

Cite as Det. No. 14-0387, 34 WTD 571 (2015)

BEFORE THE APPEALS DIVISION  
DEPARTMENT OF REVENUE  
STATE OF WASHINGTON

|   |   |                                  |
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| In the Matter of the Petitions for Correction | ) | <u>D E T E R M I N A T I O N</u> |
| and Refund of Assessments of                  | ) |                                  |
|   | ) | No. 14-0387                      |
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RCW 82.32.105; WAC 458-20-228; PENALTY WAIVER – CIRCUMSTANCES BEYOND THE CONTROL OF THE TAXPAYER – BASED ON THE ALLEGED FRAUD OF KEY EMPLOYEE. The taxpayer’s statements alleging employee fraud, along with evidence that the former employee was denied unemployment benefits, are insufficient to establish that employee fraud occurred sufficient to waive penalties as a circumstance beyond the taxpayer’s control.

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.

Sohng, A.L.J. – Out-of-state [companies protest] the imposition of [late payment of assessment penalties] on the grounds that such late [payments were] the result of employee fraud. The [petitions are] denied.<sup>1</sup>

ISSUE

Under WAC 458-20-228, is an employer entitled to a waiver of late payment penalties on the grounds that the late payment was the result of employee fraud?

FINDINGS OF FACT

[Taxpayers] are affiliated out-of-state companies that provide alarm monitoring services to customers located in Washington. The Department of Revenue’s (the “Department”) Audit Division (Audit) examined [Taxpayers’] books and records for the period . . . (the “Audit Period”). On October 21, 2013, Audit issued the following assessments against Taxpayers, which included taxes, interest, 5% assessment penalties, and delinquent penalties:

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



. who had been engaged to assist with the Department's audit.<sup>2</sup> Both Employee and Consultant attended the initial meeting between Taxpayers and the Department's auditor ("Auditor") in July 2012. In late-2012 and early-2013, Auditor made repeated requests for additional records from Taxpayers. Auditor and Employee arranged to meet on April 22, 2013 at Taxpayers' offices in . . . to review the records and other materials that Auditor had requested. When Auditor arrived at Taxpayers' offices that day, Employee refused her entry and did not provide her with any of the requested documents.

Because Employee failed to provide Auditor with the requested documentation, Auditor estimated Taxpayers' assessments based on the limited information that she had available to her at the time (e.g., trial balance sheets and federal income tax returns). On August 6, 2013, Auditor mailed the estimated assessments to Taxpayers (care of Employee) by certified mail, indicating that the deadline to provide additional documentation regarding the audit would be September 6, 2013. Taxpayers did not respond to the August 6, 2013 letter. On September 17, 2013, Auditor sent Employee an email, informing him that the estimated assessments dated August 6, 2013 would be submitted for processing and issued shortly. On October 21, 2013, Auditor sent the assessments by certified mail to Taxpayers. According to the U.S. Postal Service's delivery records, the assessments were physically received at Taxpayers' offices on October 24, 2013.<sup>3</sup> As previously mentioned, Taxpayers did not pay the assessments by their due date of November 20, 2013. Taxpayers claim that their failure to timely pay the original assessments was the direct result of fraudulent acts by Employee, as described below.

On December 6, 2013, the Department's Compliance Division (Compliance) attempted to call Employee regarding the delinquent assessments, but could not get in touch with him. Compliance then called Consultant (because of the CTIA on file) and informed him that Taxpayers' assessments were delinquent. Consultant immediately informed Taxpayers' financial reporting manager (and Employee's direct supervisor) of the delinquency. Taxpayers state that when the supervisor confronted Employee about the outstanding assessments, Employee denied any knowledge that the assessments had been issued. Shortly thereafter, Taxpayers terminated Employee's employment for cause. Taxpayers state that they subsequently searched Employee's email account and discovered the email from Auditor, dated September 17, 2013, which included draft audit schedules, and indicating that the assessments would be issued and sent for processing.

Taxpayers state that although they were aware that the Department's audit was ongoing, they were not aware that the assessments had actually been issued until Compliance notified Consultant, on December 6, 2013, that they were past due. In support of their claim of Employee's fraud, Taxpayers have submitted a sworn affidavit of its Vice President of Finance ("Vice President"), who oversees Taxpayers' financial and tax reporting. The affidavit states, in relevant part:

12. Based on my understanding of the events surrounding the Washington assessments, I believe that [Employee] was fully aware of the assessments when issued, and for some reason chose not to inform [Taxpayers'] management of them. Furthermore, it appears

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<sup>2</sup> The Department had a Confidential Tax Information Authorization ("CTIA") form on file for Consultant.

