

Cite as Det. No. 98-039, 19 WTD 101 (2000)

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. 98-039
	)	
...	)	Registration No. . . .
	)	FY. . . /Audit No. . . .
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- [1] RULE 230; RCW 82.32.050: RETAIL SALES TAX – ASSESSMENT PERIOD – STATUTE OF LIMITATIONS – COLLECTED BUT UNREMITTED SALES TAX – LAUNDRIES. In general, the assessment period may be extended when retail sales tax is collected and not remitted to the state. This tolling of the statute of limitations results from the fraud or misrepresentation inferred from the unexcused failure of a taxpayer holding trust funds to pay over such funds to the state. Such an inference is reasonable because sales tax, with limited exception, is separately stated from the selling price and collected from the buyer. An exception occurs with respect to sales tax levied on sales by coin-operated laundries, where sales tax is not separately stated and collected from the buyer. Under such circumstances, the Department must show by clear, cogent, and convincing evidence that the failure to remit sales tax to the state was the result of fraud or misrepresentation before the assessment period can be extended beyond four years after the close of the tax period.
- [2] RCW 82.32.090: EVASION PENALTY -- PROOF. In order to sustain an evasion penalty, the Department must prove intent to evade by clear, cogent, and convincing evidence. This entails proof that the intent to evade was "highly probable," or stated another way, that evidence was "positive and unequivocal." Intent to evade is highly probable when a taxpayer knows he has a use tax liability and engages in various acts of deceit and misrepresentation to avoid paying the tax.

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:

Taxpayer who operates a laundry business and owns a 45 foot boat protests: (1) the assessment of business and occupation (B&O) tax and retail sales tax exceeds the statute of limitations period; (2) an evasion penalty as a result of a failure to report all income from the laundry business; and (3) an evasion penalty as a result of not paying retail sales or use tax on the purchase of the boat.<sup>1</sup>

#### FACTS:

Mahan, A.L.J. -- In August, 1991 taxpayer purchased a coin-operated laundry. Prior to that time, the taxpayer had been an owner of various business interests registered with the state, including a convenience store. In June, 1994, he added a dry cleaning segment to the business. He then reopened an inactive account and began reporting income from the dry cleaning segment of the business. Prior to June, 1994, he had not reported any income from the laundry. In 1994, he reported income only for the dry cleaning business segment of the business and in 1995 reported only 56% of the income from the laundry business. During that same period of time he had reported his full income on his federal income tax returns. The business was subsequently reregistered as a sole proprietorship.

The Department of Revenue (Department) audited the laundry's records for the January 1, 1991 through March 31, 1996 period. It issued a deficiency assessment on December 11, 1996. The Department concluded that the statute of limitations on assessments was tolled because the taxpayer had failed to register as required, had committed fraud or misrepresentation, and collected sales tax and not reported it to the state. A fifty percent evasion penalty was also assessed.

In response, the taxpayer stated that he was not aware retail sales tax was due on income from coin-operated laundries until he saw an article in a trade magazine in 1994. According to the taxpayer, this occurred about the time he added the dry cleaning business. As to the underreporting of income after June 1994, the taxpayer's representative states:

[The taxpayer] explained that while he had reported all income and remitted all sales tax from July 1994 on the dry cleaning business, he could not do so on the laundry portion (where sales tax is not separately stated but is "deemed" on each coin deposited and must be backed out) until he raised prices, and this in truth could only be done gradually.

The taxpayer also argued the fact that the taxpayer registered and reported income for other business operations shows the taxpayer registers and reports income when he is aware of reporting requirement, rather than showing an intent to evade taxes.

With respect to the B&O tax that was due and not reported, the taxpayer's representative states:

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

Any failure to report prior to that time [1994] can involve only B&O tax on vending machine sales. Therefore, any intent to evade can apply only to failure to report B&O taxes prior to 1993 (the audit cutoff date under the normal period) but not to retail sales tax). The point is that even had [the taxpayer] reported for 1992 what he arguably knew to be his liability for B&O taxes, he would not have known about the sales tax liability.

At the hearing on this matter, the taxpayer was asked to provide a copy of the trade journal article and copies of the records that the taxpayer reviewed when he bought the business. The taxpayer provided a copy of a September 1994 article that indicated that Washington was one of eight states that charges sales tax on coin-operated laundries. He also provided a copy of a summary of expenses from the previous owner, which did not have a line item for taxes. No other records were provided.

The taxpayer operates another sole proprietorship, [a charter business]. That business was audited in conjunction with the audit of the taxpayer's laundry business. The Department discovered that the taxpayer owned two boats during the audit period that were moored at the taxpayer's home. The taxpayer did not pay retail sales or use tax on either purchase, claiming that they were for bare boat charter. One of the boats, a 42 foot boat, was purchased in 1990 and sold in 1993. In 1994, the taxpayer purchased a 45 foot Bayliner. The Department assessed use tax on the purchase of the 45 foot boat, but did not assess tax on the 42 foot boat because the statute of limitation had run on that purchase. The Department also assessed an evasion penalty with respect to the 45 foot boat.

