

Cite as Det. No. 18-0135, 37 WTD 192 (2018)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS 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. 18-0135
)	
...)	Registration No. . . .
)	

[1] RULE 228; RCW 82.32.090: RETAIL SALES TAX – EVASION PENALTY – INTENT TO EVADE. Evidence that a taxpayer collected retail sales tax from its customers but failed to remit those taxes to the Department proves that it was aware of its tax liability and establishes an intent to evade.

[2] RULE 228; RCW 82.32.105: RETAIL SALES TAX – LATE PAYMENT PENALTY – WAIVER – FRAUD OR EMBEZZLEMENT ON THE PART OF EMPLOYEE. Evidence that a CPA was subject to professional discipline and that a taxpayer filed a civil action against the CPA does not show that the taxpayer’s failure to file and pay its taxes was due to circumstances beyond the control of 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.

Margolis, T.R.O. – A provider of . . . services (Taxpayer) appeals the assessment of evasion penalties on grounds that it did not intentionally evade its tax liability, and delinquent penalties on grounds that its failure to pay was due to circumstances beyond its control. We deny the petition.¹

ISSUES

1. Whether, under RCW 82.32.090, Taxpayer intentionally evaded its known tax liability and is subject to the evasion penalty.
2. Whether, under RCW 82.32.105(1), delinquent penalties should be waived on grounds that Taxpayer’s failure to pay was the result of its CPA committing fraud.

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

FINDINGS OF FACT

Taxpayer is a provider of . . . services for commercial and residential customers. The Department of Revenue's (Department's) Audit Division (Audit) examined Taxpayer's records for the period January 1, 2012, through March 31, 2016, and on April 17, 2017, issued an adjusted assessment against Taxpayer for \$ The assessment is comprised of \$. . . in retail sales tax, \$. . . in public road construction business and occupation (B&O) tax, \$. . . in retailing B&O tax, \$. . . in wholesaling B&O tax, \$. . . in use/deferred sales tax, \$. . . in 29% delinquent penalty, \$. . . in evasion penalty, \$. . . in 5% assessment penalty, \$. . . in additional late payment penalty, and \$. . . in interest.

[Predecessor], a sole proprietor, is Taxpayer's predecessor. [Predecessor] reported retail sales tax and retailing B&O tax from Q1/2009 through Q3/2010. [Predecessor] closed on August 31, 2010, and Taxpayer, a limited liability company, opened on September 1, 2010. Taxpayer collected retail sales tax from its customers, but failed to file combined excise tax returns and remit tax to the Department. It did not report any income until Q3/2015, and then filed without a payment. The Department's Compliance Division (Compliance) made multiple phone calls and sent multiple letters and secure messages to Taxpayer from 2011 to 2015, but to no avail. In 2011 alone, Department records show that it left five messages seeking return calls, sent four delinquent letters, and on two occasions, spoke with . . . , Taxpayer's Administrative Operations Manager.

Audit starting trying to contact Taxpayer in the beginning of 2012. The Department obtained a Confidential Taxpayer Information Authorization (CTIA) for . . . (of . . . , hereafter referred to collectively as "CPA"), and tried to contact Taxpayer or CPA in order to audit Taxpayer's account. Audit left telephone messages for Taxpayer or CPA seeking a return call to discuss the audit on October 14, 2014, January 14, 2015, and February 20, 2015, to no avail. Audit followed up with a letter to both Taxpayer and CPA, and was eventually able to discuss Taxpayer's account with CPA. Audit requested records, and when records were not provided, Audit sent estimated schedules to both Taxpayer and CPA. On March 29, 2016, Taxpayer sent the Department a CTIA for . . . , and . . . called Audit. . . . claimed that CPA failed to report any taxes, Taxpayer was unaware of this omission, and that she would reconstruct the recordkeeping. . . . began providing records, and explained that [Predecessor] had failed to return Audit's phone calls and letters because they were afraid of Department auditors.

Taxpayer appeals the assessment of penalties on grounds that [Predecessor] was unaware of the outstanding returns and Taxpayer's failure to file and pay was beyond Taxpayer's control because it was a result of fraud by CPA, who assured Taxpayers that they were in compliance and that she would properly handle tax liabilities, including the Department's audit. Taxpayer alleges that it provided CPA with requisite records on a quarterly basis, and that CPA told Taxpayer that it had no liability because it could take tax paid-at-source deductions.

Taxpayer provided documents in support of its petition, including a partial affidavit of . . . explaining her involvement in the matter; archived internet pages from CPA touting various services, qualifications and accomplishments; IRS bulletins showing that CPA had been placed under consent suspension from practice before the IRS; records of proceedings before the Washington State Board of Accountancy that describe various violations by CPA and under which

CPA's license was suspended; financial records showing Taxpayer payments to CPA; email between Taxpayer and CPA showing that [Predecessor] was working with CPA on payroll and time sheets, and that CPA had responded to "made up audit findings;" email from CPA indicating that she is handling an August 11, 2015, Department Notice of Deficiency; and, a Complaint for Accounting Malpractice filed by Taxpayer versus CPA in Superior Court

ANALYSIS

RCW 82.32.090(7) imposes a 50% evasion penalty when "the department finds that all or any part of the tax deficiency resulted from an intent to evade the tax" WAC 458-20-228 (Rule 228) is the Department's administrative rule that discusses the evasion penalty. Rule 228(5)(f) provides further explanation as follows (in pertinent part):

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.

