

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Refund of)	<u>D E T E R M I N A T I O N</u>
)	
)	No. 98-097
)	
...)	Registration No. . . .
)	Reporting Period . . .
)	

- [1] RULE 228; RCW 82.32.105; SALES TAX -- DELINQUENCY PENALTY -- WAIVER -- DESTRUCTION OF RECORDS. Destruction of records by the taxpayer's bookkeeper in an effort to destroy evidence of the bookkeeper's embezzlement of funds is not a "casualty" under Rule 228(6)(b)(v).
- [2] RCW 82.32.105; SALES TAX -- DELINQUENCY PENALTY -- WAIVER -- PRIOR DELINQUENCIES WITHIN TWENTY-FOUR MONTHS. An excise tax payment that was late due to circumstances beyond the taxpayer's control is not considered untimely for purposes of applying RCW 82.32.105's twenty-four month waiver provision to a subsequent delinquency.

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.

NATURE OF ACTION:

Taxpayer seeks refund of a late-payment penalty assessed for its failure to timely file and pay taxes.¹

FACTS:

Prusia, A.L.J. -- The taxpayer is a registered business in the State of Washington, engaged in the restaurant business.

The taxpayer opened for business in late November 1995. A fire at the place of business in December 1995 forced it to suspend operations.

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

The Department of Revenue (Department) opened a new tax reporting account for the taxpayer in December 1995. It set up the account for monthly filings.

The taxpayer did not timely file a tax return for December 1995. It did not request an extension of the due date. On February 21, 1996, the Department sent the taxpayer an outstanding return contact letter. In telephone conversations on February 23 and March 11, 1996, the taxpayer informed the Department that: the business had closed in December because of the fire; the taxpayer intended to reopen the business; the taxpayer was expecting to receive insurance proceeds soon; an accountant was reviewing the taxpayer's records; and the taxpayer would send payment of taxes owing when the accountant finished with the records.

On March 20, 1996, the Department administratively closed the taxpayer's tax reporting account. The account remained closed until November 1996.

The taxpayer filed its tax return for December 1995 in April 1996. The taxpayer also filed "no business activity" returns for the first three months of 1996. On May 1, 1996, the Department assessed a late payment penalty for the December 1995 reporting period.

The taxpayer reopened for business in April 1996. It has operated continuously since then. During the remainder of 1996, the taxpayer did not file any monthly excise tax returns or pay excise taxes.

In November 1996, the Department reopened the taxpayer's tax reporting account. On February 13, 1997, the Department sent the taxpayer an outstanding return contact letter. In subsequent telephone conversations, the taxpayer stated: it did not realize the sales taxes were not being paid; the taxpayer's account with the Department had been closed in error and the taxpayer's bookkeeper had not told taxpayer that anything was wrong; the bookkeeper had embezzled money and had destroyed the taxpayer's business records; the taxpayer was obtaining a loan to pay the sales taxes; and a new accountant was preparing tax returns. The Department mailed the taxpayer an annual return form to report taxes for 1996. The Department also advised the taxpayer that it must pay a delinquency penalty of 20% of the taxes owing.

On April 29, 1997, the taxpayer filed an annual excise tax return for 1996. The taxpayer remitted with the return a portion of the taxes that were due. On June 16, 1997, the taxpayer paid the remaining taxes due for 1996, and requested waiver of the late-payment penalties assessed for December 1995 and for 1996. The Department's Taxpayer Account Administration (TAA) Division granted a waiver for the December 1995 payment period because of the December 1995 fire, under RCW 82.32.105(2). The TAA Division denied the request for waiver of the late-payment penalty for 1996. The taxpayer subsequently paid the late-payment penalty, and petitions for refund of the penalty.

In requesting waiver and refund of the penalty, the taxpayer states that the following circumstances caused the late filing for 1996. The taxpayer is a small family-owned business. All members of the family are occupied in the physical operation of the business. When the business reopened in April 1996, after the fire, the taxpayer sought professional help with its

bookkeeping. It hired an outside bookkeeper (Bookkeeper 1). After using Bookkeeper 1 for several months, the taxpayer became concerned that Bookkeeper 1 was not competently handling taxpayer's books, and terminated Bookkeeper 1's employment. Among other problems, Bookkeeper 1 expressed an inability to obtain information from the Department regarding the taxpayer's excise tax liability.

An individual (Bookkeeper 2) then offered to help the taxpayer with its bookkeeping. Bookkeeper 2 stated that he was waiting to begin a job in a local accounting business. He appeared to be a professional. The taxpayer hired him.

