

Excise Tax Advisory

Excise Tax Advisories are interpretive statements authorized by RCW 34.05.230.

NUMBER: 3114.2009

ISSUE DATE: February 2, 2009

Substantial Underpayment Penalty

Chapter 256, Laws of 2006, changed the penalties related to tax assessments by amending RCW 82.32.090(2). Prior to July 1, 2006, the law imposed a 5% penalty anytime the Department issued an assessment of underpaid taxes. This penalty applied regardless of the amount of the underpayment.

Effective July 1, 2006, the 5% penalty applies only when there is a **substantial** underpayment of taxes due. The law defines substantial underpayment as the payment of “less than eighty percent of the amount of tax determined by the department to be due for all types of taxes included in, and for the entire period of time covered by, the department’s examination, and the amount of underpayment is at least one thousand dollars.” The substantial underpayment penalty is imposed only when both tests are satisfied. The purpose of this excise tax advisory is to explain how the Department will determine whether the 80% threshold is met.

For the purposes of the substantial underpayment penalty the Department considers use tax and retail sales tax as complementary taxes. Thus, if the Department examines the taxpayer’s records to verify either retail sales tax collected or use tax due, then retail sales tax paid to vendors will be included in determining whether the 80% threshold is met. Because the Department does not generally review the amount of retail sales tax paid to vendors, the burden is upon the taxpayer to demonstrate the amount. NOTE: Retail sales and use taxes paid to other states will not be considered in the calculation of the 80% threshold.

Audit Assessments:

1. **Full Audits:** When the Department performs a full audit of a taxpayer’s records, it generally reviews the taxpayer’s records for potential underreporting of:
 - Retail sales or use tax liability related to purchases of consumable supplies, retail services, and capital assets;
 - Retail sales taxes due on retail sales, which is to be collected and remitted to the Department;
 - Business and occupation (B&O) tax due on business activities; and

All ETAs were cancelled on February 2, 2009 and those which had a continued use were rewritten and reissued using a new numbering system. The new ETAs are numbered using the following format 3nnn.yyyy. The Department of Revenue issued ETA 3001.2009 which includes a cross reference table showing the old and new ETA numbers for those ETAs that were rewritten.

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- Other taxes that are to be reported on an excise tax return (e.g., litter tax, public utility tax, and hazardous substance tax).

The above is not an exclusive list of the taxes to be examined. When the Department reviews transactions that are subject to retail sales tax, the retail sales tax paid to vendors by the taxpayer will be included in the calculation to determine whether the 80% threshold is met. The following scenarios demonstrate how the 80% threshold is determined:

Scenario 1:

Assume that the Department audits Corporation A, and the only types of taxes reviewed in the audit are B&O, retail sales, and use taxes on capital assets, but did not review Corporation A's purchase of consumable supplies and retail services. The results of the audit are as follows:

Tax Type	Tax Due	Tax Paid	Assessed Underpayment
B&O Tax	10,000	8,000	2,000
Retail sales tax due on sales	36,000	28,000	8,000
Use tax due on capital assets	3,000	2,500	500
Totals	49,000	38,500	10,500

In this scenario the 5% substantial underpayment penalty will apply. Corporation A has paid only 78.6% (\$38,500/\$49,000) of the amount of tax determined by the Department to be due for all types of taxes included in the Department's examination, and thus has not satisfied the 80% threshold.

Scenario 2:

Same as Scenario 1, except after paying the assessment before the due date, Corporation A reviews its records and demonstrates that during the audit period it paid an additional \$5,000 retail sales tax to vendors for consumable supplies and retail services. Corporation A is responsible for providing this information. The results of the audit, combined with Corporation's demonstration of the amount of tax it paid to vendors, are as follows:

Tax Type	Tax Due	Tax Paid	Assessed Underpayment
B&O Tax	10,000	8,000	2,000
Retail sales tax due on sales made by Corporation A	36,000	28,000	8,000
Retail sales tax paid to vendors on purchases of consumable supplies and retail services	5,000	5,000	0
Use tax due on capital assets	3,000	2,500	500
Subtotal	54,000	43,500	10,500

In this scenario the 5% substantial underpayment penalty previously assessed and paid by Corporation A will be refunded. Corporation A has satisfied the 80% threshold because it has paid 80.6% (\$43,500/\$54,000) of the amount of tax determined by the Department to be due for all types of taxes included in the Department's examination.

2. **Limited scope audits:** When the Department conducts a limited scope audit, only certain taxes are examined. Examples of limited scope audits include verification that the appropriate amount of:

- Leasehold excise tax was paid;
- B&O tax was paid on income;
- Sales or use tax was paid on the acquisition of consumables, capital assets, and/or retail services;
- Sales tax collected on income was remitted to the Department; or
- Petroleum products tax was paid on the possession of petroleum products.

