Cite as Det. No. 01-067, 20 WTD 525 (2001)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment of	)	D E T E R M I N A T I O N
	)	
	)	No. 01-067
. . .	)	Registration No. . . .
	)	FY. . ./Audit No. . . .
	)	Warrant No. . . .
	)	Docket No. . . .

RULE 228; RCW 82.32.105: LATE PAYMENT PENALTIES – WAIVER – CIRCUMSTANCES BEYOND TAXPAYER'S CONTROL -- EMBZZLEMENT – FAILURE TO ADOPT REASONALBE SAFEGUARDS OR INTERNAL CONTROLS. The Department cannot waive late payment penalties due to embezzlement by the taxpayer's bookkeeper when the taxpayer failed to put in place reasonable safeguards or internal controls to detect embezzlement.

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:

A taxpayer seeks a waiver of late payment penalties and related interest.[1]

FACTS:

De Luca, A.L.J. -- The taxpayer is a real estate brokerage company doing business in Washington. The Audit Division of the Department of Revenue (the Department) reviewed the taxpayer's books and records for the period January 1, 1994 through June 30, 1998 and assessed $. . . in taxes and interest, plus $. . . in three late payment penalties. The penalties were for the months of March, April, and June 1998 when the taxpayer failed to file excise tax returns. Document No. FY. . . . On January 7, 1999, the Department issued Warrant No. . . . in the amount of $. . . as a result of the audit assessment. The taxpayer has paid most of the warrant, but requests a waiver of the three penalties and related interest.

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

TAXPAYER'S EXCEPTIONS:

The taxpayer's owner explains the taxpayer's troubles that resulted in the late payment penalties began when he hired a woman in February 1998 to be the bookkeeper and office manager. The owner stated that for the first several months after the bookkeeper was hired the office appeared to run smoothly. By the fall of 1998 the owner began receiving unexpected calls at home from bill collectors. The bookkeeper explained to the owner that the taxpayer's sales production and income had been down, which caused her to delay payment of bills. Similarly, that fall the water service to the taxpayer's office was disconnected due to unpaid utility bills. The bookkeeper explained she had not received a bill from the utility company. A week later the Department levied the taxpayer's bank account and seized all funds in it. The owner was surprised by the levy. When the owner contacted the Department about the levy, he was told the Department had sent two notices to his office informing him of the levy if taxes were not paid. His bookkeeper denied receiving the notices at the office. By January 1999 other problems became apparent. The Department of Labor & Industries had not received industrial insurance premiums. Payments had not been made to the Department of Employment Security, and federal taxes had not been paid to the Internal Revenue Service. Real estate commission checks for the agents were returned to the taxpayer for insufficient funds.

In February 1999, a check from the taxpayer's earnest money trust account was returned for insufficient funds. By then, the owner and his business banker decided to begin a review of the taxpayer's financial records and bank accounts, which the owner discovered were not at the taxpayer's office, but at the bookkeeper's home. The owner had to retrieve the books and records from her home. The review revealed numerous discrepancies in books, records, and accounts. The owner says he found his signature had been forged on numerous checks. He and his banker concluded the bookkeeper had embezzled funds from the taxpayer. According to the owner, the bookkeeper confessed to him and two other witnesses that she had embezzled the taxpayer's money. The owner fired the bookkeeper on February 15, 1999. The owner filed a complaint with the police, but the owner states the former bookkeeper never appeared at her court hearing and has fled the area. The owner calculates $30,000 was embezzled. Thus, the taxpayer requests a waiver of the penalties and interest due to the embezzlement by the former bookkeeper.

ISSUE:

May the Department waive or cancel the three late payments penalties assessed in the audit due to the alleged embezzlement?

DISCUSSION:

The statute that governs the waiver or cancellation of penalties is RCW 82.32.105, which provides:

> (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.
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> (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:
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> (a) The taxpayer requests the waiver for a tax return required to be filed under RCW 82.32.045, 82.14B.061, 82.23B.020, 82.27.060, 82.29A.050, or 84.33.086; and
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> (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.
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> (3) The department shall waive or cancel interest imposed under this chapter if:
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> (a) The 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 an assessment of deficiency was not at the request of the taxpayer and was for the sole convenience of the department.
>
> (4) The department of revenue shall adopt rules for the waiver or cancellation of penalties and interest imposed by this chapter.

The statute provides the Department can waive or cancel penalties when the late payment or underpayment of tax was due to circumstances beyond a taxpayer's control (RCW 82.32.105(1)). Alternatively, the Department can waive a penalty if the taxpayer has timely filed and remitted payment on all tax returns for a period of twenty-four months immediately preceding the period covered by the return for which the waiver is being requested (RCW 82.32.105(2)). The number of times penalties may be waived due to circumstances beyond a taxpayer's control does not influence whether a penalty can be waived under the twenty-four month provision. *See* WAC 458-20-228(9)(b)(ii) (Rule 228). The Department adopted Rule 228 to administer the waiver or cancellation of penalties and interest.

