA Docket No. 41913, 13 WTD 203 (1993), and *David Grimes v. Dept. of Revenue*, BTA Docket No. 51276 (1998).

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, 152 P. 1029 (1915); *see also* Det. No. 99-049, 20 WTD 136 (2001).

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 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 DOR 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 DOR'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 DOR. Because the burden placed on the taxpayer is one of production only, the burden of proof as to evasion still rests with DOR. The evidence of evasion presented by DOR when viewed alone, or along with the taxpayer's evidence, must weigh heavily in favor of upholding the assessment.

[3] [4] 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).

[5] Taxpayer has come forward with evidence of some mistake or ignorance of the law, and evidence of inexperience with state taxes. However, the evidence does not rebut DOR's evidence. 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. He concedes he intended to not report or pay when the taxes were due, and his mistake does not in any way negate that intent. He was inexperienced in state tax matters, but inexperience is relevant on the issue of intent only when a taxpayer claims it was unaware or mistaken about its tax obligation, which is not the case here.

We appreciate Taxpayer's cooperation with the Audit Division when it contacted him to examine his records, but that does not affect his liability for the evasion penalty. Any attempt to evade payment of collected retail sales tax is a very serious matter. We realize that this is not the most egregious case of evasion. Taxpayer did not deliberately fail to register, file false reports, or take actions to evade detection beyond not filing, and did not lie when discovered. Taxpayer credibly stated that he planned to eventually report and pay the taxes. If, as Taxpayer claims, paying the penalties all at once would be impossible or create severe financial hardship, these mitigating circumstances are ones DOR's Compliance Division, in its discretion, could take into account in deciding whether to allow payment of the taxes and penalties in installments.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 28th day of April 2004.