Only taxes examined are considered in calculating the 80% test. For example, in the case of a leasehold excise tax limited scope audit, the Department only examines leasehold excise taxes. Thus, retail sales tax and use tax payments are not considered when determining whether the 80% threshold is met.

In the case where the Department conducts a limited scope audit to verify that sales tax collected from customers was properly remitted, the amount of retail sales tax the taxpayer can demonstrate that it paid to vendors and use tax it can demonstrate it paid to the Department will be considered.

Examination of a tax return:

When reviewing a tax return to determine if the return itself was correctly completed, the Department examines all the tax types reported on the return.

When the tax return reports B&O tax only, the Department is not examining the taxpayer's payment of retail sales or use tax. Therefore, payment of retail sales tax to a vendor is not considered in calculating the percentage of tax paid.

If a taxpayer reports a retail sales or use tax liability on a return, the amount of retail sales tax the taxpayer can demonstrate that the taxpayer paid to vendors will be considered for purposes of determining whether the 80% threshold is met. The Department will assess the substantial underpayment penalty based on the information on the return. If the Taxpayer provides documentation showing that retail sales tax was paid to vendors, the Department will include the amount of such taxes in a recalculation to determine if the 80% threshold was met.

Scenario 3

Assume that Partnership B filed a tax return with the following information:

Tax Type	Tax reported	Tax Paid	Amount underpaid
Retailing B&O Tax	471		
Service and Other B&O tax	1,500		
Retail sales tax - State	6,500		
Retail sales tax- local	2,300		
Total	10,771	8,000	2,771

The percentage of tax paid per the tax return is 74.3% (\$8,000/\$10,771). Under these circumstances, the Department will issue an assessment (commonly referred to as a “Notice of Balance Due”) that will include the 5% substantial underpayment penalty.

Scenario 4

If Partnership B demonstrates that it paid retail sales tax of \$3,100 directly to vendors during the return period, then the percentage of taxes paid would be 80.02% (\$11,100/\$13,871). In this case, the substantial underpayment penalty will be canceled or refunded if Partnership B complies with the timelines described below. (See Table below.)

Tax Type	Tax reported	Tax Paid	Amount underpaid
Retailing B&O Tax	471		
Service and Other B&O tax	1,500		
Retail Sales Tax paid to vendors	3,100	3,100	
Retail sales tax - State	6,500		
Retail sales tax - local	2,300		
Paid with return		8,000	
Total	13,871	11,100	2,771

Actions by taxpayers to cancel penalty:

How do taxpayers demonstrate to the Department that they paid retail sales tax to vendors?

If you want to ask us to recalculate the tax paid by considering retail sales tax paid to vendors, you must submit proof of payment to the Department.

What constitutes proof of payment of retail sales tax?

You can prove you paid retail sales tax by providing any of the following:

1. Copies of cash register receipts that show you as the payor, the date of the payment, and separately stating the retail sales tax;
2. Copies of receipts that separately state the retail sales tax but do not show your name. In this case, you must show that you actually paid for the items by cancelled check, bankcard receipt, or other means. You must also prove the date of payment.
3. Copies of invoices separately stating the retail sales tax, proof that you paid that invoice (cancelled check, bankcard receipt, etc.), and proof of the date of payment.

Alternatively, you may submit a spreadsheet which identifies the vendor, purchase date, sales price, and retail sales tax. You must certify that the information on the spreadsheet is accurate. We will review the spreadsheet and, if reasonable, accept your statement, subject to future audit verification.

NOTE: Only taxes paid during the period covered by the Notice of Balance Due or tax assessment will be considered.

How do you submit additional documentation?

If you want to submit additional documentation for the Department to consider, you must mail the documentation to the address shown on the notice containing the assessment of the penalty (e.g., notice of balance due, tax assessment). The documentation must be accompanied by a spreadsheet or other summary documentation.

When must you submit the documentation?

If you are assessed the substantial underpayment penalty and you pay the entire assessment before the due date, you may submit additional documentation any time before the close of the fourth tax year following the payment to obtain a refund. RCW 82.32.060 and 82.32.170.

Alternatively, you have three other options, any one of which must be performed before the due date shown on the notice of balance due:

1. You may pay the tax portion of a balance due notice and submit the additional documentation, and the Department will consider whether the penalty applies.
2. You may pay the tax portion of a balance due notice and request extra time to submit the additional documentation. We will consider requests for extra time on an individual basis.
3. You may appeal the penalty following the procedure specified in WAC 458-20-100.

What happens if you do not submit the additional documentation and do not pay the balance due by the due date?

If the tax is not paid by the due date and additional documentation is not submitted, the penalty becomes 15% of the tax due because the payment is late, regardless of whether there was a substantial underpayment. If the tax is not paid on or before the 30th day following the due date specified in the notice, the penalty is 25% of the tax due, regardless of whether there was a substantial underpayment.
