Cite as Det. No. 05-0066, 24 WTD 454 (2005)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON[1]

In the Matter of the Petition For Correction of Trust Fund Accountability Assessment of	)	D E T E R M I N A T I O N
	)	
	)	No. 05-0066
. . .	)	
	)	Registration No. . . .
	)	Document No. . . .
	)	Docket No. . . .
	)	Warrants . . .

[1] RULE 217; RCW 82.32.145: TRUST FUND ACCOUNTABILITY ASSESSMENT -- COLLECTED RETAIL SALES TAX--REASONABLE MEANS TO COLLECT DIRECTLY FROM THE CORPORATION OR LLC. Where a corporation or a limited liability company (LLC) is dissolved, its cash depleted, and its assets abandoned, DOR does not have an obligation to pursue the assets through litigation in an attempt to retrieve the "trust funds" collected and held by the corporation or LLC. DOR is required to attempt to collect the tax from a corporation or LLC only if it is reasonable to do so. If there is no reasonable means to collect from the corporation or LLC, DOR may endeavor to collect the "trust funds" from the responsible party(ies).

[2] RULE 217; RCW 82.32.145: TRUST FUND ACCOUNTABILITY ASSESSMENT -- COLLECTED RETAIL SALES TAX -- NO REASONABLE MEANS TO COLLECT DIRECTLY FROM THE CORPORATION OR LLC -- WHEN THIS DETERMINATION MUST BE MADE. When a corporation or LLC collects retail sales tax but does not remit the tax to DOR, DOR must first determine that there is no reasonable means of collecting the tax from the dissolved corporation or LLC prior to issuing a trust fund accountability assessment against the principals of the dissolved corporation or LLC.

[3] MISC: ESTOPPEL -- LACHES. DOR cannot grant relief on the alleged equitable grounds of estoppel or laches in contravention of a statutory requirement. Equitable principles cannot be asserted to establish equitable relief in derogation of statutory mandates.

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[1] This unpublished Determination applies only to the taxpayer named herein and may not be relied on by any other taxpayer.

[4] RULE 228; RCW 82.32.105: PENALTY WAIVER – CIRCUMSTANCES BEYOND THE CONTROL OF THE TAXPAYER. "Financial hardship" is a circumstance specifically delineated as not beyond the control of the taxpayer and is, therefore, not a circumstance that qualifies as a basis for a penalty waiver.

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.

STATEMENT OF CASE

Breen, A.L.J. – The principals of a limited liability company (LLC) appeal a trust fund accountability assessment (TFAA) issued against them by the Compliance Division (Compliance) of the Department of Revenue (DOR) for tax liability incurred by the LLC. We find the principals liable, pursuant to RCW 82.32.145, for collected, but unremitted retail sales tax, plus penalties and interest. We conclude that equitable estoppel does not prevent DOR from assessing the tax against the principals of the LLC. We deny the taxpayer's petition for correction of assessment of trust fund accountability. We further deny the taxpayer's request for waiver of penalties and interest imposed in the TFAA.[2]

ISSUES

1) Whether the principals of an LLC are personally liable for the retail sales tax liability of a dissolved LLC when DOR determined there was no reasonable means of collection from the LLC prior to issuing the TFAA against the principals.

2) Whether DOR can waive the penalties and interest assessed in conjunction with a TFAA when financial hardship was the circumstance that caused the untimely payment of tax.

FINDINGS OF FACT

The taxpayers, . . . (taxpayer S) and . . . (taxpayer R), owned [LLC]. The LLC operated a restaurant in Washington (restaurant or business). The LLC collected retail sales tax during the periods August, October, November, and December 2003 and January 2004 but did not remit the collected taxes to DOR. DOR issued a TFAA against the taxpayers, personally, on July 1, 2004 for $[x].

The taxpayers closed the restaurant on January . . ., 2004. In a letter dated January . . ., 2004, the taxpayers reported the closure of the restaurant to the lessor of the property, . . . (property owner). As a condition of the . . . 2002 lease between the taxpayers and the property owner, the taxpayers and the property owner executed a $[8x] promissory note to recompense the property owner for upfront improvements to the leased property (Tenant Improvement – Line of Credit). The taxpayers personally guaranteed the promissory note. In the January . . ., 2004 letter, the

[2] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

taxpayers requested a release from the $[6x] remaining balance on the note. The taxpayers reported that all of the tenant improvements . . . were left in place and the restaurant was vacated in a "ready for business" condition.[3] In this letter, the taxpayers made additional note of a number of items of tangible personal property they had left in the restaurant. . . . The taxpayers estimated the value of this abandoned property at $[4x].

