

Cite as Det. No. 18-0209, 39 WTD 090 (2020)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS 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. 18-0209
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...)	Registration No. . . .
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RCW 82.32.105; WAC 458-20-228: WAIVER OR CANCELLATION OF PENALTIES OR INTEREST - CIRCUMSTANCE BEYOND THE TAXPAYER’S CONTROL. The Department does not have a duty to ensure taxpayers properly report their business activities, thus the Department’s failure to notify a taxpayer that the taxpayer had incorrectly classified its taxable business activities as tax-exempt is not a circumstance beyond the taxpayer’s control for purposes of granting a penalty waiver.

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.

Farquhar, T.R.O. – A property management company that failed to pay business and occupation (“B&O”) tax seeks a refund of penalties because it asserts the Department should have known Taxpayer was reporting its business activities improperly and notified Taxpayer of the error. Taxpayer argues that it made the error in “good faith” and, had it been notified, it would have paid the tax on time. Taxpayer’s petition is denied.¹

ISSUE

Whether the Department’s failure to notify Taxpayer that it improperly characterized its business activities constitutes a circumstance beyond the taxpayer’s control such that it qualifies for a penalty waiver under RCW 82.32.105 and WAC 458-20-228(9)(a).

FINDINGS OF FACT

. . . (“Taxpayer”) is [an out-of-state] property management company that performs real estate management services in Washington. Taxpayer manages real property owned by affiliated businesses that rent the properties to tenants for periods of greater than 30 days. Taxpayer first began doing business in Washington in late 2012.

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

On February 21, 2013, the Department sent a notice to Taxpayer after Taxpayer failed to file its 2012 tax return. Taxpayer responded with a letter, in which it described its business activities and the reason for the overdue filing as follows:

*[Taxpayer] is in the business of leasing real property, single-family homes, to tenants on annual contracts and began business operations in the State of Washington in late 2012. As the receipts of [Taxpayer] are not subject to excise tax or B&O tax in the State, we were not aware that a \$0 tax due return needed to be filed.*²

(Emphasis added). Taxpayer then filed its 2012 return and reported no taxable receipts. On June 5, 2013, the Department changed Taxpayer's filing frequency to Active Non-Reporter status. Taxpayer did not pay any tax on its business activities in Washington for 2012 through 2016.

In late 2015, the Department's Compliance Division ("Compliance") began an investigation of Taxpayer's business activities and mailed Taxpayer an Active Non-Reporter Questionnaire. In Taxpayer's response, dated December 3, 2015, Taxpayer described its business activities as follows:

[Taxpayer] through its affiliated entities . . . generates rental income on leases for 30 days or more on single family residential properties these entities own. This lease income is exempt per Washington Administrative Code ("WAC") 458-20-118(1): Amounts derived from the sale and rental of real estate are exempt from taxation under the business and occupation tax.

(Emphasis added).

On January 13, 2016, Compliance discussed Taxpayer's questionnaire responses with Taxpayer's Tax Director (the "Director"). The Director told Compliance that Taxpayer manages several property holding companies in Washington, and that Taxpayer only manages the [properties] and does not receive profit. Compliance stated its review of Taxpayer's business activities was ongoing and it would contact Taxpayer regarding its findings after the review was complete. During the conference, Compliance described Washington's service and other B&O tax and economic nexus thresholds to the Director.

On June 10, 2016, Compliance mailed an audit commencement letter to Taxpayer. The letter stated that Taxpayer "may have a tax reporting requirement in Washington" and included educational materials regarding Washington tax rules and regulations. The letter requested Taxpayer provide the Department with documentation related to Taxpayer's relationship with its affiliated businesses by July 15, 2016. Taxpayer failed to respond by the deadline. Taxpayer also failed to respond to Compliance's attempts to follow up on the documentation request on August 26, 2016, and

² Taxpayer submitted two copies of this letter and its 2012 tax return, both signed by different people. The first letter and return was dated March 25, 2013, and was signed by . . . , Chief Financial Officer. The second letter and return, which were substantively identical to the first, was dated May 28, 2013, and was signed by . . . , Vice President Corporate Finance and Acquisition Accounting. The latter was referenced in Compliance's response to Taxpayer's petition.

