

Cite as Det. No. 05-0061, 24 WTD 440 (2005)

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. 05-0061
)	
)	Registration No. . . .
)	Doc. No. . . . /Audit No. . . .
)	Docket No. . . .
)	

- [1] RULE 228; RCW 82.32.105: PENALTY WAIVER – CIRCUMSTANCES BEYOND THE CONTROL OF THE TAXPAYER. “Reliance by the taxpayer on incorrect advice received from the taxpayer’s legal or accounting representative” is a circumstance specifically delineated as not being beyond the control of the taxpayer and is, therefore, not a basis for the cancellation or waiver of a penalty.

- [2] RCW 82.32.090: 2003 LEGISLATIVE CHANGES TO PENALTY STRUCTURE -- WHEN EFFECTIVE. The Washington Legislature amended RCW 82.32.090 in 2003. Prior to the amendment, delinquent excise tax returns were subject to a three-tier penalty. The 2003 legislation increased the latter two penalty rates by 5%. The legislation also added a 5% assessment penalty to be imposed in addition to the delinquency penalties. All changes to the penalty rates were effective on July 1, 2003, and attached to penalties applied on and after that date, including penalties applied to taxes due on activities that occurred prior to that date. The five percent assessment penalty applies to all assessments originally issued after June 30, 2003.

- [3] RCW 82.32.050: APPLICABLE INTEREST RATE -- 2003 LEGISLATIVE CHANGES – RATE APPLICABLE TO UNDERPAYMENTS. Because RCW 82.32.050(1) directs that “[t]he rate so computed shall be adjusted on the first day of January of each year for use in computing interest for that calendar year,” a different interest rate is applied to each respective year. The Washington Legislature amended the excise tax interest rate provisions in 2003. In respect to underpayments (*i.e.*, assessments), DOR bases the interest rate on the federal short-term rate as published by the U.S. Treasury. Prior to July 2003, the calculation averaged the federal rates from January, April, July and October of the

prior year. The 2003 change substituted the October rate of the prior year with the previous preceding October rate, thereby allowing DOR to calculate the interest rate earlier and provide earlier notification to taxpayers.

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. – A taxpayer requests a waiver of penalties and interest imposed by the Department of Revenue (DOR). Alternatively, the taxpayer requests that we apply the penalty and interest provisions that existed prior to July 2003 to an assessment originally issued in August 2004. We find no discretion to grant the taxpayer's request and deny the petition.¹

ISSUE

1. Whether DOR can waive penalties and interest when a problem with an accounting program and lack of accountant oversight caused the underpayment of tax.
2. Whether DOR should apply the penalty and interest provisions that existed prior to July 2003 to an assessment originally issued in August 2004 when the taxpayer contends that the tax underpayments that gave rise to the assessment occurred prior to July 2003.

FINDINGS OF FACT

The taxpayer . . . operates a sole proprietorship . . . [in] Washington. DOR performed a partial audit of taxpayer's financial records for the period January 1, 1999 through December 31, 2002,^[2] and issued an assessment for tax liability on August 16, 2004. After the taxpayer provided additional records documenting certain tax paid at source deductions, DOR issued a post assessment adjustment (PAA) on December 10, 2004. The PAA included an assessment of tax (\$. . .), a 5% assessment penalty (\$. . .), a 25% delinquency penalty (\$. . .), and interest (\$. . .). The total amount of assessed was \$. . . The taxpayer paid the tax portion of the assessment. The amounts relating to penalties and interest remain owing.

During the audit period, the taxpayer's business activities in Washington included acting as a general contractor primarily involved in the speculative and custom construction of homes Various repairs and remodels of existing homes were also performed by the taxpayer during the audit period.

The taxpayer states that the unpaid taxes resulted from a problem with his accounting program as his company transitioned from a speculative builder to a custom homebuilder in 2001/2002. Unfortunately, the taxpayer's former accountant did not catch the problem in his monitoring of

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

² The taxpayer did not file returns during this period.]

the taxpayer's books. Based on these problems, the taxpayer requests a waiver of the penalties and interest.

The taxpayer notes that he has changed computer programs and has been current with his taxes since January 1, 2003. Due to this fact, the taxpayer believes that if we do not waive the penalties and interest in their entirety, we should charge him the penalty and interest rates that were in effect in July 2003.

ANALYSIS

1) Penalty/interest waiver issue

Although the taxpayer does not dispute the underlying tax liability that gave rise to the tax component of the audit assessment, a brief discussion of the taxable differences between being a "speculative" builder and a "custom" builder may be helpful for putting the taxpayer's penalty/interest waiver request in context. Generally, the difference turns on being a consumer (speculative) versus reselling the materials and/or services (custom). The retail sales tax is imposed on all "retail sales" in Washington. RCW 82.08.020. "Retail sales" are defined in RCW 82.04.050, and include sales of tangible personal property and charges for labor and other services rendered "in respect to constructing" (RCW 82.04.051) new buildings on real property for consumers (RCW 82.04.190). As a speculative builder, the taxpayer is the consumer. RCW 82.04.020(2); 82.04.190; WAC 458-20-170(2) (Rule 170(2)). A fuller explanation of the distinction can be found in Rule 170.