Within two weeks of closing the restaurant, Taxpayer R called DOR and informed the Revenue Agent (RA) handling the taxpayer's case of the improvements and fixtures to the property as well as the tangible personal property that remained at the business site. Taxpayer R further informed the RA that there were no UCC filings against any of the improvements, fixtures, or equipment.[4] However, this conflicts with a UCC Financing Statement signed by taxpayer S on December . . ., 2003. Taxpayer R states that the RA told him "it was not worth the effort" for DOR to distrain the property. In this conversation, the RA purportedly remarked to taxpayer R that she had taken the matter to her manager, but he was "not interested in completing the paperwork or going through the hassle of filing the lien documents."

A number of notes in DOR's Automated Compliance System (ACS) indicate that DOR contacted the LLC on a number of occasions and the LLC committed to pay the outstanding liabilities.[5] After the LLC did not keep those commitments, DOR filed the above referenced tax warrants against the LLC with the . . . County Superior Court on February . . ., 2004 and April . . ., 2004, respectively.

On February 13, 2004, the taxpayer's attorney contacted DOR and informed the RA that the taxpayers had closed the restaurant on January . . ., 2004. The RA explained the outstanding tax liability. The attorney stated that he would talk to his clients and see if they could pay the balances owing soon. On March 9, 2004, the taxpayer's attorney faxed the RA financial statements for the taxpayers. The attorney stated that he would call to discuss a payment plan.

On March 9 , 2004, the taxpayers' attorney informed the RA that taxpayer S had filed a Chapter 7 bankruptcy petition on February . . ., 2004.[6] The attorney further explained that the taxpayers had walked away from the restaurant and left all of the equipment in the building.

The RA then contacted the attorney for the property owner. This attorney informed the RA that the property owner had financed equipment purchases and capital improvements through a promissory note. The attorney noted that the taxpayers, personally, guaranteed the note. The attorney further noted that per the terms of the lease, tenant improvements belonged to the property owner and the property owner had a security interest in any remaining property. Finally, the property owner's attorney relayed that the taxpayers had offered these items to the property owner in return for forgiveness of any deficiency on the lease and promissory note. The

[3] In a notice sent to the taxpayers, the . . . County Assessors office stated the value of the taxable tenant improvements as $[15x].
[4] DOR would presumably be first in line to settle any outstanding claims.
[5] All of the "facts," from DOR's perspective, are based on notes in ACS.
[6] The bankruptcy was discharged in June 2004.

LLC owed the property owner approximately $[15x] in unpaid rent plus $[6x] on the promissory note. The property owner did not accept this offer because the property owner already owned most of these items pursuant to the lease/promissory note. The property owner deemed the remaining items as having negligible or unknown value.[7]

On April 13, 2004, the RA received Acknowledgment of Personal Liability forms signed by the taxpayers, individually. Taxpayer R stated that the LLC had left about $[4x] worth of equipment at the restaurant and requested the RA to put a lien on the equipment to fulfill the outstanding tax liability. The RA informed taxpayer R that she had already investigated the equipment and determined that it appeared to belong to the property owner per her conversations with the property owner's attorney and per the terms of the lease/promissory note. DOR issued a TFAA for $[x] against the taxpayers, personally, on July 1, 2004.

DOR determined that there were no reasonable means of collection of the assessed amount from the LLC. DOR noted that the taxpayer did not provide an appraisal of the equipment but merely stated that it was worth $[4x]. Nor, did the taxpayers attempt to sell or protect the equipment. This, in DOR's view, made the value of the equipment, ownership, and feasibility of seizing the equipment suspect to the RA handling the account. In respect to the value of the equipment, the RA concluded:

> The equipment would have a 72.15 "percentage good" after 18 months (June 2002 through January 2004) which valued the equipment at $[3x], this assumes $[4x] was the "new" value of the equipment.[8] This value reflects the Jan 2004 "retail" value without consideration for any discount for equipment seized and sold at auction, or for any depreciation between January 2004 and the time it would take to seize, clear title and sell the equipment.

DOR's investigation revealed that the property owner had dominion over the taxpayer's property and claimed ownership pursuant to the terms of the lease/promissory note.[9] The RA determined prior to issuing the TFAA that there was "no reasonable means of collection" from the LLC because:

1. The promissory note, lease, UCC financing statement, and the fixture and equipment inventories led the RA to conclude that the improvements, fixtures, and equipment appeared to be owned by a third party, namely the property owner, and as such would not be subject to DOR's lien. Alternatively, if the improvements and fixtures were determined to be subject to distraint it would be difficult, if not impossible, to seize, remove, store, and sell them.