February 9, 2017. Then, on March 8, 2017, Compliance received a call from an individual representing Taxpayer in the ongoing audit (“Representative”). Representative requested an additional two weeks to gather the requested documents. Compliance granted the request.

Representative responded to Compliance’s audit commencement letter on March 23, 2017. Along with the requested documents, Representative provided the following description of Taxpayer’s business activities:

[Taxpayer] has *agreements to manage residential real estate* owned by six entities located in Washington and other states. The *property management services* include leasing, rent collection, property maintenance, and operations. [Taxpayer] receives expense reimbursements for its *property management services*. . . .

(Emphasis added). After discussing the matter with Representative again on May 2, 2017, Compliance notified Taxpayer on May 4, 2017, that Taxpayer had been removed from non-reporting status and was now required to submit monthly returns because Taxpayer provides property management services and does not rent real estate. Compliance determined that Taxpayer met the economic nexus threshold for all periods and that Taxpayer’s activities were subject to B&O tax.

On July 21, 2017, Compliance issued a \$. . . assessment against Taxpayer for the period of January 1, 2013, to December 31, 2016. This assessment is comprised of \$. . . in service and other activities B&O taxes, \$. . . in interest, a \$. . . delinquency penalty, and a \$. . . assessment penalty.

Taxpayer timely filed a petition for review on August 21, 2017. Taxpayer does not dispute the assessment of tax but requests a waiver of penalties because its failure to pay the taxes due was based on a good faith belief that it did not owe taxes. Taxpayer also argues that the Department should have notified Taxpayer of the error when it was discovered and the Department failed to respond to Taxpayer’s request for clarification on its filing requirements. Finally, Taxpayer argues that, at the least, it should receive a partial waiver of the penalties because the Department took too long in issuing the assessment. Taxpayer has paid the assessment in full.

ANALYSIS

Penalties

Washington law places the responsibility for knowing tax reporting obligations squarely on the taxpayer. RCW 82.32A.030(2). Taxpayers must also ensure that they pay taxes on time and that the information entered on their tax returns is accurate. RCW 82.32A.030(4), (5). In general, taxpayers subject to the B&O tax must submit payment “within twenty-five days after the end of the month in which” the activity subject to B&O tax occurs. RCW 82.32.045.³

Washington law penalizes taxpayers that fail to timely remit taxes. RCW 82.32.090(1) imposes the delinquency penalty and states that “if payment of any tax due on a return to be filed by a

³ The Department may permit a taxpayer to remit excise tax returns for periods that exceed a month so long as the period assigned does not exceed one year. RCW 82.32.045(2).

taxpayer . . . is not received on or before the last day of the second month following the due date, there is assessed a total penalty of twenty-nine percent of the amount of the tax under this subsection.” The assessment of delinquency penalties is mandatory when the conditions for imposing them are met. RCW 82.32.090; Det. No. 01-193, 21 WTD 264 (2002); Det. No. 99-279, 20 WTD 149 (2001).

RCW 82.32.090(2) provides for an assessment penalty where a taxpayer substantially underpays its tax for the relevant time period. RCW 82.32.090(2) states that “[i]f the department . . . determines that any tax has been substantially underpaid, there is assessed a penalty of five percent of the amount of the tax determined by the department to be due.” A tax is considered “substantially underpaid” when a taxpayer has paid less than 80% of the tax due and the amount of the underpayment is at least \$1,000. RCW 82.32.090(2).

Here, as of the issue date of the assessment (July 21, 2017), Taxpayer had paid no tax during the audit period and Compliance determined that \$. . . in tax was due. The issue date was well beyond the “last day of the second month following the due date” for all periods covered by the audit (the latest due date for the audit period was for the December 2016 return, due January 25, 2017), and Compliance properly assessed the 29% delinquency penalty. Furthermore, because the amount Taxpayer initially paid (\$. . .) was less than 80% of the tax due and the underpayment was more than \$1,000, the assessment penalty was also properly assessed.

Penalty Waiver

The Legislature has granted the Department limited authority to waive or cancel penalties through RCW 82.32.105. That statute requires the Department to waive penalties when it finds that “circumstances beyond the control” of the taxpayer caused its failure to timely pay the tax properly due. RCW 82.32.105(1).⁴ “Circumstances beyond the control of the taxpayer” is defined in WAC 458-20-228(9) (“Rule 228”), which states:

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.

