

Cite as Det. No. 15-0067, 34 WTD 424 (2015)

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. 15-0067
) )	
... )	Registration No. ...
) )	

[1] RULE 102, RULE 170; RCW 82.08.130, RCW 82.04.050, RCW 82.32.070, RCW 82.32A.030: RETAIL SALES TAX – TAX PAID AT SOURCE DEDUCTIONS – RECORDS TO SUPPORT SUCH DEDUCTIONS. Taxpayer failed to maintain and provide the Department with records to support tax paid at source deductions it claimed. In addition, contrary to law, taxpayer erroneously claimed tax paid at source deductions against the measure of retailing business and occupation (B&O) tax it reported to the Department. Therefore, the Department properly disallowed tax paid at source deductions taxpayer claimed during the audit period.

[2] RULE 254; RCW 82.32.110, RCW 82.32.070, RCW 82.32A.030: B&O TAX – LOAN REPAYMENT – RECORDS EVIDENCING LOAN. Taxpayer failed to maintain and provide the Department with a promissory note, an initial deposit, or any other documentary evidence of indebtedness by Taxpayer, and, without any evidence that the claimed receipts were loan proceeds and not gross receipts, the Department has the authority to assess tax on payments received.

[3] RULE 228; RCW 82.32.090: PENALTY -- EVASION – INTENTIONAL AVOIDANCE. Evidence that Taxpayer was aware of his tax liabilities, based on invoices that showed Taxpayer charged sales tax to its customers, and that 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.

Weaver, A.L.J. – A taxpayer engaged in landscaping services, janitorial services, and construction services petitions for the correction of assessment, claiming that it was entitled to an additional “tax paid at source” deduction and that use tax should not be assessed on loan repayments. Taxpayer also requests the waiver of the evasion penalty on sales taxes it failed to remit to the Department of Revenue (Department) in 2009. Because Taxpayer has failed to provide documentation showing additional taxes paid at source, has failed to provide

documentation evidencing the existence of a loan, and because we find that Taxpayer willfully failed to remit sales taxes to the Department in 2009, we sustain the assessment. Taxpayer's petition is denied.<sup>1</sup>

### ISSUES

1. Whether the Department can estimate the tax due for part of the audit period, under RCW 82.32.100, because the taxpayer failed to provide adequate books and records.
2. Whether, under RCW 82.08.130, taxpayer has provided records sufficient to substantiate an additional tax paid at source deduction.
3. Whether, under RCW 82.32.070 and WAC 458-20-254, a taxpayer has provided records adequate to show that amounts assessed as gross income were instead repayments of loans.
4. Whether, under RCW 82.32.090, the taxpayer is liable for the evasion penalty when it collected retail sales tax in 2009, but did not remit any sales tax to the Department.

### FINDINGS OF FACT

[Taxpayer] is a business engaged in providing cleaning services, landscaping services, and construction services, to both individuals and businesses. Taxpayer began doing business as a cleaning service then transitioned into a landscaping business around 2009. The Audit Division (Audit) of the Department examined Taxpayer's books and records for the period of January 1, 2009 through June 30, 2012.

During the audit period, Taxpayer reported many of its sales under the wholesaling business and activities (B&O) tax classification. Taxpayer failed to maintain documentation of its wholesale sales and did not keep copies of resale certificates or reseller permits. Audit gave Taxpayer a credit for wholesaling B&O tax reported and paid, but reclassified all wholesale sales to retail sales and assessed retail sales tax and retailing B&O tax on those sales.

In reviewing Taxpayer's 2009 sales documentation, Audit found that Taxpayer simultaneously charged retail sales tax to some landscaping and construction customers while not charging others for the same or similar services. In 2009, Taxpayer reported all of its revenue under the service and other activities B&O tax classification, which resulted in Taxpayer not remitting any of the retail sales tax it collected to the Department. Taxpayer states that it charged sales tax on all its landscaping jobs, but did not charge sales tax on its cleaning jobs in 2009. In any event, Taxpayer did not remit any sales tax to the Department in 2009, and only reported service-taxable income on its four quarterly Combined Excise Tax Returns.

After 2009, Taxpayer began recording its revenue in QuickBooks and described that income as either "non-taxable" or "taxable" services; however, the invoice and customer detail was not recorded in all instances. Audit determined that all of Taxpayer's sales were retail sales, because Taxpayer was unable to provide records substantiating the nature of the work that was

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

performed. Audit performed a reconciliation of income reported to the Department with the amounts reported as revenue in Taxpayer's QuickBooks accounts. There were certain sales listed in Taxpayer's QuickBooks accounts that were not reported to the Department. Audit Division assessed retail sales tax and retailing B&O tax on these unreported sales.

Audit also determined that Taxpayer maintained at least 13 bank accounts, 10 of which were used for business deposits. Audit performed a reconciliation of amounts deposited in the 10 bank accounts with the deposits recorded in Taxpayer's QuickBooks records. Audit assessed retail sales tax and retailing B&O tax on deposits that were not recorded in Taxpayer's QuickBooks records. The taxable differences were considered the result of Taxpayer not recording all of its business deposits in its QuickBooks records and, in the absence of documentation on the nature of those deposits, Audit characterized the differences as revenue from retail-taxable services.