In support of the evasion penalty the Department stated that: (1) no income or deductions were taken on the taxpayers federal income tax return for 1994 and 1995 and, accordingly, the taxpayer was not engaged in a charter activity; (2) the taxpayer took a mortgage interest deduction on his federal income tax return for the boat as a second home; (3) when asked on June 28, 1996 about any personal use of the boat, the taxpayer stated that he knew that if the boat was used for personal use sales tax would be due, he had not personally used the boat, and that the boat had only 20 to 30 engine hours on it from the time of purchase; and (4) Information provided by the United States Customs Service shows that the taxpayer made 17 trips out of the country into Canada and all of the trips were for personal use and none were for charter. After being informed that the Department had information on trips to Canada, the taxpayer admitted making trips lasting a total of 28 days into Canada, and he made other trips to various destinations the in San Juan Islands.

In an attempt to show that he was running a charter business, the taxpayer provided a copy of a form charter agreement and a photograph of the boat with a sign in the window stating that the boat was available for charter.

ISSUES:

1. Should the statute of limitations be tolled as a result of fraud or misrepresentation or as a result of the taxpayer's failure to properly register?
2. Should the evasion penalty for the pre-June 1994 and/or the post-June 1994 periods be imposed as a result of the taxpayer's failure to fully report collected retail sales tax?
3. Should the evasion penalty be imposed with respect to the 45 foot boat that the taxpayer purchased without payment of retail sales or use tax when the taxpayer misrepresented how the boat was used in order to evade paying the tax?

#### DISCUSSION:

[1] The first issue raised by the taxpayer involves the statute of limitations. The applicable statute of limitations provides:

No assessment or correction of an assessment for additional taxes, penalties, or interest due may be made by the department more than four years after the close of the tax year, except (a) against a taxpayer who has not registered as required by this chapter, (b) upon a showing of fraud or of misrepresentation of a material fact by the taxpayer, or (c) where a taxpayer has executed a written waiver of such limitation. The execution of a written waiver shall also extend the period for making a refund or credit as provided in RCW 82.32.060(2).

RCW 82.32.050(3).

In a similar manner, WAC 458-20-230 (Rule 230) provides:

(2) **Assessment period.** Tax assessments must be made within four years after the close of the tax (calendar) year in which the tax was incurred with the following exceptions:

- (a) Against a taxpayer who was not registered as required by chapter 82.32 RCW.
- (b) Upon a showing of fraud or of misrepresentation of a material fact by the taxpayer.
- (c) Where the taxpayer has executed a written waiver of such limitation.
- (d) Sales tax collected by a seller upon retail sales and not remitted to the department.

This fourth ground for tolling the statute of limitations, which is not found in the statute, constitutes a specific application of the fraud and misrepresentation provisions. It arises out of fraud or misrepresentation that is inferred from the unexcused failure of a fiduciary holding trust funds to pay

over such funds to the state. See, e.g., Sunrise Fiberglass Ins., Inc. v. Department of Rev., BTA Docket No. 41913, 13 WTD 203 (1993).<sup>2</sup>

In Sunrise, the court recognized that the Department had the burden to show fraud by clear, cogent, and convincing evidence. It conclude that burden was met and stated:

In this case, Sunrise, as trustee for retail sales taxes, was a fiduciary. It knew, or should have known, and should have disclosed the proper amount of retail sales taxes collected from its customers. Sunrise has superior knowledge of this amount. The Department obviously has no way of knowing the amount of retail sales taxes Sunrise actually collected from its customers. Sunrise should have remitted the proper amount of sales taxes to the Department on a timely basis. The Department established that not only did Sunrise consistently underreport by a wide margin the amount of sales taxes it collected, it also was consistently late in remitting the taxes it did report. Sunrise's actions amounted to an egregious breach of its fiduciary responsibilities, the net result of which was that Sunrise had the beneficial use of funds belonging--not merely owing--to the state. Sunrise's actions amounted to a classic out-and-out misappropriation of sales tax trust funds.

In a similar manner the taxpayer in this case clearly misappropriated state trust funds when it failed to report or underreported sales tax once he knew that a portion of receipts constituted collected retail sales tax. The taxpayer has presented no evidence that rebuts such a conclusion for the period beginning in June, 1994. For prior periods, however, the taxpayer has presented evidence to rebut a prima facie case. He argues that, until he saw a trade journal article in 1994, he was unaware that a portion of the coin-operated sales constituted retail sales tax. In support, he produced a 1994 trade journal article stating that Washington is one of the few states that charges sales tax on coin-operated laundry sales.

In considering this evidence, we note this case is dissimilar to most retail sales tax cases where knowledge and intent is readily inferred from the fact that the tax is separately stated or separately collected from the buyer. In general, retail sales tax must be stated separately from the selling or collected separately from the buyer. RCW 82.08.050. An exception is made for coin-operated sales. RCW 82.08.080; see also WAC 458-20-165 (Rule 165). Under Rule 165, a coin-operated laundry must pay retailing B&O tax and retail sales tax on coin-operated sales. The taxpayer may deduct the tax from the total amount of sales in order to arrive at the net amount, which becomes the measure of the tax. Rule 165(f).

