

Cite as Det. No. 18-0117, 38 WTD 203 (2019)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for)	<u>D E T E R M I N A T I O N</u>
Correction of Assessment of)	
)	No. 18-0117
)	
...)	Registration No. ...
)	

[1] RCW 82.32.090(7); WAC 458-20-228(5)(f): EVASION PENALTY - INTENT TO EVADE; PATTERN. Consistent and recurring collection of substantial retail sales tax sums and alteration of records supports a finding of intent to evade. The assertion that the withholding was attributable to an honest mistake is inconsistent with ongoing collection and retention throughout the entire audit period.

[2] RCW 82.32.090(7); WAC 458-20-228(5)(f): EVASION PENALTY - INTENT TO EVADE; MISTAKE. Assertion that the collection of substantial retail sales tax sums was an honest mistake is not supported where basic due diligence would have revealed the collection and retention of the retail sales tax and there is no indication of any effort to correct the alleged error throughout the audit period.

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.

Kreger, T.R.O. – A plat development company protests the inclusion of an evasion penalty for failure to timely remit collected retail sales tax, attributing the failure to lack of familiarity with the invoicing system. We sustain the inclusion of the evasion penalty as ongoing and consistent underreporting of collected retail sales tax and willful alteration of the electronic records is a sufficient basis to support the imposition of the evasion penalty.¹

ISSUE

Was the evasion penalty properly imposed pursuant to the standards articulated by RCW 82.32.050(4) and RCW 82.32.090(7)?

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

FINDINGS OF FACT

. . . (Taxpayer) is a Washington Limited Liability Company engaged in the business of providing plat development services, which principally entail excavation and grading of land. The Audit Division of the Department of Revenue (Department) conducted an audit of the Taxpayer's Washington business activities, which identified additional tax liability. Upon examination of the Taxpayer's electronic business records, Audit discovered that the records had been altered and retail sales tax initially recorded and included on invoices issued had been deleted. Based on this failure to remit collected retail sales tax, the audit period was extended and two assessments were issued to the Taxpayer. Document No. . . . (Invoice # . . .) covering January 1, 2010, through December 31, 2011 for \$. . . , which was limited to unremitted retail sales tax and corresponding penalties and interest; and Document No. . . . (Invoice # . . .) covering January 1, 2012, through December 31, 2015 for \$² The Taxpayer subsequently remitted partial payments towards Invoice #

The Taxpayer timely petitioned for review. On review, the Taxpayer does not dispute liability for the tax at issue or that retail sales tax was collected but not remitted. Rather, the Taxpayer asserts that the failure to remit the retail sales tax was attributable to an honest mistake and that there was no intent to evade and so the evasion penalty was improperly included in the assessments.

The Taxpayer asserts that, due to a lack a familiarity with and limited technical proficiency with the bookkeeping software used to generate invoices, some wholesale transactions were incorrectly billed as retail transactions and retail sales tax was incorrectly added to the invoice. The Taxpayer did not correct the invoices, considering the amount billed to be correct. Because the Taxpayer believed the work was not actually subject to retail sales tax and the invoice total was for the amount the Taxpayer intended to bill the customer, the Taxpayer simply kept the retail sales tax as wholesale income. The Taxpayer asserts that it was not aware that the retail sales tax constituted a trust fund and was due even if collected in error until the audit.

A review of the electronic records provided, using an audit trail function, showed that the records had been modified to remove collected sales tax amounts from the records and to delete invoices. Additionally, reconciliation of the retail sales tax that was reported to the state showed that local sales tax was reported under a lower tax rate applicable to a single location, rather than at the higher rate applicable to the location where the work had been performed, as recorded in the electronic records. Unmodified back-up files were requested for review but not provided.

For the regular audit period covered by Invoice # . . . , retail sales tax was also assessed on some work that was reported as wholesale for which the Taxpayer was not able to provide reseller permits and which were reclassified as retail sales. The evasion penalty was not assessed on the retail sales tax attributable to this reclassification, but only on the retail sales tax that was collected but not remitted.

² Invoice # . . . is comprised of \$. . . in retail sales tax, interest of \$. . . in interest, a 5% assessment penalty of \$. . . and an evasion penalty of \$ Invoice # . . . is comprised of \$. . . in retail sales tax, \$. . . in retailing business and occupation tax, a credit for (\$. . .) in wholesaling business and occupation tax, \$. . . in use tax, interest of \$. . . , a 5% assessment penalty of \$. . . and an evasion penalty of \$

In this case, the audit period was extended because Taxpayer collected retail sales tax, which it failed to remit to the Department, triggering an exception to the standard four-year time limit. RCW 82.32.050(4); WAC 458-20-230(4).³ The Taxpayer does not protest the extended audit period or dispute the liability for the tax and interest assessed. The petition for review was limited to whether the evasion penalty was properly included in the assessments at issue.