When the taxpayer changed the focus of his business from speculative to custom building, his tax responsibilities changed. Unfortunately, the taxpayer, or more specifically the taxpayer's accountant, did not make the required corresponding adjustments to how income was reported to DOR; hence, the tax liabilities, penalties, and interest included in DOR's assessment.

WAC 458-20-228 (Rule 228) discusses the responsibility of taxpayers to timely pay their tax liabilities. The rule also discusses the penalties and interest that are imposed by law when a taxpayer fails to correctly or timely pay a tax liability. Finally, Rule 228 discusses the circumstances under which the law allows DOR to waive penalties or interest.

Washington's tax system is based largely on voluntary compliance. Taxpayers have a legal responsibility to become informed about applicable tax laws, to register with DOR, to seek instruction from DOR, to file accurate returns, and to pay their tax liability in a timely manner (chapter 82.32A RCW Taxpayer rights and responsibilities).

Various penalties may apply because of the failure to correctly or accurately compute the proper tax liability or to timely pay the tax. Separate penalties may apply and be cumulative for the same tax. Interest may also apply if any tax has not been paid when it is due. RCW 82.32.050; Rule 228(5).

DOR imposed a 25% penalty due to delinquency. RCW 82.32.090(2). Since July 1, 2003, DOR has been required to assess a 5% penalty whenever it determines that any tax is due. DOR adds this penalty to every billing and assessment, and is in addition to the above delinquency penalty. RCW 82.32.090(2).

[1] The taxpayer contends that his circumstances warrant the cancellation of the assessed penalties. RCW 82.32.105 authorizes DOR to waive or cancel penalties under limited circumstances. DOR will waive or cancel the penalties imposed under chapter 82.32 RCW upon finding that the underpayment of the tax was the result of circumstances beyond the control of the taxpayer. The taxpayer bears the burden of establishing that the circumstances were beyond its control and directly caused the late payment. Rule 228(9).

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. Circumstances beyond the control of the taxpayer include:

(A) The return payment was mailed on time but inadvertently sent to another agency.

(B) Erroneous written information given to the taxpayer by a [DOR] officer or employee caused the delinquency. A penalty generally will not be waived when it is claimed that erroneous oral information was given by a [DOR] employee....

(C) The delinquency was directly caused by death or serious illness of the taxpayer, or a member of the taxpayer's immediate family. The same circumstances apply to the taxpayer's accountant or other tax preparer, or their immediate family. This situation is not intended to have an indefinite application. A death or serious illness which denies a taxpayer reasonable time or opportunity to obtain an extension or to otherwise arrange timely filing and payment is a circumstance eligible for penalty waiver.

(D) The delinquency was caused by the unavoidable absence of the taxpayer or key employee, prior to the filing date. "Unavoidable absence of the taxpayer" does not include absences because of business trips, vacations, personnel turnover, or terminations.

(E) The delinquency was caused by the destruction by fire or other casualty of the taxpayer's place of business or business records.

(F) The delinquency was caused by an act of fraud, embezzlement, theft, or conversion on the part of the taxpayer's employee or other persons contracted with the taxpayer, which the taxpayer could not immediately detect or prevent, provided that reasonable safeguards or internal controls were in place....

(G) The taxpayer, prior to the time for filing the return, made timely application to the Olympia or district office for proper forms and the forms were not furnished in sufficient time to permit the completed return to be paid before its due date....

Rule 228(9)(a)(ii). None of these delineated circumstances is applicable to the taxpayer's situation. On the other hand, Rule 228(9)(a)(ii)(B) specifically provides that "[r]eliance by the taxpayer on incorrect advice received from the taxpayer's legal or accounting representative is

not a basis for cancellation of a penalty.” We find that the taxpayer’s problems with his accounting program and the lack of diligent accountant oversight fall within this description of a circumstance not suitable for a waiver of penalties. Although we appreciate the frustration caused by these difficulties, we simply do not have the discretion to cancel the penalties in such circumstances. Therefore, we must sustain the assessment of the penalties.

DOR is required by law to add interest to assessments for tax deficiencies. Interest applies to taxes only (i.e., the interest does not apply to any assessed penalties). RCW 82.32.050; Rule 228(7). DOR can only waive interest 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, and WAC 458-20-228(10). Neither of these circumstances are applicable here. Therefore, we conclude that we cannot waive the interest assessed.