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[7] The property owner eventually sold the remaining property to an unrelated third party for $[0.2x].
[8] 2004 Personal Property Valuation Guidelines, published by DOR's Property Tax Division.
[9] Additionally, RCW 60.72.010 provides a lien for persons to whom rent may be due on personal property that has been used or kept on the rented premises by the tenant. While this lien is not superior to a lien for taxes, it does raise the specter of litigation between DOR and the property owner and the associated costs resulting from such litigation.

2. The property owner had control of the equipment and would likely litigate ownership of the equipment pursuant to the terms of the lease/promissory note.
3. DOR did not have adequate facilities available to store the equipment pending a sale of the items. Thus, the costs associated with any sale of the assets would have increased.
4. The taxpayers did not attempt to sell the equipment or in any way act to protect the assets evidencing the assets having negligible value.

Based on these conclusions, DOR opted to proceed against the taxpayers personally by issuing the TFAA on July 1, 2004. In its letter to the taxpayers, DOR stated:

> [DOR] has determined there are no reasonable means of collection from the corporation. The corporation is defunct and <u>there are no known distrainable assets</u>.

(Emphasis added by the taxpayers.) This letter is the basis of the current timely filed appeal. In the alternative to relief on the substantive issue, the taxpayers request that we waive the penalties and interest.

ANALYSIS

1. <u>No reasonable means of collection issue</u>

[1] Persons making sales at retail are required to collect retail sales tax, and the collected retail sales tax is deemed held in trust until it is paid to DOR. RCW 82.08.050. RCW 82.32.140 requires that "[w]henever any taxpayer quits business . . ., any tax payable hereunder shall become immediately due and payable, and such taxpayer shall, within ten days thereafter, make a return and pay the tax due." The fact that there is a current outstanding tax liability demonstrates that the taxpayers made no such return, nor paid the tax due.

Where a corporation or LLC dissolves, or otherwise terminates, owing collected but unremitted retail sales tax to the state, RCW 82.32.145 imposes liability for the tax on "responsible persons" who had control or supervision of the trust funds, or who were responsible for filing returns. Specifically, RCW 82.32.145 provides, in part:

> (1) Upon termination, dissolution, or abandonment of a corporate or limited liability company business, any officer, member, manager, or other person having control or supervision of retail sales tax funds collected and held in trust under RCW 82.08.050, or who is charged with the responsibility for the filing of returns or the payment of retail sales tax funds collected and held in trust under RCW 82.08.050, shall be personally liable for any unpaid taxes and interest and penalties on those taxes, if such officer or other person willfully fails to pay or to cause to be paid any taxes due from the corporation pursuant to chapter 82.08 RCW. . . .
>
> (5) This section applies only in situations where the department has determined that there is no reasonable means of collecting the retail sales tax funds held in the trust directly from the corporation.

WAC 458-20-217 (Rule 217) is the administrative regulation implementing the above statutory provision. The rule largely mirrors the statutory provisions. Rule 217(8), in pertinent part, provides:

> (8) Personal liability for unpaid trust funds. The retail sales tax is to be held in trust. RCW 82.08.050. As a trust fund, the retail sales tax is not to be used to pay other corporate or personal debts. RCW 82.32.145 imposes personal liability on any responsible person who willfully fails to pay or cause to be paid any collected but unpaid retail sales tax. Collection authority and procedures prescribed in chapter 82.32 RCW apply to the collection of trust fund liability assessments. . . .
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> (b) Requirements for liability. In order for a responsible person to be held personally liable for collected and unpaid retail sales tax:
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> (i) The tax must be the liability of a corporate or limited liability business;
>
> (ii) The corporation must be terminated, dissolved, or abandoned;
>
> (iii) The failure to pay must be willful; and
>
> (iv) The department must not have a reasonable means of collecting the tax from the corporation.

Here, it is undisputed that the LLC collected but did not remit retail sales tax. Furthermore, the LLC was dissolved. In the taxpayers' petition appealing the TFAA, they do not contest their status as responsible parties or argue that the failure to pay was not willful. The taxpayers, instead, contend that DOR did not sufficiently determine that there was no reasonable means of collecting the unremitted retail sales tax from the LLC prior to proceeding against them personally. The taxpayers maintain that DOR could have seized the abandoned assets, liened them, or in some other way used those assets for payment of the LLC's outstanding retail sales tax liability, yet DOR chose not to do so. The taxpayers argue that DOR has an equitable duty to take whatever reasonable action to secure payment from the transferees of the improvements, fixtures, and equipment that remained with the business. In the taxpayers' eyes, it seems inequitable for DOR to claim that there are/were no assets available to them to seize to pay this debt and simply rely on the taxpayers, personally, to pay the outstanding liability. The taxpayer's observe:

> There is no question the liability is owed but that is not the end of the analysis. The question becomes what is [DOR's] duty to see that the tax is collected and who is the ultimate responsible person.