Bookkeeper 2 worked for the taxpayer for three months. Bookkeeper 2 came into the taxpayer's business every day to close the books and take receipts to the bank, handled all of the taxpayer's financial records, and prepared all of its statements and tax reports. Bookkeeper 2 did not sign reports or checks. During that period, he prepared all necessary federal tax returns and state tax returns other than the state excise tax returns. Bookkeeper 2 apparently did nothing with respect to state excise taxes. The taxpayer was unaware that Bookkeeper 2 was not taking care of the excise tax problem. The taxpayer states that Bookkeeper 2 lied about the taxes, saying that he was consulting with an accountant. Also, the taxpayer did not receive any notices from the Department. The taxpayer believes it did not receive notices because the Department had closed the account in error.

The taxpayer became increasingly uncomfortable with Bookkeeper 2's aggressiveness in taking control of the business. It also became suspicious that Bookkeeper 2 was stealing from the business when it discovered petty cash and property missing from its office. In early December 1996, the taxpayer asked Bookkeeper 2 to leave. Bookkeeper 2 then destroyed all of the taxpayer's records, and took money from the previous evening's deposit. The taxpayer called the police, obtained a restraining order against Bookkeeper 2, and hired an investigator. Investigations determined that Bookkeeper 2 was on parole from another state; that he had regularly embezzled daily receipts, in a total amount of about \$19,000; and that he embezzled money from at least two other local businesses during the same period. The taxpayer decided not to have Bookkeeper 2 criminally prosecuted, when Bookkeeper 2's parents agreed to repay part of the stolen money. In support of the petition, the taxpayer provided a copy of a May 15, 1997, letter from its attorney to the parents of Bookkeeper 2.

The taxpayer states that after Bookkeeper 2 destroyed the records, it took some time to recreate and update the records, even with the assistance of an accounting firm. It also took time to obtain a loan to pay the past-due taxes. The taxpayer asserts that it made a good faith and honest effort to rectify the late-filing situation caused by the misconduct of Bookkeeper 2.

ISSUES:

1. May the Department waive the late-payment penalty based upon the bookkeeper's destruction of the business records in an effort to destroy evidence of his wrongdoing?
2. May the Department waive the late-payment penalty under RCW 82.32.105(2)?

DISCUSSION:

As stated in the facts above, the taxpayer admits that it did not timely report or pay the taxes. RCW 82.32.090 requires the Department to assess late-payment penalties whenever it does not receive payment of tax due on a return by the due date. When, as here, the tax is not received within sixty days after the due date, the amount of the penalty is twenty percent of the amount of the tax. The Department properly imposed the late-payment penalties.

RCW 82.32.105 provides for the waiver or cancellation of penalties and interest. It 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.

(2) The department shall waive or cancel the penalty imposed under RCW 82.32.090(1) when the circumstances under which the delinquency occurred do not qualify for waiver or cancellation under subsection (1) of this section if:

(a) The taxpayer requests the waiver for a tax return required to be filed under RCW 82.32.045, 82.23B.020, 82.27.060, 82.29A.050, or 84.33.086; and

(b) The taxpayer has timely filed and remitted payment on all tax returns due for that tax program for a period of twenty-four months immediately preceding the period covered by the return for which the waiver is being requested.

As an administrative agency, the Department has no waiver authority beyond that granted by the statute. See Det. No. 88-220, 6 WTD 27 (1988).

WAC 458-20-228 (Rule 228) is the Department's rule that implements RCW 82.32.105. Subsection (6) of Rule 228 provides as follows:

(6) **Waiver or cancellation of penalties.** The department will waive or cancel the penalties imposed under RCW 82.32.090 and interest imposed under RCW 82.32.050 upon finding that the failure of a taxpayer to pay any tax by the due date was due to circumstances beyond the control of the taxpayer. The department has no authority to cancel penalties or interest for any other reason. Penalties will not be canceled merely because of ignorance or a lack of knowledge by the taxpayer of the tax liability.

(a) A request for a waiver or cancellation of penalties must be in letter form and In all such cases the burden of proving the facts is upon the taxpayer.

(b) The following situations will be the only circumstances under which a cancellation of penalties will be considered by the department:

(i) The return was filed on time but inadvertently mailed to another agency.

(ii) The delinquency was due to erroneous written information given the taxpayer by a department officer or

(iii) The delinquency was caused by death or serious illness of the taxpayer or his immediate family, or illness or death of his accountant or the accountant's immediate family, prior to the filing date.

(iv) The delinquency was caused by unavoidable absence of the taxpayer

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

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

(vii) The delinquency penalty will be waived or cancelled on a one time only basis if the delinquent tax return was received under the following circumstances:

(A) The return was received by the department with full payment of tax due within 30 days after the due date; i.e., within the five percent penalty period prescribed by RCW 82.32.090, and

(B) The delinquency was the result of an unforeseen and unintentional circumstance, not immediately known to the taxpayer, which circumstances will include the error or misconduct of the taxpayer's employee or accountant, confusion caused by communications with the department, failure to receive return forms timely, natural disasters such as a flood or earthquake, and delays or losses related to the postal service.

