

Cite as Det. No. 06-0155, 26 WTD 73 (2007)

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. 06-0155
	)	
	)	Registration No. . . .
	)	Warrant No. . . .
	)	Docket No. . . .
	)	

RULE 228; RCW 82.32.105: CIRCUMSTANCES BEYOND THE CONTROL OF THE TAXPAYER – ACT OF FRAUD, EMBEZZLEMENT, OR THEFT – PROOF REQUIRED. To qualify for a waiver of penalty based on allegations of fraud, embezzlement, or theft, a taxpayer must prove by a preponderance of the evidence that (1) the criminal act actually occurred, (2) that it directly caused the late payment of tax, (3) that the criminal act was of a nature that could not be immediately detected or prevented, and (4) that reasonable safeguards or internal controls were in place to detect or prevent the fraud, embezzlement or theft. Financial hardship caused by the fraud, embezzlement, or theft is not a relevant consideration.

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.

Zalesky, A.L.J. – Professional service corporation seeks waiver of penalties and interest it paid on a tax warrant . . . based on allegation that former bookkeeper embezzled money from the business. Because the taxpayer has not met the requirements for waiver of penalty or interest, we deny the refund request.<sup>1</sup>

ISSUE

Has taxpayer met the requirements under WAC 458-20-228 (Rule 228) for waiver of penalty or interest based on alleged fraud or embezzlement by an employee?

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

## FINDINGS OF FACT

[Taxpayer] is a professional service corporation doing business as [Business Name]. In 2004 the Taxpayer filed a petition with the Department seeking waiver of penalties and interest assessed on numerous late payments made during the 2001 through 2003 reporting periods. In that petition the Taxpayer alleged that the numerous late payments were all the result of misconduct of its former bookkeeper . . . who, according to Taxpayer, had embezzled considerable amounts of money from the business during the years at issue. The petition was denied on the grounds that the Taxpayer had not proved that any embezzlement had occurred. . . .

Taxpayer was represented in that prior petition by [Bookkeeper]. [Bookkeeper] was hired by the Taxpayer . . . in November 2003 after the prior bookkeeper had been fired. Taxpayer now asserts that [Bookkeeper] embezzled money from the company during the period of time she worked for the business. [Bookkeeper] was fired in October 2005.

Shortly after [Bookkeeper] was fired, Taxpayer filed a police report with the . . . County Sheriff's Office outlining the allegations against [Bookkeeper]. A few days later the Taxpayer was contacted by a Probation Officer with the United States Probation Office and informed that [Bookkeeper] had been convicted of embezzling money from a bank that she worked at in 2000. As a result of that conviction, [Bookkeeper] was sentenced to six months in federal prison and five years of probation. [Bookkeeper] did not inform Taxpayer of her criminal record when she was hired as bookkeeper in 2003 and the Taxpayer did not find out until contacted in October 2005 by [Bookkeeper's] Probation Officer.

To our knowledge, [Bookkeeper] had not been charged with a crime in connection with the alleged embezzlement of money from the Taxpayer's business. She has also not been prosecuted for violating her probation. However, the Washington Employment Security Department has issued a written order finding that [Bookkeeper's] conduct during her employment with the Taxpayer constituted "gross misconduct as defined in RCW 50.04.294(4) and RCW 50.20.066(2)." . . . . In reaching that decision, the Employment Security Department relied on much of the same evidence that has been provided by Taxpayer in support of this Petition. . . . Thus, even though there has yet to be any criminal charges brought against [Bookkeeper], we find that there is competent evidence in the record to support the Taxpayer's assertion that [Bookkeeper] embezzled from the Taxpayer.

On February 9, 2005, the Department of Revenue issued a tax warrant . . . to Taxpayer making demand for payment of the taxes, penalties, and interest . . . . After paying the amount asserted in the tax warrant, Taxpayer sent a letter to the Appeals Division of the Department of Revenue that was treated as a petition for refund. *See* letter from Taxpayer dated November 10, 2005; Acknowledgment of petition dated December 7, 2005. Taxpayer is seeking a refund of the interest and penalties set out in the tax warrant.

## ANALYSIS

Interest and the late payment penalty are both mandatory when the Department issues an assessment for additional tax due. *See* RCW 82.32.050(1) (“If upon examination of any returns . . . 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.”); RCW 82.32.090(1) (“If payment of any tax due on a return to be filed by a taxpayer is not received by the department . . . by the due date, there shall be assessed a penalty of five percent of the amount of the tax. . . .”). The warrant penalty is also mandatory. *See* RCW 82.090(3) (“If a warrant be issued by the department . . . for the collection of taxes . . . there shall be added thereto a penalty of ten percent of the amount of the tax . . .”). The Department may waive interest or penalties only where there is statutory authority to do so. Det. No. 05-0040, 24 WTD 407 (2005); Det. No. 99-042, 19 WTD 784 (2000).