[2] Rule 217(8)(e) is instructive as to what is meant by the phrase "no reasonable means of collection."

> The department has "no reasonable means of collection" if the costs of collection would be more than the amount that could be collected; if the amount that might be recovered through a levy, foreclosure or other collection action would be negligible; or if the only means of collection is against a successor corporation.

We interpreted the meaning of the above phrase in Det. No. 95-059, 15 WTD 130 (1996), wherein we applied it in a factual situation similar to the present case. The issue in that determination was whether DOR's decision not to seize a corporation's assets was a basis for overturning the assessment of individual liability where the title to and ownership of the assets was questionable, the value of the assets was unknown and/or unclear, and there was a possible superior lien.

A brief recitation of the facts in that case may be helpful to our present analysis. A number of individuals formed a corporation to operate a restaurant in Washington. The corporation collected retail sales tax pursuant to its restaurant sales. The corporation did not remit some of the collected tax to DOR. The taxpayer in that case admitted that the collected retail sales tax went to paying other corporate obligations. After the corporation closed the restaurant, DOR proceeded against the president of the corporation, individually, for payment of the collected but unremitted retail sales tax. The taxpayer notified DOR that assets with an alleged value of over $35,000 could be seized by DOR, sold, and the proceeds could be used to pay the delinquent taxes. DOR concluded that the ownership of the assets was in question, there was no place to store them pending sale, and possible security interests existed which had priority over DOR's lien. Therefore, DOR chose not to seize the assets.

The taxpayer claimed that DOR could have seized the assets and sold them to fulfill the corporation's outstanding tax liability, thus, there was a reasonable means to collect the taxes from the corporation. We disagreed with this contention. We held that for DOR to discharge its statutory duty to determine that there is no reasonable means of collecting the retail sales tax funds held in the trust directly from the corporation "does not require that [DOR] liquidate all assets of the corporation before it can pursue recourse under the theory of trust fund accountability." We noted that "[w]here a corporation is dissolved, its cash depleted, and its officers abandon its assets, [DOR] does not have the obligation to engage in protracted litigation to attempt to collect the trust fund money. [DOR] is required to collect from [the corporation] only if it is reasonable to do so." We determined that in that situation it was not reasonable.

In the present case, there is conflicting evidence as to who actually owned the property. The terms of the lease and the promissory note plainly evidence ownership rights in the improvements, fixtures, etc. in favor of the property owner. Taxpayer S signed a UCC Financing Statement on December . . ., 2003 giving the property owner a secured interest in all of the equipment, fixtures, etc. used in the "Debtor's Enterprise." Compliance obtained copies of the relevant lease and promissory note in an attempt to ascertain the nature of the assets (*i.e.*, which assets were real property improvements/fixtures versus what assets were more likely to be deemed tangible personal property, such as equipment or supplies). The RA discussed the ownership of the abandoned property with the property owner to evaluate the true ownership of the assets.

Compliance performed a rough cost/benefit analysis in an attempt to assign a liquidation value to the assets factoring in such discounts as depreciation and costs associated with the sale and/or potential litigation with the property owner. The costs associated with storing pending sale and then selling such items as a walk-in cooler, various refrigerators, and sundry restaurant equipment would severely diminish DOR's ability to settle the outstanding tax obligation by selling the items. We note that the taxpayers made no effort to sell these items to fulfill their tax obligation, but instead attempted to use them to obtain a release from the promissory note executed with the property owner. The property owner rejected this offer . . . because the remaining assets not already owned by the property owner pursuant to its secured interest had negligible value.

Finally, the discussions with the property owner, the terms of the lease/promissory note, the UCC Financing Statement providing the property owner with a secured interest in the property, and the statutory lien for lessors raised the likely potential of a competing claim on the assets and, again, increased costs for DOR associated with litigating this claim.