In its excise tax returns, Taxpayer claimed a deduction from retail sales tax for tax paid at source. Taxpayer states that it always paid sales tax on materials it purchased with respect to its construction and landscaping work. During the review of Taxpayer's consumable supplies, Audit identified a significant number of materials purchased where retail sales tax was paid to the supplier. Audit gave Taxpayer credit for tax paid at source on all documented materials purchases where the Taxpayer paid sales tax to the supplier.

Audit also assessed use tax on consumable purchases using a sampling methodology. On appeal, Taxpayer claims that funds paid to [Lender] were repayments on a loan. Taxpayer had [Lender] testify at the hearing that the checks written to him were, indeed, repayments on a loan. Audit's Workpaper E shows two payments to [Lender] from Taxpayer, one for \$. . . and the other for \$. . . . These two checks were logged by Taxpayer in its QuickBooks account labeled "Job Materials" and were characterized as "Cost of Goods Sold." Neither Taxpayer nor [Lender] presented evidence of a promissory note or any other documentary evidence of indebtedness.

On December 18, 2013, Audit issued Assessment No. . . . , in the amount of \$. . . . That assessment included \$. . . in retail sales tax, \$. . . in retailing B&O tax, \$. . . in use tax, a small business credit of \$. . . , a wholesaling B&O tax credit of \$. . . , a service and other activities B&O tax credit of \$. . . , \$. . . in interest, a 5% assessment penalty of \$. . . , and an evasion penalty for tax year 2009, totaling \$. . . .

Taxpayer appeals the assessment.

## ANALYSIS

### Records

Washington imposes a B&O tax "for the act or privilege of engaging in business" in Washington. RCW 82.04.220. The B&O tax measure and rate are determined by the type or nature of the business activity in which a person is engaged. *See generally* Chapter 82.04 RCW. RCW 82.04.050(3)(e) specifically includes "[l]andscape maintenance" in the definition of a retail sale. Likewise, RCW 82.04.050(2)(c) specifically includes construction services in the

definition of a retail sale. As such, Taxpayer's landscaping and construction services are taxable under the retailing B&O tax classification. RCW 82.04.250.

Further, Washington levies a retail sales tax on each retail sale in this state. RCW 82.08.020; RCW 82.04.050. Under RCW 82.32.050, persons making retail sales are liable for retail sales tax when they fail to charge, collect, and remit the retail sales tax to the Department. Taxpayer was, therefore, required to remit retail sales tax on all of its qualifying business activity, even if it did not collect retail sales tax from their customers.

Audit estimated Taxpayer's retailing B&O tax liability and the retail sales tax due for the audit period because Taxpayer's books and records were incomplete. Taxpayers have a statutory duty to maintain suitable records and to allow the Department to examine them. RCW 82.32.070 provides as follows:

Every person liable for any fee or tax . . . shall keep and preserve, for a period of five years, suitable records as may be necessary to determine the amount of any tax for which he may be liable, which records shall include copies of all federal income tax and state tax returns and reports made by him. All his books, records, and invoices shall be open for examination at any time by the department of revenue . . . .

RCW 82.32.070; *see also* WAC 458-20-254 (Rule 254). If a taxpayer fails to maintain or provide adequate records to determine the taxpayer's tax liability, the Department is authorized to use the records available to arrive at its best estimate of the taxpayer's tax liability. RCW 82.32.100(1). We conclude that Audit was authorized to estimate Taxpayer's tax liability based on due to the absence of records in this case.

#### Tax Paid at Source Deduction

There are a number of deductions from retail sales tax, one of which is the tax paid at source deduction. On appeal, Taxpayer maintains that he is entitled to an additional tax paid at source deduction, above and beyond the tax paid at source deduction allowed by Audit. This deduction is found in RCW 82.08.130 as follows:

A buyer who pays a tax on all purchases and subsequently resells property or services at retail, without intervening use by the buyer, must collect the tax from the purchaser as otherwise provided by law and is entitled to a deduction on the buyer's tax return equal to the cost to the buyer of the property or service resold upon which retail sales tax has been paid. The deduction is allowed only if the taxpayer keeps and preserves records that include the names of the persons from whom the property or services were purchased, the date of the purchase, the type of property or services, the amount of the purchase, and the tax that was paid.

RCW 82.08.130(2) (emphasis added).

Businesses subject to B&O tax or obligated to collect and remit retail sales tax must keep, for five years, records necessary to determine the amount of any tax for which it may be liable.

RCW 82.32.070(1). These records are to be kept, preserved, and presented upon request of the Department, demonstrating the amounts of all deductions . . . claimed . . . . WAC 458-20-254(3)(b)(ii). In this case, Taxpayer has not provided any additional records to justify his claimed tax paid at source deduction and we must therefore deny his petition. Specifically, Taxpayer has not provided any documentation, required by RCW 82.08.130(2), to show entitlement to the tax paid at source deduction, above and beyond the amount allowed by Audit.

