

Cite as Det No. 10-0358, 30 WTD 99 (2011)

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. 10-0358
)	
... )	
)	Registration No. . . .
)	Document No. . . .
)	Docket No. . . .

RULE 228; RCW 82.32.090: PENALTY -- EVASION – INTENTIONAL AVOIDANCE.  
Evidence that the taxpayer was aware of his tax liabilities based on his prior years of reporting income, paying tax and remitting collected retail sales tax, and that the taxpayer deliberately failed to file tax returns while knowingly performing retailing activities, establishes 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.

Eckholm, A.L.J. – The owner of a flooring business petitions for waiver of an evasion penalty assessed for unpaid tax liability including collected and unremitted retail sales tax, and seeks credit for sales tax paid on purchases. The taxpayer asserts that he should not be penalized for evasion because he did not collect retail sales tax from his customers and that certain purchase receipts establish allowable sales tax credit. The taxpayer’s petition is denied.<sup>1</sup>

ISSUES

(1) Whether the taxpayer is liable for an evasion penalty assessed pursuant to RCW 82.32.090(7) for unpaid tax liability.

(2) Whether the taxpayer’s records establish that he should be credited for retail sales tax paid on purchases used in his flooring business.

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

## FINDINGS OF FACT

[Taxpayer] owns a flooring business in Washington State. During the relevant period the taxpayer also owned and maintained certain residential rental properties. The Audit Division of the Department of Revenue (Audit) conducted a partial audit of the taxpayer's business activities for the period January 1, 2005, through June 30, 2009, to verify proper excise tax reporting. Audit estimated the taxpayer's income based on the taxpayer's federal income tax returns and bank account records because the taxpayer failed to maintain income records. Audit issued an assessment for retail sales tax of \$ . . . , retailing B&O tax of \$ . . . , use/deferred sales tax of \$ . . . , delinquency penalty of \$ . . . , evasion penalty of \$ . . . , assessment penalty of \$ . . . , and interest of \$ . . . , resulting in a total assessment of \$ . . . . The assessment remains unpaid.

Audit issued the evasion penalty based on the following: the taxpayer has been registered with the Department since 1997 and filed excise tax returns for annual periods from 1997 through 2001; the taxpayer reported and remitted retail sales tax for the 1998 annual period; the taxpayer engaged in retailing and retail sales taxable construction activities throughout the audit period and did not file any excise tax returns during this period; the taxpayer admitted that he was performing work "on a cash basis, under the table" and indicated that he has never issued sales receipts to his customers; and the taxpayer did not provide any documentation that retail sales tax was not charged or collected.

In his appeal petition, the taxpayer asks that the evasion penalty be waived because he did not charge and collect retail sales tax from his customers. In addition, the taxpayer requests that he be credited for retail sales tax paid on certain purchases for his flooring business based on receipts provided to Audit and at the hearing.

At the hearing the taxpayer indicated that he was out of work for a period of time in 1998 as a result of [medical treatment]. The taxpayer indicated that after the surgery he started back to work slowly and began filing excise tax returns but did not collect retail sales tax from his customers. The taxpayer explained that he performs work based on oral agreements and that he has never written a contract for work in his life. The taxpayer indicated that he does not keep records related to his business activities because he does not do well with paperwork. The taxpayer also indicated that he throws all paperwork away "to make the problems go away."

## ANALYSIS

### Evasion Penalty

The evasion penalty is authorized in RCW 82.32.090(7), which states: "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 must be added." The Department's administrative rule that addresses the imposition of an evasion penalty, WAC 458-20-228(5)(f) (Rule 228(5)(f)), provides:

. . . 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.

To sustain an assessment of the evasion penalty, the Department must find that the taxpayer acted with intent. To this end, the Department must show that the taxpayer acted with the specific purpose of escaping a tax liability which the taxpayer knew to exist. Det. No. 99-049, 20 WTD 136 (2001). The imposition of the evasion penalty requires proof of the following by clear, cogent, and convincing evidence that is both objective and credible: (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. *Id.*

The facts show that the taxpayer was aware of his tax liabilities based on his prior years of reporting income, paying tax and remitting collected retail sales tax. The first element for imposing the evasion penalty is met.

The second element is also met. The facts show that the taxpayer attempted to escape payment of tax by dishonestly reporting no business activity for tax periods before and during the audit period, when he now admits he was in fact actively engaged in business activities. The taxpayer also indicated that he disposed of paperwork related to his business activities in order to avoid problems. Although an intent to evade does not exist where a tax deficiency is the result of an honest mistake, miscommunication, or the lack of knowledge regarding proper accounting methods, we do not find that to be the case here. *See* Rule 228(5)(f). Here, the taxpayer intentionally conducted business without creating any invoices or written evidence of the work he performed and amounts he was charging, and intentionally reported no business activities for periods when he was conducting business “under the table.”

The taxpayer’s arguments do not rebut the clear and convincing evidence that the taxpayer intended to evade his tax liability. . . . We conclude that the failure to correctly report and remit the excise taxes in question was the result of the taxpayer intentionally acting to avoid paying the tax, with the knowledge or belief the tax was in fact owed. We therefore sustain the evasion penalty.

#### Deductions for Retail Sale Tax Paid

The taxpayer has also failed to establish that he should be allowed deductions from assessed deferred retail sales tax for materials he claims he purchased for use in performing flooring services.

RCW 82.32.070 requires taxpayers in this state to maintain records adequate for the Department of Revenue to determine the tax liability of such taxpayer. WAC 458-20-254 (Rule 254) defines

the requirements for the maintenance and disclosure of books, records, and other sources of information to the Department. Rule 254 states, in relevant part:

(a) Every taxpayer liable for a tax or fee imposed by the laws of the state of Washington for which the department of revenue has primary or secondary administrative responsibility... must keep complete and adequate records from which the department may determine any tax liability for such taxpayer.

(b) It is the duty of each taxpayer to prepare and preserve all records in a systematic manner conforming to accepted accounting methods and procedures. Such records are to be kept, preserved, and presented upon request of the department or its authorized representatives which will demonstrate:

(i) The amounts of gross receipts and sales from all sources, however derived, including barter or exchange transactions, whether or not such receipts or sales are taxable. These amounts must be supported by original source documents or records including but not limited to all purchase invoices, sales invoices, contracts, and such other records as may be necessary to substantiate gross receipts and sales.

(ii) The amounts of all deductions, exemptions, or credits claimed through supporting records or documentation required by statute or administrative rule, or other supporting records or documentation necessary to substantiate the deduction, exemption, or credit.

...

(c) The records kept, preserved, and presented must include the normal records maintained by an ordinary prudent business person. Such records may include general ledgers, sales journals, cash receipts journals, bank statements, check registers, and purchase journals, together with all bills, invoices, cash register tapes, and other records or documents of original entry supporting the books of account entries. The records must include all federal and state tax returns and reports and all schedules, work papers, instructions, and other data used in the preparation of the tax reports or returns.

The taxpayer did not keep or disclose normal records maintained by an ordinary prudent business person. The taxpayer did not keep general ledgers, sales journals, cash receipts journals, invoices or purchase journals. Audit did not allow credit for sales tax paid because the purchases could not be verified. The taxpayer makes purchases for both his flooring customers and for the investment real estate he owns personally. The taxpayer did not provide documentation showing where or how the purchases were used. We agree with Audit that the taxpayer has failed to provide reliable documentation to establish allowable deductions for sales tax paid.

#### DECISION AND DISPOSITION

The taxpayer's petition is denied

Dated this 24<sup>th</sup> day of November, 2010.