DOR is an administrative agency, and its authority to waive or cancel penalties and interest is restricted to the authority granted by the Legislature. The Legislature has granted DOR limited authority to waive or cancel penalties and interest, 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).

2) Pre-July 2003 penalty/interest provisions issue

[2] In the alternative to canceling the penalties and interest in their entirety, the taxpayer requests that DOR apply the penalties and rate of interest that existed prior to July 2003 because from January 1, 2003 he has been compliant in all his Washington tax obligations. Stated somewhat differently, the taxpayer believes that since the incorrect tax reporting that gave rise to the assessment occurred prior to July 2003, DOR should apply the penalty and interest structure that existed prior to that time.

We will address the taxpayer’s penalty argument first. The taxpayer correctly observes that the Washington Legislature amended RCW 82.32.090 in 2003.³ Prior to the amendment, delinquent excise tax returns were subject to a three-tier penalty. If the tax return was not received by the due date (25th of the month following the tax liability for monthly reporters and the end of the following month for quarterly and annual reporters), a penalty of 5% of the tax due was applied. If the return was not received by the end of the next month following the due date, the penalty increased to 10%. If the return was still outstanding by the end of the second month following the due date, the penalty increased to 20%. The 2003 legislation increased the latter two penalty rates by 5%. The legislation also added a 5% assessment penalty to be imposed in addition to the above delinquency penalties. Pursuant to the language of the legislation, the imposition of all of the above penalties is mandatory; DOR has no discretion in the matter.

All changes to the penalty rates were effective on July 1, 2003 and attached to penalties applied on and after that date, including penalties applied to taxes due on activities that occurred prior to that date. Section 14 of the legislation specifically states that the change in penalties “applies to

³ Laws of Washington, 2003 1st Sp. Sess. Ch. 13.

all penalties imposed after June 30, 2003. The five percent penalty . . . applies to all assessments originally issued after June 30, 2003.” Thus, we must reject the taxpayer’s request to apply the pre-July 2003 penalty structure to the current assessment originally issued on August 16, 2004.⁴

[3] As for the application of interest to the taxpayer’s assessment, RCW 82.32.050 provides:

1) If upon examination of any returns or from other information obtained by the department it appears that a tax or penalty has been paid less than that properly due, the department shall assess against the taxpayer such additional amount found to be due and shall add thereto interest on the tax only

(b) For tax liabilities arising after December 31, 1991, the rate of interest shall be variable and computed as provided in subsection (2) of this section from the last day of the year in which the deficiency is incurred until the date of payment. The rate so computed shall be adjusted on the first day of January of each year for use in computing interest for that calendar year. . . .

(2) For the purposes of this section, the rate of interest to be charged to the taxpayer shall be an average of the federal short-term rate as defined in 26 U.S.C. Sec. 1274(d) plus two percentage points. The rate set for each new year shall be computed by taking an arithmetical average to the nearest percentage point of the federal short-term rate, compounded annually. That average shall be calculated using the rates from four months: January, April, and July of the calendar year immediately preceding the new year, and October of the previous preceding year. (Emphasis added.)

Because subsection (1) directs that “[t]he rate so computed shall be adjusted on the first day of January of each year for use in computing interest for that calendar year,” a different rate is applied to each respective year.

The taxpayer correctly notes that the Washington Legislature amended RCW 82.32.050 in 2003, thereby modifying the excise tax interest provisions.⁵ Most of the legislative changes relate to the interest rate calculation on refunds and, thus, are inapplicable to the present case. In respect to the interest rate applicable to underpayments (*i.e.*, assessments), DOR bases the interest rate on the federal short-term rate as published by the U.S. Treasury. Prior to July 2003, the calculation averaged the federal rates from January, April, July and October of the prior year. The 2003 change substituted the October rate of the prior year with the previous preceding October rate, thereby allowing DOR to calculate the interest rate earlier and provide earlier notification to taxpayers.⁶ The amendment was effective on July 27, 2003. Nevertheless, as the statutory provisions cited above make clear the interest rate is variable so the rate assessed

⁴ The taxpayer’s current appeal is based on the PAA issued on December 10, 2004. However, DOR *originally issued* the assessment the previous August.

⁵ Laws of Washington, 2003, Ch. 73.

⁶ For example, to calculate the interest rate effective January 1, 2003, DOR averaged the federal rates from January, April, July and October of 2002. After the 2003 legislative change, to calculate the interest rate effective for calendar year 2004, DOR averaged the federal rates from October 2002, and January, April, and July 2003.

against any outstanding tax liabilities varies year to year. The 2003 amendment merely changed the periods to which Washington looked at the federal short terms rates to determine the Washington State rate from 2004 forward, it does not affect the calculation of interest rates for prior years.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 21st day of March, 2005.