

Cite as Det. No. 18-0138, 37 WTD 249 (2018)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for)	<u>D E T E R M I N A T I O N</u>
Correction of Assessment of)	
)	No. 18-0138
)	
. . .)	Registration No. . . .
)	

[1] RCW 82.32.105; WAC 458-20-228; PENALTY WAIVER - CIRCUMSTANCES BEYOND THE CONTROL OF THE TAXPAYER - ALLEGED FRAUD OF KEY EMPLOYEE. The taxpayer’s statements alleging employee fraud and misconduct, coupled with filing a small claims action after seeking the penalty waiver, do not provide the required evidence of the fraud to waive penalties.

[2] RCW 82.32.105; WAC 458-20-228; PENALTY WAIVER - CIRCUMSTANCES BEYOND THE CONTROL OF THE TAXPAYER - ALLEGED FRAUD OF KEY EMPLOYEE – REASONABLE SAFEGUARDS. A taxpayer must also establish that reasonable safeguards and controls were in place and were circumvented in order to facilitate the fraud. Repeated reliance on bare assurances from the employee engaging in misconduct over a substantial period of time without any efforts to verify the assertions is not reasonable.

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.

Kreger, T.R.O. – Taxpayer seeks waiver of late payment penalties on annual returns for 2015 and 2016 asserting that the late filing was due to a former accountant’s fraudulent conduct and mismanagement. As the Taxpayer has not sufficiently substantiated the assertion of fraud or established that reasonable safeguards were in place, we find the requirements for a waiver under WAC 458-20-228 are not met and deny the Taxpayer’s petition.¹

ISSUE

Has the Taxpayer established employee fraud, under WAC 458-20-228, to support a waiver of delinquent penalties?

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

FINDINGS OF FACT

. . . (Taxpayer) is a Washington limited liability company engaged in the business of providing musical entertainment. The Taxpayer stated that it hired a CPA . . . (CPA-1) in . . . Washington. The Taxpayer stated that it believed that it was hiring a qualified professional in part by assertions made by CPA-1 that he also worked for the . . . [a professional sports] organization and individual players of the team.²

The Taxpayer stated that it paid CPA-1 a substantial fee and signed a contract under which CPA-1 was to handle all tax filing and bookkeeping duties for both state and federal taxes. The Taxpayer stated that it paid CPA-1 in excess of \$. . . for these services. CPA-1 informed the Taxpayer that it did not have any Washington tax liability for its Washington business activities. The Taxpayer acknowledges receiving automated calls and notices from the Department of Revenue (Department) about the missing returns and states that it contacted CPA-1 about these calls and that CPA-1 instructed the Taxpayer to disregard the calls as they were just automated messages and informed the Taxpayer that the necessary returns had been submitted. After a period of time, CPA-1 stopped responding to the Taxpayer's calls and relocated [out-of-state].

The Taxpayer subsequently discovered that, in addition to not filing the Washington tax returns for the business, CPA-1 had also failed to properly report income to the IRS, which resulted in additional federal tax liabilities also being outstanding. The Taxpayer subsequently retained a new CPA (CPA-2) who has reviewed the Taxpayer's federal and state tax liabilities. CPA-2 filed annual returns for 2015 and 2016 without payment on September 30, 2017. The 2015 annual return showed a tax liability of \$. . . , to which interest of \$. . . , and a delinquent penalty of \$. . . were added. A partial payment of \$. . . was made to the 2015 balance due on December 7, 2017. The 2016 annual return showed a tax liability of \$. . . to which interest of \$. . . and a delinquent penalty of \$. . . was added. The Taxpayer requested a waiver of the penalties added to returns. The waiver request was denied by the Taxpayer Account Administration Division. The Taxpayer timely sought review of this denial.

On review, the Taxpayer has provided a copy of a small claims petition filed against CPA-1 in . . . District Court asserting "fraudulent tax service and theft" and alleging that CPA-1 owes the Taxpayer \$

ANALYSIS

As an administrative agency, the Department is given no discretionary authority to waive or cancel penalties. Det. No. 87-300, 4 WTD 101 (1987). The Department's only authority to waive or cancel penalties is set forth in RCW 82.32.105, which provides that the Department may waive penalties if it finds that the late payment of taxes due resulted from circumstances beyond the control of the taxpayer.³

² [The Department has not independently verified the truth of this assertion.]

³ RCW 82.32.105(1) states: "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."

WAC 458-20-228 (Rule 228) is the administrative regulation addressing the waiver of penalties, and provides additional information on the type of circumstances that are considered beyond the taxpayer's control and thus sufficient to support a waiver of penalties. The rule notes that the taxpayer bears the burden of establishing that the circumstances were beyond its control and directly caused the late payment. Rule 228(9)(a)(i). The circumstances beyond the control of the taxpayer must actually cause the late payment and are generally those which are immediate, unexpected, or in the nature of an emergency. Rule 228(9)(a)(ii). The rule includes in the listed examples of circumstances that are beyond the control of the taxpayer: "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).

We have previously detailed the four necessary elements that a taxpayer needed to establish to support a waiver of penalties based on allegations of fraud:

- 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) . . .
- 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.

. . . 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)).

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

In 34 WTD 571, we found that the Taxpayer had only provided statements and allegations alleging fraud and found that these were insufficient to show the employee conduct at issue legally amounted to fraud. Similarly here, the only evidence provided to support the assertion of fraud by CPA-1 is the small claims filing in . . . District Court, which was filed after the hearing was held in this matter. No evidence close in time to the discovery of the misconduct of CPA-1 has been provided or any other support evidence of the requisite elements of fraud.

While it may be the case that CPA-1 erroneously informed the Taxpayer that the returns at issue had been filed, this information does not rise to objective evidence that fraud occurred in this case. What is lacking is detail of affirmative promises by CPA-1, much less the Taxpayer’s reasonable reliance upon any such representations or promises. However, even if such evidence were available, there are also issues with other elements of the requirements detailed.

Most significantly, there is no showing that the alleged fraud of CPA-1 could not have been detected or that the Taxpayer had any safeguards in place that would have allowed for the detection or prevention of the acts at issue. It is not clear what, if any, due diligence was performed by the Taxpayer prior to retaining CPA-1. Even after receiving indications of problems from the Department, there is no evidence of the Taxpayer making any efforts to verify the statements made by CPA-1. It has not even been established if the Taxpayer requested copies of the returns that CPA-1 had purported filed or otherwise sought to review pertinent documents. Rather the Taxpayer chose to rely upon bare assurances offered by CPA-1. There is no indication that any review was attempted to confirm the representations made by CPA-1.

It is also noteworthy that there is a substantial period of time at issue here. Consecutive annual returns were not filed and, despite multiple calls and notices from the Department, it took months for the Taxpayer to discover the inaction of CPA-1. While it may have been reasonable to rely on an initial assertion made by CPA-1 that the first call from the Department was an error, there is no

explanation offered for why it took multiple calls and contacts over a period of months to more thoroughly investigate the “work” being done by CPA-1.

. . . [T]he information available does not establish that the misconduct of CPA-1 has been proven to rise to the level of fraud necessary under Rule 228 to waive the delinquent penalties at issue. We therefore deny the Taxpayer’s petition and sustain the imposition of the delinquent penalties on the 2015 and 2016 annual returns.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 16th day of May 2017.