<sup>3</sup> The Certified Mail return receipt was signed by . . . on October 24, 2013 at 10:44 AM in . . .

that [Employee] received paper copies of the assessments that were mailed to the company and either destroyed them or removed them from company premises, as they have never been recovered.

13. [Employee] either was aware or reasonably should have been aware that he was responsible to inform company management of any significant tax assessments he knew had been issued or were likely to be issued to the company. His failure to do so in this case was a clear violation of [Employee's] duties to the company which led directly to his termination.

14. Although [Employee's] actions in this matter appear to have been fraudulent and to involve the theft or conversion of company property, [Taxpayers have] chosen for a variety of reasons not to press criminal charges against [Employee] or involve law enforcement, instead choosing to terminate [Employee's] employment and then focus limited resources on other matters.

Vice President also appeared in-person at the appeals hearing and testified consistent with his affidavit above.

Taxpayers state that after Employee's termination, Employee attempted to obtain unemployment benefits from the State of . . . Taxpayers objected to Employee's unemployment claim on the grounds that Employee intentionally misrepresented the status of the Department's assessments to Taxpayers' management, which resulted in substantial penalties being levied against Taxpayers by the Department. Taxpayers provided a written decision from the [Commission], dated January 6, 2014, in which the Commission denied the payment of unemployment benefits to Employee. The decision states, in relevant part: "Reason for Decision: Our investigation found your employer fired you for violation of company rules and policies. This is considered misconduct connected with the work."

#### ANALYSIS

The authority to waive or cancel penalties or interest is found in RCW 82.32.105. RCW 82.32.105(1) provides that if the failure to pay a tax when due is the result of circumstances beyond the control of the taxpayer, the Department shall waive penalties. WAC 458-20-228 ("Rule 228") provides guidance on "circumstances beyond the control of the taxpayer" within the meaning of RCW 82.32.105. Circumstances that are generally considered beyond the control of a taxpayer are "immediate, unexpected, or in the nature of an emergency." Rule 228(9)(a)(ii). 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. 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 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. Rule 228(9)(a)(i).

In Det. No. 06-0155, 26 WTD 73 (2007), we explained that in order to be entitled to a waiver of penalty based on allegations of fraud, there are four things that a 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.

26 WTD at 76 (emphasis added). With respect to the first element, we note that Washington law requires the nine elements of fraud to be proven by “evidence that is clear, cogent, and convincing.” *Beckendorf v. Beckendorf*, 76 Wn.2d 457, 462, 457 P.2d 603, 606 (1969). In *Beckendorf*, the Supreme Court of Washington explained:

The elements necessary to establish fraud – all of which must be shown by clear, cogent, and convincing evidence – are [1] a representation of an existing fact; [2] its materiality; [3] its falsity; [4] the speaker’s knowledge of its falsity; [5] his intent that it shall be acted upon by the person to whom it is made; [6] ignorance of its falsity on the part of the person to whom it is addressed; [7] the latter’s reliance on the truth of the representation; [8] his right to rely upon it; and [9] his consequent damage.

76 Wn.2d at 562 (citing *Williams v. Joslin*, 65 Wn.2d 696, 399 P.2d 308 (1965); *Michielli v. U.S. Mortgage Co.*, 58 Wn.2d 221, 361 P.2d 758 (1961); *Chiles v. Kail*, 34 Wn.2d 600, 208 P.2d 1198 (1949)).

Under either the “preponderance of evidence” standard or the “clear, cogent, and convincing” standard, we conclude that Taxpayers have submitted no evidence to establish that Employee actually committed fraud. Taxpayers’ statements and allegations alone are insufficient to show that Employee’s actions amounted to fraud. We do not have police reports or statements from Employee to corroborate Taxpayers’ claims. While the Employee may have been negligent in performing his job duties with respect to the Department’s audit, there is no objective evidence that he committed fraud in this case. Nor does the [Commission’s] denial of unemployment benefits establish that Employee committed fraud; rather, that decision concluded only that Employee’s actions constituted misconduct, not fraud.

Because we conclude that the first element required by 26 WTD 73 has not been satisfied, we decline to discuss the remaining three elements. We also decline to address whether Employee’s alleged actions satisfy the nine elements of fraud under *Beckendorf* and other Washington case law. Taxpayers are not entitled to a waiver of penalties for late payment of the assessments. Taxpayers’ petitions are denied.

#### DECISION AND DISPOSITION

Taxpayers’ petitions are denied.<sup>4</sup>

Dated this 8th day of December, 2014.

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<sup>4</sup> In its appeal petition, Taxpayers also argued that they were entitled to a \$ . . . bad debt deduction under RCW 82.04.0284. Following the hearing, Taxpayers withdrew this argument and it will not be discussed in this determination.