. . .

(ii) . . . The following is a nonexclusive list of actions that are generally considered to establish an intent to evade a tax liability

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

Rule 228(5)(f).

Evasion requires that the taxpayers (1) know they have a tax obligation; and (2) intentionally do something, which is false or fraudulent to evade that obligation. Det. No. 92-133, 12 WTD 171 (1992). The Department has the burden to show the elements of evasion by clear, cogent, and convincing evidence. Det. No. 90-314, 10 WTD 111 (1990). Clear, cogent, and 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, 735, 853 P.2d 913 (1993). Once the Department has demonstrated the existence of each element of evasion (i.e., *a prima facie* case), the taxpayer bears the burden of production to come forward with evidence of honest mistake, ignorance of the law, or some other fact which tends to rebut the Department's evidence. Det. No. 04-0098, 23 WTD 331 (2004). Mere subjective and self-serving statements by the taxpayer regarding intent, without more, are insufficient to meet this burden of production. *Id.*

Here, the first element is met because Taxpayer's member had reported and paid taxes when the business operated as a sole proprietorship, and it ignored years of phone calls, delinquent notices, and secure messages. Taxpayer also collected retail sales taxes. This shows that Taxpayer knew

that it had a tax obligation. The second element is met because Taxpayer willfully failed to remit sales tax it collected from its customers, which establishes intent to evade under Rule 228(5)(f)(ii)(B). *See* Det. No. 15-0067, 34 WTD 424 (2015) (intent to evade found where the taxpayer's invoices indicated that it consistently collected retail sales tax, but did not remit the tax to the Department). Thus, the Department has made a *prima facie* case of evasion.

Taxpayer asserts that it thought CPA was properly handling its accounting, and that it was unaware that it was not correctly reporting and remitting taxes. In support of this assertion, Taxpayer provided evidence that it was paying CPA and that CPA had committed various violations, was disciplined by the IRS and the Board of Accountancy, and Taxpayer filed an action against CPA. However, the evidence is clear that the Department contacted Taxpayer directly regarding its liability, and we do not find it credible that a business run by a member with a history of reporting and remitting taxes would not file any returns and pay any excise taxes for several years, keeping the collected retail sales tax for itself, being unaware of its failure to report and remit taxes, despite the Department's extensive efforts to contact Taxpayer. Evidence that CPA was subject to discipline and that Taxpayer filed an action against CPA does not show that Taxpayer's failure to file and pay was due to ignorance. Because Taxpayer's evidence is comprised of self-serving statements regarding intent, it does not meet the burden of production and we find that Audit correctly assessed the evasion penalty.

RCW 82.32.105(1) provides for waiver of the late payment penalty where there are “. . . circumstances beyond the control of the taxpayer” The application of this authority is discussed in Det. No. 06-0155, 26 WTD 73 (2007) as follows:

“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.” WAC 458-20-228(9)(a)(ii). Examples of circumstances beyond the control of the taxpayer include fraud, embezzlement, or theft on the part of an employee or agent; but only if the taxpayer could not immediately detect or prevent the act and reasonable safeguards or internal controls were in place. WAC 458-20-228(9)(a)(ii)(F). The burden is on the taxpayer to show that circumstances beyond its control directly caused the late payment or tax assessment. WAC 458-20-228(9)(a)(i).

In order to be entitled to the waiver of penalty based on allegations of fraud, embezzlement, or theft, there are four things the taxpayer must prove:

- First, the taxpayer must establish that the alleged criminal act actually occurred. Because the waiver provision is civil in nature, we do not require proof beyond a reasonable doubt or proof that the employee or agent was convicted of the crime. However, mere allegations of fraud, embezzlement, or theft are not sufficient. Under the “preponderance of the evidence” standard the taxpayer must produce documents or witness statements that show that it is more likely than not that the alleged criminal act occurred. Documents that may be useful in this regard include police reports, sworn affidavits or witness statements, public records showing that the individual has

been indicted or charged with the crime being alleged, or a federal income tax return signed by the taxpayer that includes a claim for theft loss.

- Second, the taxpayer must establish that the alleged criminal act caused the late payment or assessment of the underlying tax. *See* Det. No. 01-067, 20 WTD 525, 528 (2001) (“the circumstances must actually cause the late payments.”). Again, the standard of proof is a preponderance of the evidence (*i.e.*, more likely than not). However, the evidence must show a direct link between the alleged criminal act and the late payment or underpayment of the tax.
- Third, the taxpayer must establish that the act of fraud, embezzlement, or theft was of a nature that could not be immediately detected or prevented . . .
- Fourth, the taxpayer must establish that it had reasonable safeguards or internal controls in place to detect or prevent acts of fraud, embezzlement, or theft. *See* Det. No. 01-067, 20 WTD 525, 528 (2001) . . .

We find that none of the above elements have been satisfied. Taxpayer has provided no proof that CPA engaged in a criminal act, that such act caused late payment or underpayment, that Taxpayer could not immediately detect or prevent the act, nor that it had reasonable safeguards or internal controls in place to prevent the act. Taxpayer’s failure to file and pay was not due to circumstances beyond its control.

DECISION AND DISPOSITION

Taxpayer’s petition is denied.

Dated this 16th day of May 2018.