

Cite as Det. No. 02-0115, 23 WTD 21 (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. 02-0115
...)	
)	Registration No. . . .
)	FY . . . /Audit No. . . .
)	Docket No. . . .

RULE 245; RCW 82.32.070: RETAIL SALES TAX – RETAILING B&O TAX – RECORDKEEPING – FAILURE TO KEEP RECORDS. A contractor that fails to keep or provide records cannot challenge an assessment that was estimated from the few invoices and contract proposals that were acquired by the Department, even if one or more of the contract proposals may not have resulted in income to the taxpayer.

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.

Mahan, A.L.J. – A contractor protests the assessment of retail sales tax, retailing B&O tax and an evasion penalty.

ISSUE

When a taxpayer does not produce records and the Department issues an assessment based on proposals and invoices discovered in an investigation by [another state agency], should the assessment include amounts where [another state agency] was able to ascertain that no work was done under a proposal or amounts where [another state agency] was not able to ascertain whether certain proposals were accepted and the work completed?¹

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

FACTS

The taxpayer is a limited liability company owned by It is engaged in roofing, framing and remodeling. [Another state agency] investigated the taxpayer for purposes of determining whether the taxpayer had properly reported workers' hours for [another state agency] purposes. In its field audit, [another state agency] determined that the taxpayer had underreported hours. An estimated assessment was issued because the taxpayer "supplied minimal records, with almost no way of verifying if the records supplied are in any manner complete."

The minimal records provided by the taxpayer to [another state agency] included various invoices and contract proposals from 1998 and 1999. Some of the proposals showed an acceptance of the proposal by the customer and some did not. An investigation by [another state agency] auditor showed that several proposals, for [N] dated 8/15/99 ("[N] proposal"), for [T] dated 2/4/98 ("[T] proposal"), and possibly for one of the proposals to [B], never resulted in work for the taxpayer. The investigation was inconclusive as to several other proposals. Sales tax was separately stated on some of the invoices and proposals. Based on the limited records and interviews with employees and customers, [another state agency] estimated underreported hours for the three-year period covered by the audit.

[Another state agency] also assessed penalties against the taxpayer and stated in its March 6, 2000 Field Audit Report:

I explained to him I was assessing the two times penalty because he had failed to report any employees, paid his employees in cash, failed to keep any records for payroll, and the only reason I could determine he was paying cash was to evade payroll taxes. When I asked him why he did not keep any records he said, when paying cash, you do not want any records. He then went on to say part of his problem was that he had decided to pay back some of his creditors of his previous bankruptcy, and had paid cash to obtain the funds to pay past creditors that probably should have been paid for taxes. From this I concluded he knew and planned what he had been doing.

Following issuance of [another state agency] field audit, the Department of Revenue (Department) attempted to audit the business. The taxpayer was uncooperative and did not provide requested records to the Department for review. In interviews with the Department, the taxpayer denied having collected retail sales tax.

Based on [another state agency] investigation and the documents obtained by [another state agency], the Department issued a deficiency assessment for the May 15, 1997 through June 30, 2000 period. The Department assessed retail sales tax and retailing B&O tax in an amount based on the proposals and invoices obtained by [another state agency]. The amount assessed included an amount based on the [N] and [T] proposals and on proposals where the evidence was inconclusive as to whether the work was done. The Department did not attribute any income to 1997 and 2000 because invoices or proposals were not obtained for those periods.

The Department also assessed a 50% evasion penalty. It based the penalty on the following facts:

1. You have denied charging and collecting retail sales tax from your customers. [Another state agency] has provided copies of your invoices since you refused to do so. These invoices show that you indeed charged and collected retail sales tax from your customers.
2. Your prior business was audited and found to have substantially under reported your income. In a May 20, 1993 letter, you were instructed to ensure that all retail sales tax collected be remitted timely on your excise tax returns. This shows that you knew that you were to report the collected retail sales tax. It is evident that the successor business has not followed these instructions.
3. You attempted to conceal the fact that you had collected retail sales tax.
4. You converted the retail sales tax trust funds to your own use.

