Cite as Det. No. 00-112, 20 WTD 106 (2001)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Refund of	)	D E T E R M I N A T I O N
	)	
	)	No. 00-112
. . .	)	
	)	Registration No. . . .
	)	Late Payment Penalties 6/97 -- 10/98
	)	Warrant . . . / Audit No. . . .

RULE 228: LATE PAYMENT PENALTIES -WAIVER - EMBEZZLEMENT - SAFEGUARDS/INTERNAL CONTROLS. Even though it took a considerable time to discover the fraud leading to Taxpayer's late payments, Taxpayer's safeguards and internal controls were considered to be reasonable when inexperienced family members had been forced to assume control of the family business when its managing shareholder unexpectedly became ill and unable to work, and the bookkeeper hired to help in the business embezzled its funds..

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:

Petition protesting the assessment of penalties when a business had been embezzled.[1]

FACTS:

Bauer, A.L.J. -- Taxpayer is a family-owned business. It provides pavement maintenance services, which including: sweeping, vacuuming, flushing, striping, sandblasting, and pressure washing.

The Compliance Division (Compliance) of the Washington Department of Revenue (Department) issued an assessment on December 8, 1998 for outstanding taxes, interest, and penalties in the amount of $. . . with a due date of January 7, 1999. As of April 30, 1999, $. . . remained unpaid. A warrant was issued on April 30, 1999, in the total amount of $. . ., which included an additional 10% penalty and an additional 5% warrant penalty.

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

By letter dated May 3, 1999, Taxpayer, has requested the refund of all late payment penalties imposed from June 1998 through October 1998, and the refund of the 10% late payment of assessment and 5% warrant penalty imposed when the warrant was issued in April 1999.[2]

The following penalties are at issue:

PENALTY	**AUTHORIZING RCW**	**AMOUNT**
Late Payment Penalty (10%) -- June 1997	RCW 82.32.090(1)	. . .
Late Payment Penalty (10%) -- July 1997	RCW 82.32.090(1)	. . .
Late Payment Penalty (20%) -- August 1997	RCW 82.32.090(1)	. . .
Late Payment Penalty (10%) -- September 1997	RCW 82.32.090(1)	. . .
Late Payment Penalty (10%) -- October 1997	RCW 82.32.090(1)	. . .
Late Payment Penalty (5%) -- November 1997	RCW 82.32.090(1)	. . .
Late Payment Penalty (10%) -- December 1997	RCW 82.32.090(1)	. . .
Late Payment Penalty (20%) -- January 1998	RCW 82.32.090(1)	. . .
Late Payment Penalty (10%) -- February 1998	RCW 82.32.090(1)	. . .
Late Payment Penalty (5%) -- March 1998	RCW 82.32.090(1)	. . .
Late Payment Penalty (20%) -- April 1998	RCW 82.32.090(1)	. . .
Late Payment Penalty (10%) -- May 1998	RCW 82.32.090(1)	. . .
Late Payment Penalty (5%) -- June 1998	RCW 82.32.090(1)	. . .
Late Payment Penalty (5%) -- July 1998	RCW 82.32.090(1)	. . .
Late Payment Penalty (20%) -- August 1998	RCW 82.32.090(1)	. . .
Late Payment Penalty (10%) -- September 1998	RCW 82.32.090(1)	. . .
Late Payment Penalty (5%) -- October 1998	RCW 82.32.090(1)	. . .
Late Payment of Assessment Penalty(10%)	RCW 82.32.090(2)	. . .
Warrant Penalty (5%)	RCW 82.32.090(3)	. . .
TOTAL AMOUNT PENALTIES:		$. . .

ISSUES:

Whether late payment and other penalties assessed in accordance with RCW 82.32.090 should be waived when Taxpayer was unable to pay its taxes timely because its bookkeeper was embezzling funds.

DISCUSSION:

RCW 82.32.105(1) provides as follows:

[2] Because Taxpayer has already paid $. . . attributable for this period, we are treating Taxpayer's petition as a Petition for Refund, deeming penalties to have already been paid in accordance with RCW 82.32.080 which states: ". . . the department shall apply the payment of the taxpayer first against penalties and interest, and then upon the tax, without regard to any direction of the taxpayer."

> 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.

Taxpayer argues this provision is directly relevant to its situation. Taxpayer did not have the money to pay its taxes timely because, unbeknownst to Taxpayer's owners, Taxpayer's bookkeeper was stealing funds from Taxpayer's accounts. The bookkeeper would file the taxes due, and manipulate the books so that it appeared insufficient funds were available to pay the taxes owing. The embezzlement was not discovered until the last part of August 1998, and the bookkeeper was immediately terminated on September 1, 1998. On March 23, 1999, Taxpayer first requested a waiver of penalties to the Department's Taxpayer Account Administration Division (TAA), explaining the situation, which request was denied by letter dated April 5, 1999 because at that time there was no documentary proof supporting the contention that there had been an embezzlement. The above-referenced warrant was filed soon thereafter.