Based on the evidence, we conclude that the taxpayer has rebutted the prima facie case of fraud related to the nonpayment of sales tax for periods prior to June 1994. The only other basis to

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<sup>2</sup> RCW 82.08.050 declares that sales taxes collected by a seller are held in trust by the seller until paid to the Department. Any seller who appropriates or converts those funds to his own use or any other use other than payment of the tax shall be guilty of a gross misdemeanor.

exceed the statute of limitations concerns the taxpayer's failure to properly register the business as a sole proprietorship. With respect to registration Rule 230 provides:

(3) **Unregistered taxpayer.** Except for evasion or misrepresentation, if the department of revenue discovers any unregistered taxpayer doing business in this state, the department will assess taxes, interest, and penalties for a period of seven years plus the current year. If a taxpayer voluntarily registers before being contacted by the department, assessments will not exceed four years plus the current year, provided the taxpayer has made a good faith attempt to report correctly and there is no evidence of intent to evade tax under RCW 82.32.050. It will be presumed that a taxpayer has registered with the department if the taxpayer voluntarily files for an identification number under the Unified Business Identifier (UBI) system prior to any contact from the department of revenue.

The taxpayer's reporting under an existing registration number complies with this requirement, but the taxpayer's intent to evade payment of taxes, as discussed above, would appear to extend the limitation period to seven years. However, Rule 230 goes on to limit the liability to "taxes which were underpaid as a result of the evasion or misrepresentation." As discussed above, the Department has not met its burden to show an intent to evade with respect to unreported sales tax prior to 1994. Accordingly, we conclude that the assessment for the 1991 period must be canceled.

[2] The next issue is whether the evasion penalties were properly assessed. The Department's authority for imposing the evasion penalty is found in RCW 82.32.090(5), which provides:

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.

Use of the word "shall" by the legislature indicates that the penalty is mandatory if an intent to evade is found. Although the subjective intentions of a person are difficult to ascertain, they may be determined from objective facts, including the actions or statements of the taxpayer. Det. No. 87-188, 3 WTD 219 (1987).

Imposition of the evasion penalty requires proof of the following: (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. The burden is on the Department to prove each of these elements by clear, cogent, and convincing evidence. Det. No. 90-314, 10 WTD 111 (1990). In this regard, Rule 230 provides:

(4) **Evasion or misrepresentation.** There is no limitation for the period in which an assessment or correction of an assessment can be made upon a showing of evasion or of misrepresentation of a material fact. Evasion involves a situation where the taxpayer knows a tax liability is due and the taxpayer attempts to escape detection through deceit, fraud, or

other intentional wrongdoing. The evasion must be shown by clear, cogent, and convincing evidence which is objective and creditable. However, in the case of evasion or misrepresentation, any assessment for taxes which extends beyond four years and the current year will be limited to taxes which were underpaid as a result of the evasion or misrepresentation. (See RCW 82.32.050 and 82.32.090.)

Clear, cogent, convincing evidence has been described as evidence convincing the trier of fact that the issue is "highly probable," or, stated another way, the evidence must be "positive and unequivocal." Colonial Imports, Inc. v. Carlton Northwest, Inc., 121 Wn.2d 726, 853 P.2d 913 (1993).

Applying these principles to the laundry business, we conclude that the Department has met its burden of proof with respect to the unreported or underreported retail sales and B&O tax for periods beginning in June, 1994, for the reasons discussed above. With respect to the purchase of the 45 boat, we conclude that the Department has met its burden to show that the taxpayer intended to evade payment of sales tax.

In this case, the taxpayer purchased a boat allegedly for use in a charter business, but had no income over a two year period from chartering the boat, claimed a mortgage interest deduction for the boat for federal income tax purposes, and moored the boat at his home. He also made personal use of the boat. The only purported efforts to charter the boat involved a sign in the window of the boat and allegedly having brochures to pass out when he was making personal use of the boat.

He also admitted knowing that he would owe use tax if he made personal use of the boat. However, when asked about the use of the boat he denied personal use of the boat and claimed that it had only 20 - 30 hours on the engine over a two year period. Only when he was confronted with custom records that showed 17 trips to Canada did he admit to having made personal use of the boat. Under the facts of this case, we conclude the taxpayer knew he had a use tax liability that was due and he engaged in acts of deceit and misrepresentation to evade paying the tax. The Department has proven these elements by clear, cogent, and convincing evidence.

#### DECISION AND DISPOSITION:

The petition is denied with respect to [the charter business].

The petition with respect to [the laundry business] is granted in part and denied in part. It is granted with respect to the statute of limitations for the 1991 period and with respect to the assessment of an evasion penalty for periods prior to June, 1994. In all other respects it is sustained. That case is remanded to the Audit Division for adjustment in accordance with this determination.

Dated this 26th day of March 1998.