[3] We find that DOR investigated the reasonableness of collecting from the LLC prior to issuing the TFAA against the taxpayers, personally, as required by RCW 82.32.145. Nonetheless, the taxpayer's argue that DOR's inaction worked to their detriment; therefore, DOR should now be equitably estopped from proceeding directly against them, presumably under the doctrine of laches.[10] We fail to see how DOR unreasonably delayed. In fact, the evidence indicates a rather active investigative effort and multiple attempts to have the taxpayers fulfill their outstanding tax liability to Washington. The taxpayers signed the appropriate forms acknowledging their personal liability for the outstanding debt. The subsequent issuance of the TFAA should have come as no surprise. In either case, we simply cannot grant relief on the alleged equitable grounds of estoppel or laches in contravention of a statutory requirement. Equitable principles cannot be asserted to establish equitable relief in derogation of statutory mandates. *Longview Fibre Co. v. Cowlitz County*, 114 Wn.2d 691, 790 P.2d 149 (1990). We reject the taxpayer's contention that DOR is equitably estopped from now asserting sales tax liability against them personally.

2. <u>Penalty/interest issue</u>

[4] In respect to penalties and interest, Rule 217(8)(d) states:

> Extent of liability. Trust fund liability includes the collected but unpaid retail sales tax as well as the interest and penalties due on the tax.

Here, a number of penalties were included in the TFAA issued by DOR against the taxpayers, namely penalties for delinquency, issuing an assessment, and issuing a warrant. RCW 82.32.090; WAC 458-20-228(5) (Rule 228(5)).

When a taxpayer fails to timely pay taxes due on a return, DOR also is required to add interest on the tax due. RCW 82.32.050. Assessment of the above penalties and interest is mandatory. *See also, e.g.,* Det. No. 01-193, 21 WTD 264 (2002); Det. No. 99-279, 20 WTD 149 (2001); Det. No.

[10] The equitable doctrine of laches refers, generally, to an inexcusable or unreasonable delay in pursuing an equitable right or claim that results in prejudice to another party. Black's Law Dictionary (8th ed. 2004).

87-235, 3 WTD 363 (1987). All were properly assessed against the taxpayer, as required by the applicable statutes.

DOR is an administrative agency, and its authority to waive or cancel interest and penalties is restricted to the authority granted by the Legislature. The Legislature has granted DOR limited authority to waive or cancel interest and penalties, set out in RCW 82.32.105 and RCW 82.32A.020. DOR has 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 is authorized to waive interest only if the failure to timely pay the taxes was due to written instructions from DOR, or was for the sole convenience of DOR. RCW 82.32.105, RCW 82.32A.020; Rule 228(10). Neither of the circumstances that would allow us to cancel interest is present in this case. Therefore, we conclude that we cannot waive the interest assessed.

RCW 82.32A.020(2) gives taxpayers the right to have penalties waived where they have detrimentally relied on specific, official written advice from DOR to them. This provision applies to all the penalties referenced above. However, this provision obviously does not afford a basis for relief in this case. There was no change in DOR's position.

The other penalty waiver statute, RCW 82.32.105, provides, in pertinent part:

> (1) If the department of revenue finds that the payment by a taxpayer of a tax less than that properly due or the failure of a taxpayer to pay any tax by the due date was the result of circumstances beyond the control of the taxpayer, the department of revenue shall waive or cancel any penalties imposed under this chapter with respect to such tax.

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 Rule 228 (9). Rule 228(9)(a)(ii) states, in pertinent part:

> Circumstances beyond the control of the taxpayer are generally those which are immediate, unexpected, or in the nature of an emergency. Such circumstances result in the taxpayer not having reasonable time or opportunity to obtain an extension of the due date or otherwise timely file and pay.

The taxpayers' circumstances were not in the nature of an emergency, at least in the terms described above, and, therefore, ordinarily would not be considered a circumstance qualifying for waiver. The only circumstance that would seemingly come close to providing a basis for relief is financial hardship. Rule 228(9)(a) sets out examples of circumstances that ordinarily are, and circumstances that ordinarily are not, considered "circumstances beyond the control of the taxpayer," and one of the examples specifically delineated as not qualifying for a waiver under this provision is "financial hardship." Rule 228 (9)(a)(iii)(A). We find no other circumstance that comes close to explaining the taxpayers' untimely payment of its tax obligation.

Based upon these provisions, we conclude DOR has no authority under RCW 82.32.105 to cancel any of the penalties imposed against the taxpayers in relation to the TFAA. The above provisions are the extent of our authority to waive or cancel penalties or interest. None of these provisions allows us to waive or cancel the penalties or interest in the present case. Accordingly, we must deny the taxpayers' petition for cancellation of penalties and interest.

DECISION AND DISPOSITION

The taxpayers' petition is denied.

Dated this 30th. day of March, 2005.