Taxpayer's president further explained at the hearing in this matter that her husband, who had previously run the business, had to unexpectedly retire because of multiple sclerosis. One son took over the operation of the operations, and she had to take over the office. Because she lacked computer and business office experience, she hired a bookkeeper, "Suzie,"[3] in June 1997 soon after her husband became ill. The son operating the business was going through a contested divorce. The business had many employees, some of whom were on one payment schedule, and others were on another. Suzie began claiming to have "computer problems," and it was difficult for Taxpayer's President to access the records when she wanted to review them because Suzie would claim the computer was "frozen."

Because Taxpayer's president was experiencing her own medical problems, was relatively inexperienced in running a business office, and was not yet very computer literate, it was not until May 1998 when she became seriously suspicious of "Suzie." She went to an outside accountant to have the federal income taxes done, the accountant advised her that Suzie had a gambling problem, had previously embezzled from another larger business, and had pled guilty in that case. (It was later determined that she was on probation and making restitution to that victim while working for Taxpayer.) Suzie was fired on September 1, 1998.

By the time Suzie's dishonesty had been discovered and she had been fired, the books were in a complete disarray. Creditors -- many of whom the books and check ledger indicated had been paid -- were hounding Taxpayer for payment. Taxpayer's checkbook and books indicated checks had been written for IRS "941" tax payments and had been cashed when, in fact, the IRS never received any of these payments. Even though Suzie had been directly responsible for filing returns and paying employer taxes, state employment taxes had not been paid, although she had filed the reports and manipulated the checkbook register to indicate checks had been made out

[3] The name used herein has been changed.

and had cleared the bank. Taxpayer's president estimates Suzie stole more than $20,000 from the business. The books were falsified to such a degree that it is still difficult to tell how much was taken.

At the time of the hearing in this matter, it was thought Suzie would be charged with only 5-10 counts of theft, some of which, standing alone, do not meet the dollar requirements necessary for a felony charge. On December 29, 1999, since the hearing on this matter, Suzie was formally charged by the . . . County Prosecutor of one count of first degree theft and three counts of second degree theft while in the employ of Taxpayer. That criminal case is now pending.

Upon learning of the theft, Taxpayer's president assumed complete personal control of the finances. Of the total assessment ($. . .), Taxpayer has paid an amount equal to the taxes and interest due and owing ($. . .). Left unpaid is an amount believed to be equal to the penalties imposed ($. . .). Taxpayer has been current with its payments ever since. The amount still owing on the warrant is equal to penalties assessed.

WAC 458-20-228 (Rule 228) provides in pertinent part:

> (9) RCW 82.32.105 authorizes the department to waive or cancel penalties under limited circumstances.
>
> (a) Circumstances beyond the control of the taxpayer. The department will waive or cancel the penalties imposed under chapter 82.32 RCW upon finding that the underpayment of the tax, or the failure to pay any tax by the due date, was the result of circumstances beyond the control of the taxpayer. Refer to WAC 458-20-102 (Resale certificates) for examples of circumstances which are beyond the control of the taxpayer specifically regarding the penalty for misuse of resale certificates found in RCW 82.32.291.
>
> . . . (ii) The circumstances beyond the control of the taxpayer must actually cause the late payment. 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, but are not necessarily limited to, the following.
>
> . . . (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.

> . . . (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. See subsection (9)(a)(iii)(E).

In this case, it is evident that the present difficulties began when Taxpayer, a family business was thrown, by virtue of the sudden illness and retirement of its managing shareholder, into a state of emergency. By necessity, inexperienced family members were forced to assume control of various aspects of the business. Taxpayer's president was inexperienced at operating a computer, and even less so a business office, when she had to succeed her husband. An already bad situation became worse when, to obtain experienced assistance, the family unwittingly hired an experienced embezzler with not only a gambling problem, but also a court-imposed substantial debt to her previous embezzlement victims. We recognize that, under more normal circumstances, more stringent safeguards or internal controls might have detected the embezzling activity in a more timely manner. We conclude, however, Taxpayer's safeguards and internal controls were reasonable considering the circumstances, and the intent of Rule 228 is to extend relief in such a context.

DECISION AND DISPOSITION:

Taxpayer's petition is granted.

Dated this 15th day of June, 2000.