The taxpayer timely appealed the assessment and contended that the assessment is in error because it includes in the taxable base proposals that were not accepted and for which no sales tax was collected. At the hearing on this matter, the taxpayer stated that other proposals (e.g., the 11/9/98 [A] and the 11/03/1999 [O] proposals), in addition to the [N] and [T] proposals identified by [another state agency], never resulted in any work. The Taxpayer further argued that the 4/1/98 [V] job was a wholesale job, although the taxpayer does not have a resale certificate for the job.

The taxpayer further stated that it started in business in mid-1998 and quit business in 1999. The taxpayer stated that it was working in [State A] in the first half of 1998. When asked for copies of his [State A] income tax returns, the taxpayer's owner stated that the project owner lived in Washington and paid him in cash, so he did not believe he was required to report any income in [State A].

As to other records, the taxpayer stated he might be able to locate some additional contract records and federal tax returns, but was not certain. As to bank records, he stated that he used his personal account for his business, and it was common practice not to deposit checks from customers, but to cash them so he could make cash payments to employees.

ANALYSIS

In general, a company constructing, repairing, or improving new or existing buildings for a consumer is required to collect retail sales tax from the consumer and to pay retailing B&O tax. RCW 82.04.050; WAC 458-20-170 (Rule 170). "All sales are treated as retail sales unless the seller takes from the buyer a properly executed resale certificate." WAC 458-20-102(4). The taxpayer has not produced any resale certificates that would show some of its work was wholesale in nature. Accordingly, the Department properly assessed retail sales tax and retailing B&O tax on all transactions.

Problematic in this case is the measure of the tax. According to all accounts and by the taxpayer's own admissions, its records are inadequate. What few records the taxpayer provided do not provide a basis for determining the exact amounts subject to tax.

Under the applicable law taxpayers have the responsibility to maintain suitable records as may be necessary for the Department to be able to determine the taxpayer's tax liability. Any person who fails to comply with this requirement shall be forever barred from questioning the correctness of any assessment of taxes for any period in which adequate records were not kept. RCW 82.32.070; WAC 458-20-254 (Rule 254); Det. No. 97-134R, 18 WTD 163 (1999).

RCW 82.32.070 provides:

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. . . Any person who fails to comply with the requirements of this section shall be forever barred from questioning, in any court action or proceedings, the correctness of any assessment of taxes, made by the department of revenue based upon any period for which such books, records, and invoices have not been so kept and preserved.

(Emphasis added). *See also* WAC 458-20-254(6).

In the present case, if the assessment had been based on actual records, it would clearly be inappropriate to include amounts attributed to proposals such as the [N] proposal in the taxable base. However, the assessment at best is only an estimate. There is no way to tell if there were other proposals that were accepted for which records were not supplied or if there was work done for cash and no invoice issued. The Department was required to estimate the tax as a result of the taxpayer's failure to keep or provide suitable records for the Department's examination. If anything, the Department's estimate may favor the taxpayer by not projecting the results for 1998 and 1999 over the entire period, which would result in a substantially increased assessment.

The taxpayer further argues that the 50% evasion penalty should cover any amounts for which he did not keep adequate records. 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 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). With respect to retail sales tax, a statutory duty is imposed on sellers of tangible personal property and retail services to collect and remit retail sales tax. RCW 82.08.050.

Utilizing collected retail sales tax for a taxpayer's own business purpose provides a basis to sustain a 50% evasion penalty. *See, e.g.*, Det. No. 91-173, 11 WTD 215 (1991).

In the present case, the taxpayer does not claim that its statements and actions, including the conversion of collected retail sales tax to its own use, fail to come under the penalty provisions of RCW 82.32.090(5). Rather, the taxpayer argues that the penalty should account for some of its inadequate record keeping and underpayment of tax and, accordingly, the tax amount should be reduced before calculating the evasion penalty. However, the statute by its terms penalizes misconduct. It is not a method of estimating underpaid tax. Accordingly, the taxpayer's argument in this regard is without merit.

DECISION AND DISPOSITION:

Taxpayer's petition is denied.

Dated this 17th day of July 2002.