ANALYSIS

Under RCW 82.32.090(7), an evasion penalty of 50% of the tax assessed “must be added” if the Department shows that the taxpayer knew of the tax liability and that the deficiency resulted from “an intent to evade the tax payable.” The Department will impose an evasion penalty when the failure to pay the proper amount of the tax “resulted from an intent to evade the tax.” RCW 82.32.090(7). 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).

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). WAC 458-20-228 (Rule 228) is the administrative regulation that addresses the imposition of penalties and as to the application of evasion penalties, it states: “to the extent that the evasion involved only specific taxes, the evasion penalty will be added only to those taxes.” Rule 228(5)(f)(i).

The willful failure of a seller to remit collected retail sales tax to the Department is generally considered to establish intent to evade a tax liability. Rule 228(5)(f)(ii)(B). However, intent to evade does not exist where a deficiency was due to an honest mistake, miscommunication, or ignorance of proper accounting methods. Rule 228(5)(f).

Here, the first element of evasion is met, because Taxpayer separately stated retail sales taxes on some customer invoices and correctly remitted retail sales tax on some project work, which shows awareness of its retail sales tax liability. The Taxpayer asserts that the inclusion of retail sales tax was in error in some instances and attributable to its lack skill and familiarity with the accounting system. The Taxpayer asserts that these billing errors were not corrected because the invoice totals were for the correct amount due, so it did not think it necessary to issue a corrected invoice. The Taxpayer has admitted to willfully collecting and failing to remit retail sales tax, which meets the first element of evasion. The second element requires the Department to prove

³ WAC 458-20-230(4) provides:

Evasion or misrepresentation. There is no limitation for the period in which an assessment or correction of an assessment can be made upon a showing of evasion or of misrepresentation of a material fact. 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. The evasion must be shown by clear, cogent, and convincing evidence which is objective and creditable. However, in the case of evasion or misrepresentation, any assessment for taxes which extends beyond four years and the current year will be limited to taxes which were underpaid as a result of the evasion or misrepresentation. (See RCW 82.32.050 and 82.32.090.)

that Taxpayer intended to evade a known tax liability through fraud, deceit, or other intentional wrongdoing. Taxpayer's willful failure to remit sales tax it collected from its customers and misappropriation of these trust funds for other purposes establishes intent under Rule 228(5)(f)(ii)(B). Thus, the Department has made a *prima facie* case of evasion.

Once the Department has clearly established the elements of evasion, a burden of production is imposed on the taxpayer to produce evidence of honest mistake, miscommunication, ignorance of law, lack of knowledge, or some other fact which tends to rebut the Department's evidence. Det. No. 04-0098, 23 WTD 331 (2004). 23 WTD 331 goes on to explain that:

Mere subjective and self-serving statements by the taxpayer regarding intent, without more, are insufficient to meet this burden of production. Any evidence presented by the taxpayer must be weighed against that presented by [the Department]. Because the burden placed on the taxpayer is one of production only, the burden of proof as to evasion still rests with [the Department]. The evidence of evasion presented by [the Department] when viewed alone, or along with the taxpayer's evidence, must weigh heavily in favor of upholding the assessment.

Id. at 338.

In this case, the Taxpayer has generally asserted that the error is attributable to a lack of familiarity with the accounting software and that the erroneous collection and failure to remit the retail sales tax was due to an honest mistake. However, the fact that the erroneous collection occurred throughout the audit period, coupled with the alteration of the electronic records to delete collected retail sales tax after the fact, contrarily indicates that the error was recurring and intentional.

This is not a case where the error was made for the first quarter, or even the first year, of the audit period, and then corrected when the Taxpayer became aware of the erroneous billings. It is also noteworthy that a portion of the sales tax that was remitted was reported for a lower tax location rather than being reported at the rate applicable to the location where the work occurred, which was the location and rate indicated in the electronic records. Thus, the Taxpayer was not only completely withholding collected retail sales tax from some sales but also underreporting collected retail sales tax on another category of sales. It is also significant that the amount of collected retail sales tax that was deleted from the period covered by both assessments was substantial (\$. . . for Invoice # . . . covering 2010-2011 and \$. . . for Invoice # . . . covering 2012-2015). Thus, in addition to the error occurring throughout the audit period on a material number of invoices, it also involved a significant amount of money. Discrepancies of this magnitude should have been identified and corrected with even a limited level of due diligence. The magnitude and consistency of the erroneous collection is more consistent with an intentional error than a good faith mistake and a lack of understanding of how the bookkeeping software worked.

We conclude that the Taxpayer's failure to correctly report and remit the tax at issue was intentional and undertaken with the knowledge or belief the tax was in fact owed. We sustain the imposition of the evasion penalty and deny the Taxpayer's petition.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 3rd day of May 2018.