#### Repayment of Loan

The Department is authorized to examine a taxpayer's books and records "bearing upon the amount of any tax payable or upon the correctness of any return." RCW 82.32.110. To ensure consistent application of the revenue laws, taxpayers have certain responsibilities under chapter 82.32 RCW, including the responsibility to keep accurate and complete business records. RCW 82.32A.030(3). RCW 82.32.070 states:

Every person liable for any fee or tax imposed by chapters 82.04 through 82.27 RCW shall keep and preserve, for a period of five years, suitable records as may be necessary to determine the amount of any tax for which he may be liable, which records shall include copies of all federal income tax and state tax returns and reports made by him. All his books, records, and invoices shall be open for examination at any time by the department of revenue.

RCW 82.32.070(1). Rule 254(3)(b) provides as follows, in pertinent part:

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:

....

(ii) The amounts of all deductions . . . claimed through supporting records or documentation . . . or other supporting records or documentation necessary to substantiate the deduction, exemption, or credit.

(iii) The payment of . . . use tax on capital assets, supplies, articles manufactured for your own use, and other items used by the taxpayer as a consumer.

Rule 254(3)(b)(ii), (iii).

Taxpayer's records show that its receipt of \$. . . from [Lender] was for "Job Materials" and were characterized in QuickBooks as "Cost of Goods Sold." While [Lender] testified at the appeals hearing that he loaned money to Taxpayer and that Taxpayer repaid the funds to him, neither Taxpayer nor [Lender] presented any evidence of a promissory note, an initial deposit from [Lender], or any other documentary evidence of indebtedness. Because Taxpayer's assertions are not supported by its records, we sustain the assessment of use tax on these payments.

### Evasion Penalty

Washington law requires the Department to add a fifty percent evasion penalty when it finds that “any part of the deficiency resulted from an intent to evade the tax.” RCW 82.32.090(7). “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.” WAC 458-20-230(4) (Rule 230). To sustain an assessment of the evasion penalty, the Department must present evidence of these two elements now found in Rule 230. Det. No. 10-0125, 29 WTD 90 (2010); Det. No. 04-0098, 23 WTD 331 (2004). To meet this burden, the Department must show intent to evade “by clear, cogent, and convincing evidence which is objective and credible.” Rule 230(4). The mere suspicion of intent to evade is not enough to meet this burden. Det. No. 90-314, 10 WTD 111 (1990).

Rule 228 lists a few circumstances that can show intent to evade tax. That rule provides, in pertinent part:

(ii) **What actions may establish an intent to evade?** The following is a nonexclusive list of actions that are generally considered to establish an intent to evade a tax liability. This list should only be used as a general guide. A determination of whether an intent to evade exists may be ascertained only after a review of all the facts and circumstances.

...

(B) *The willful failure of a seller to remit retail sales taxes collected from customers to the department;....*

Rule 228(5)(f)(ii) (emphasis added).

Audit relies on this example as evidence that Taxpayer intended to evade the taxes at issue. As explained recently in Det. No. 10-0125, “[t]he Department has consistently held that ‘utilizing retail sales tax for a taxpayer’s own business purpose provides a basis to sustain a 50% evasion penalty.’” Det. No. 20-0125, 29 WTD at 94 (quoting Det. No. 02-0115, 23 WTD 21 (2004)). As explained above, retail sales taxes are trust funds that when collected must be remitted to the Department. RCW 82.08.050; *see also Kitsap-Mason Dairymen’s Ass’n*, 77 Wn.2d 812, 817, 467 P.2d 312 (1970) (“Inherent in RCW 82.08 is the fact that taxes collected in the name of the state are not [the] property of the seller.”).

In this case, Taxpayer’s actions show intent to evade the retail sales tax in 2009. Taxpayer’s invoices throughout 2009 showed that it consistently collected retail sales tax from its customers. It never remitted any of these taxes to the Department. These actions show that Taxpayer intended to collect retail sales tax and never intended on remitting the tax to the Department. This establishes that Taxpayer intended to evade retail sales tax by clear, cogent, and convincing evidence.

Once the Department clearly establishes the elements of evasion, a burden of production is imposed on the taxpayer to rebut evasion by showing that the deficiency was the result of honest mistake, miscommunication, ignorance of the law, lack of knowledge, or some other fact. Det. No. 10-0125, 29 WTD at 94; Det. No. 04-0098, 23 WTD 331 (2004). Taxpayer did not provide

evidence to show that its practice of collecting and keeping retail sales tax in 2009 was due to one of these circumstances. Taxpayer knew that it was imposing sales tax in 2009 and failed to remit those taxes to the Department. We sustain the evasion penalty on retail sales taxes collected and not remitted during 2009.

#### DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 12th day of March, 2015.