Rule 228(9).

Rule 228 provides examples of circumstances that are considered beyond a taxpayer’s control sufficient to cancel penalties. The examples include receiving erroneous written information from the Department, an act of fraud or conversion by the taxpayer’s employee or contract helper which the taxpayer could not immediately detect or prevent, emergency circumstances around the time of the due date, such as the death or serious illness of the taxpayer or a family member or

⁴ In the case of a delinquent penalty, the Department may also waive this penalty if the taxpayer has a good filing and payment history. RCW 82.32.105(2). Here, Taxpayer did not have the requisite on-time reporting history necessary to qualify for such a waiver.

accountant, or destruction of the business or records by fire or other casualty. RCW 458-20-228(9)(a)(ii)(B), (C), (E) and (F).

Rule 228 also lists examples of situations that are generally considered *not* beyond the taxpayer's control, which include a "misunderstanding or lack of knowledge of a tax liability." Rule 228(9)(a)(iii)(B). The Department has long held that tax, interest, and penalties cannot be waived based on a taxpayer's good faith belief that it was reporting correctly. *See, e.g.,* Det. No. 01-165, 22 WTD 5 (2003) (holding the Department cannot waive tax, penalties, and/or interest on the basis of good faith); Det. No. 01-047, 21 WTD 189 (2002) ("The Department has no authority to waive a tax deficiency based on a taxpayer's good-faith belief it was reporting and paying correctly").

Here, Taxpayer argues its decision to report its income as tax-exempt was based on a "good faith" belief that its income was tax-exempt. Washington law is clear that such a mistake, even if made in "good faith," is not a basis for a penalty waiver. It was Taxpayer's responsibility to determine what its tax responsibilities were before the tax was due. RCW 82.32A.030(2). Therefore, even if Taxpayer truly believed it was reporting accurately, its "good faith" mistake alone is not enough to warrant a penalty waiver.

Taxpayer also argues that the Department's failure to notify Taxpayer that Taxpayer was misclassifying its business activities caused Taxpayer's failure to pay and constitutes a circumstance beyond Taxpayer's control. This argument is unpersuasive because it is based on the notion that it is the Department's duty to ensure a taxpayer's filing information is correct. No such duty exists. RCW 82.32A.030 places that responsibility on the taxpayer and the burden does not shift to the Department at any point. Furthermore, the Department's actions did not *cause* the late payment. It was Taxpayer's decision to report its activities as tax-exempt and not remit taxes and those actions were at all times within Taxpayer's control.

Even if the Department had a duty to ensure Taxpayer was filing correctly, it could not have done so here because Taxpayer provided an inaccurate description of its business activities. In its May 28, 2013 letter to the Department, Taxpayer described its business activities as leasing real property. Taxpayer described its activities similarly in response to the questionnaire the Department sent out in November 2015. It was not until March 23, 2017, that Taxpayer provided a more accurate description of its activities. The Department could not have known that Taxpayer was incorrectly reporting its activities if the description of those activities was itself inaccurate.

Taxpayer's petition also suggests that it reached out to the Department for guidance on its reporting requirements, though there is no record it ever did so. While it is true that relying on erroneous, specific written information from the Department is a basis for a penalty waiver, Taxpayer did not provide any evidence of written information from the Department that could have formed the basis for Taxpayer's decision not to remit taxes.

Finally, Taxpayer argues that even if it does not qualify for a full penalty waiver, it should receive partial relief from the penalties associated with the later portion of the audit period because the Department took too long issuing a final determination on Taxpayer's liabilities. Taxpayer suggests that, had the Department determined Taxpayer was misfiling sooner, Taxpayer could have avoided at least some of the penalties. This argument is also unpersuasive. Taxpayer directly

contributed to the length of the audit by failing to produce documents when requested. The Department first requested documentation from Taxpayer on June 10, 2016, yet, despite at least two reminders, Taxpayer did not respond until March 23, 2017. Again, it was Taxpayer's own actions – which were at all times within its control – that caused the situation from which Taxpayer seeks relief.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 2nd day of August 2018.