We note that Rule 228 has not yet been amended to reflect subsection (2) of RCW 82.32.105, which was added to the statute effective January 1, 1997.

A threshold question is whether the taxpayer was an annual filer or a monthly filer during 1996, for purposes of applying Rule 228 and RCW 82.32.105 to the penalty assessment. The Department originally assigned the taxpayer a monthly filing status, in December 1995. However, it accepted annual filing as the correct form for 1996. The Department had closed the account in March 1996, and, after reopening the account, mailed the taxpayer an annual reporting form for 1996 and assessed the penalty on one balance due. Our application of Rule 228 and RCW 82.32.105 will treat the taxpayer as an annual filer whose return and payment for 1996 were due on or before January 31, 1997. We will not decide whether the outcome would be different if the TAA Division had required the taxpayer to file separate returns for each month of 1996, and had assessed nine separate penalties.

Because the taxpayer was an annual filer for 1996, our focus is upon circumstances that occurred shortly before the due date for the 1996 annual return. Circumstances more remote in time cannot be considered the cause of the late payment. Based upon the taxpayer's statements, the circumstance that caused it to file late for 1996 was Bookkeeper 2's intentional destruction of the taxpayer's records in an effort to conceal his wrongdoing.

That circumstance does not fit any of the waiver circumstances set out in Rule 228(6)(b).

The situation described in subsection (6)(b)(v) -- destruction by fire "or other casualty" of the taxpayer's business records -- does not describe the situation presented. The term "casualty" is

not defined in the rule. Black's Law Dictionary, Revised Fourth Edition, defines "casualty" as follows:

Accident; event due to sudden, unexpected or unusual cause; event not to be foreseen or guarded against; inevitable accident; misfortune or mishap; that which comes by chance or without design. A loss from such an event or cause; as by fire, shipwreck, lightning, etc.

Unlike fire, shipwreck, or lightning, an employee's deliberate destruction of records in an effort to conceal misconduct is not an accident, is not inevitable, and does not come by chance or without design. Employee misconduct often may be foreseen and guarded against. We do not believe that such an act is encompassed by the term "casualty" in Rule 228(6)(b)(v). Moreover, it is a circumstance that is expressly addressed in another part of the rule, subsection (6)(b)(vii).

A situation described in subsection (6)(b)(vii)(B) of Rule 228 -- employee or accountant misconduct -- best describes the circumstance that caused the late payment. However, the condition required by subsection (6)(b)(vii)(A) -- that full payment must have been made within 30 days of the due date -- is not met. Therefore, the circumstance presented by the taxpayer does not fit situation (vii) either. All conditions of situation (vii) must be satisfied in order for the Department to waive penalties under that situation. See, e.g., Det. No. 88-13, 5 WTD 5 (1988).

The only other possible basis for waiving the late-payment penalties is the twenty-four month provision of RCW 82.32.105 (2). It applies when the circumstances that caused a late payment were not beyond the control of the taxpayer.

Waiver is required under the twenty-four month provision if the taxpayer timely filed and remitted payment on all excise tax returns due during the twenty-four months immediately preceding the period covered by the 1996 annual return. An obstacle to this penalty assessment qualifying for waiver under that provision is the late payment for December 1995.

Despite that earlier late payment, we conclude that we are required to waive the penalty for 1996 under the twenty-four month provision of RCW 82.32.105(2). This conclusion depends upon two other conclusions. The first is that a late payment is not considered untimely for purposes of applying RCW 82.32.105(2) to a subsequent delinquency if the first payment was late due to circumstances beyond the control of the taxpayer. RCW 82.32.105(2) appears designed to excuse occasional taxpayer neglect, mistake, or other fault. To deny application of the provision to a taxpayer whose only prior late payment was due to circumstances beyond its control would be inconsistent with that purpose.

The second conclusion is that the payment for December 1995 was late due to circumstances beyond the taxpayer's control. Although the TAA Division waived the penalty for that late payment under the twenty-four month provision of RCW 82.32.105(2), the TAA Division states that it granted the penalty waiver because of the December 1995 fire. Because the fire, a circumstance beyond the taxpayer's control, was the reason for the waiver, the late payment

penalty for December 1995 qualified for waiver under Rule 228(6)(b)(v), and should have been waived under that provision.²

Thus, we find that the taxpayer did not make a late payment, other than for circumstances beyond its control, during the period of twenty-four months immediately preceding the period covered by the return for which waiver now is being requested. RCW 82.32.105 (2) requires the Department to waive the penalty assessed for the late payment of 1996 taxes.

DECISION AND DISPOSITION:

The taxpayer's petition for refund of the late-payment penalty assessed on the late-filed return for 1996 is granted.

Dated this 29th day of May, 1998.

² The penalty could not be waived under RCW 82.32.105(2) in any event. The new legislation does not apply to penalties assessed before its effective date.