We first examine whether the taxpayer can qualify under the twenty-four month provision, which requires that the taxpayer have no late payments and returns in the immediately preceding twenty-four months. The first month for which the waiver request applies is March 1998. Our review of the Department's electronic records reveals the taxpayer does not meet the requirements of this provision. Prior to October 1996, the taxpayer filed its excise tax returns on a quarterly basis. Beginning October 1996, the taxpayer began filing its returns on a monthly basis. Starting with Q4/95 and continuing through February 1998, the taxpayer was delinquent in filing its excise tax returns for twenty-one consecutive reporting periods. The Department assessed late payment penalties for each of the twenty-one delinquencies.

We will next examine whether the taxpayer can qualify for the penalty waiver due to circumstances beyond its control. Rule 228(9)(a)(ii) provides:

> (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.
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> . . .
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> (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.

Thus, the circumstances must actually cause the late payments. As we discussed, prior to hiring the bookkeeper, the taxpayer had twenty-one consecutive late payment penalties from Q4/95 through 2/98, which was more than two years. In light of this payment history, we do not find the bookkeeper's actions actually caused the three late payments at issue. She may have created additional problems for the taxpayer, but by the time she began working for the taxpayer late payment penalties were a regular part of the taxpayer's cost of doing business. We note that since the bookkeeper was fired two years ago, the taxpayer has had another fifteen late payment penalties including seven in 2000 and a two in 2001.

Furthermore, the Department can waive late payment penalties due to embezzlement only if the taxpayer had reasonable safeguards or internal controls in place. We find the taxpayer did not meet this burden. In short, we are not aware of any reasonable safeguards or internal controls that were in place. The owner stated his business seemed to operate smoothly for the first several months after the bookkeeper was hired, but he began to notice problems with bill collectors calling his home, bank accounts being levied by the Department, and water service being disconnected, all for the lack of payment. The bookkeeper explained the office never received the various bills and notices. She also claimed sales production by the taxpayer's agents had not been sufficient to generate enough income to timely pay the bills. The taxpayer could have scrutinized the bookkeeper's claims at that time. However, as months went on, the taxpayer had continuing late payments with the Department, plus more payment problems with the IRS, the Department of Labor and Industries, the Department of Employment Security, real estate commissions for its agents, and its earnest money trust account. Finally, after all these events and many months having passed since problems became noticeable, the owner decided to review the taxpayer's books and records. Even then, the review was delayed because the books and records were missing from the taxpayer's office. The taxpayer had to retrieve them from the bookkeeper's home. We find that reasonable safeguards or internal controls likely would have prevented some, if not all, of the problems and certainly would have prompted the taxpayer's owner to investigate the problems long before he did.

We compare the present matter with the appeal decided in Det. No. 00-112, 20 WTD 106 (2001), where the Department waived late-penalties caused by an employee's embezzlement. In that matter, the managing shareholder of a family-owned business became seriously ill and had to suddenly retire. His inexperienced and untrained family members assumed his duties in a "state of emergency." His spouse hired a bookkeeper to perform the bookkeeping services, including filing tax returns and paying employer taxes. While the spouse was learning the business and becoming computer literate, the bookkeeper embezzled. In time, the spouse hired an outside accountant who alerted the spouse to the problems. The county prosecutor charged the bookkeeper with several counts of theft. The determination stated:

> 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.

The circumstances in the present matter are more normal than the ones described in Det. No. 00-112 and, therefore, more stringent safeguards or internal controls were required in this matter than were in place in either this case or Det. No. 00-112. Unlike Det. No. 00-112, there was no sudden, debilitating illness to the owner and inexperienced persons did not have to take control of the business in a state of emergency. Instead, the taxpayer's owner was experienced and in control of the business throughout all times.

We also cannot waive the interest that was assessed. Rule 228(10) provides:

> **Waiver or cancellation of interest.** The department will waive or cancel interest imposed under chapter 82.32 RCW only in the following situations:
>
> (a) The failure to pay the tax prior to issuance of the assessment was the direct result of written instructions given the taxpayer by the department; or
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> (b) The extension of the due date for payment of an assessment was not at the request of the taxpayer and was for the sole convenience of the department. RCW 82.32.105(3).

Neither situation for waiving interest applies to this matter.

DECISION AND DISPOSITION:

The taxpayer's petition is denied.

Dated this 23rd day of May, 2001.