The Department’s authority to waive interest is limited to situations where: (a) the taxpayer’s failure to timely pay the tax was the direct result of written instructions given the taxpayer by the Department, or (b) the extension of a due date for payment of a tax deficiency was for the sole convenience of the Department. RCW 82.32.105(3). Neither situation allowing the waiver of interest is present here. Specifically, the Taxpayer’s failure to timely pay the tax owed for the periods covered in the tax warrant . . . was not the result of written instructions from the Department. Further, we conclude that the Department did not grant an extension of the due date for payment of the assessment for the convenience of the Department. As a result, the interest cannot be waived.

The Department’s authority to waive the late payment penalty and the warrant penalty is set out in RCW 82.32.105. That statute provides in pertinent part as follows:

(1) If the department . . . finds that the payment by a taxpayer of a tax less than that properly due . . . was the result of circumstances beyond the control of the taxpayer, the department . . . shall waive or cancel any penalties imposed under this chapter with respect to such tax.<sup>2</sup>

“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)Rule 228(a)(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

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<sup>2</sup> RCW 82.32.105(2) also authorizes the Department to waive the late payment penalty in certain circumstances. In general, the provision requires the taxpayer to have no late filings or late payments for a period of twenty-four months prior to the period in which the waiver is being requested. Based on the Department’s records, it is clear that Taxpayer does not meet the requirements for waiver of the penalty under RCW 82.32.105(2). Therefore, to the extent Taxpayer is seeking a waiver of the late payment penalty under that provision, the petition for refund is denied.

or internal controls were in place. Rule 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. Rule 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. Because employee theft is usually secretive in nature, this element is generally not difficult to meet. However, if the alleged criminal act was not secretive in nature, the circumstance is not one that “result[s] in the taxpayer not having reasonable time or opportunity to obtain an extension of the due date or otherwise timely file and pay.” Rule 228(9)(a)(ii). Thus, waiver of penalty is not appropriate.
- 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). Since accounting safeguards and internal controls are normally within the control of the taxpayer, they must be in place in order for any employee misconduct to qualify as a circumstance beyond the taxpayer’s control.

We find that the second requirement necessary under Rule 228(9)(a)(ii)(F) has not been met. Therefore, even though the allegations made against [Bookkeeper] have been supported by competent evidence, Taxpayer is still not entitled to a waiver of any of the penalties set out in the warrant . . . .

With respect to the second requirement of Rule 228(9)(a)(ii)(F), Taxpayer has not established a direct link between the alleged embezzlement and the late payment of taxes. According to the information provided by the Taxpayer, the theft engaged in by [Bookkeeper] involve the payment of personal expenses using a credit or debit card belonging to the business or to [Business Owner], unauthorized withdrawals of cash from accounts belonging to the business or to [Business Owner]; and unauthorized or forged checks from the business that were payable directly to [Bookkeeper] or to friends or family of [Bookkeeper]. . . . None of the allegations relate to business expenses that were listed in Taxpayer's accounting records as having been paid when, in fact, the expenses were not paid. Thus, we find no evidence that [Bookkeeper] used her position . . . to deceive the Taxpayer into believing that monthly taxes were being timely and properly remitted. *Compare* [the prior unpublished determination issued to Taxpayer] (where Taxpayer, through its representative [Bookkeeper] alleged that the former bookkeeper . . . had reported the payment of state taxes in the company accounting records "but, in actuality, . . . wrote many of those checks to herself."). Rather, the clear inference from the record is that Taxpayer was aware that it was not timely paying its Washington excise taxes.

The record reflects that [Bookkeeper] may have embezzled a considerable amount from Taxpayer during the two years and eleven months she was employed. . . . In all likelihood this embezzlement resulted in financial difficulties for the Taxpayer. However, financial hardship is not considered a circumstance beyond the control of a taxpayer. Rule 228(9)(a)(iii)(A). In the present case, there is no evidence to suggest that [Bookkeeper's] embezzlement prevented Taxpayer from timely paying its Washington excise taxes or that [Bookkeeper] misled Taxpayer into believing those taxes had been timely paid. Rule 228(9)(a)(ii)(F) requires evidence that the embezzlement directly caused the late payment or underpayment of tax. A showing of financial hardship created by the embezzlement is not enough.

We find that the embezzlement by [Bookkeeper] was not directly linked to Taxpayer's late payment of Washington excise taxes. As a result, the penalties set out in the warrant . . . were not due to underpayment or late payment of tax that resulted from circumstances beyond the control of the Taxpayer. Consequently, those penalties cannot be waived.

#### DECISION AND DISPOSITION

For the reasons stated herein, Taxpayer's petition for refund is denied.

Dated this 20th day of July, 2006.