

Cite as Det. No. 18-0300, 40 WTD 039 (2021)

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

In the Matter of the Petition for Correction of )	<u>D E T E R M I N A T I O N</u>
Assessment of )	
)	No. 18-0300
)	
... )	Registration No. . . .
)	

[1] RCW 82.04.220; WAC 458-20-111: B&O TAX – GROSS INCOME OF THE BUSINESS – ADVANCES AND REIMBURSEMENTS. Certain payments a parent company made to vendors for goods and services to benefit its wholly-owned affiliate did not qualify under WAC 458-20-111, because it had primary or secondary liability to the vendors for the payments, as shown by related invoices, contracts, and other records.

[2] RCW 82.04.030; RCW 82.32A.030; WAC 458-20-203; ETA 3134.2009: B&O TAX – TRANSACTIONS BETWEEN RELATED ENTITIES – PARENT COMPANY CONTRIBUTIONS TO SUBSIDIARY – SEPARATE LEGAL ENTITY – PERSON – CONSOLIDATED TAX RETURNS. Because a parent company and its affiliate are separate legal entities and separate persons, each has a duty to file its own combined excise tax return. A parent company’s payments or contributions to its affiliate are the parent company’s costs of doing business, are included in its gross income, and should be reported on its own tax return. The parent company’s payments or contributions to the affiliate are gross income to the affiliate and should be reported on the affiliate’s return.

[3] RCW 82.04.080; RCW 82.04.220: B&O TAX – IMPUTED INCOME: Amounts posted for certain expenses a parent company paid on behalf of its affiliate are not imputed income but intercompany transactions, as shown by the parent company’s treatment of the amounts as accounts receivable from the affiliate, and the affiliate’s treatment of corresponding entries as accounts payable. Also, the affiliate listed its acquisitions of tangible personal property from the parent company as purchases, and depreciated the property on its federal tax returns.

[4] RCW 82.32.105; WAC 458-20-228: PENALTY WAIVER - CIRCUMSTANCES BEYOND THE CONTROL OF THE TAXPAYER. The taxpayer’s lack of knowledge about its excise tax reporting obligations is not a circumstance beyond its control, and is not a basis for waiver of penalties.

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.

LaMarche, T.R.O. – A taxpayer that, in relevant part, provides support services to an affiliate that owns restaurants in Washington State disputes the assessment of business and occupation (B&O) tax on certain expenditures. First, Taxpayer contends that certain costs were erroneously duplicated in the audit, resulting in an overstatement of tax due. Second, Taxpayer argues that certain expenditures do not constitute gross income, because they were paid solely on behalf of its affiliate and constituted non-taxable advances and reimbursements.

Third, Taxpayer argues, alternatively, that it never actually received payment from its affiliates for the services it purchased, that journal entries were made solely for internal management purposes, and [the amounts posted] are “imputed income” not subject to B&O tax.

Finally, Taxpayer requests a waiver of delinquent penalties and substantial underpayment penalties. We grant the petition with regard to the issue of duplication errors in the audit and some charges that were billed solely to affiliates, and deny the petition as to the remaining issues.<sup>1</sup>

#### ISSUES

1. Under RCW 82.04.220 and WAC 458-20-111 (Rule 111), has Taxpayer shown that certain expenditures were non-taxable advances and reimbursements that should not be included in the measure of B&O tax?
2. Under RCW 82.04.030, RCW 82.32A.030, and WAC 458-20-203 (Rule 203), are parent companies not subject to taxes imposed under Title 82, RCW, on goods and services they provide to wholly-owned affiliates who are separate legal entities?
3. Under RCW 82.04.080 and RCW 82.04.220, do the disputed transactions constitute “imputed income” not subject to B&O tax?
4. Were delinquent penalties and substantial underpayment penalties properly assessed pursuant to RCW 82.32.090 and WAC 458-20-228 (Rule 228), and, if so, has Taxpayer shown a basis upon which to waive them, pursuant to RCW 82.32.105 and Rule 228?

#### FINDINGS OF FACT

. . . (Taxpayer) is an [out-of-state] corporation that owns and operates restaurants nationwide. It registered its business with the Department on August 27, 2009. Taxpayer does not own any restaurants in Washington State. However, Taxpayer is the parent corporation of . . . (Affiliate), a wholly-owned subsidiary and separate legal entity that owns and operates . . . of the restaurants nationwide, including . . . in Washington State.

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



Taxpayer provided totals of costs. Audit did not perform sampling of individual entries. Taxpayer also provided certain invoices that showed Taxpayer as the sole buyer, and the items were billed directly to Taxpayer.

Audit reviewed some general ledger entries for Taxpayer and Affiliate for certain expenses. Using an account named “Intracompany Transaction Report,” Taxpayer posted its expenses into its own ledger as accounts receivable, and corresponding journal entries were entered on the books of Affiliate as accounts payable to Taxpayer, with separately itemized sales tax.

Audit also noted that Taxpayer made some purchases of tangible personal property, which it entered into its books as accounts payable to the vendor, for which cash payment was made to the vendor. Rather than listing the assets as its own tangible personal property, Taxpayer listed them as accounts receivable from Affiliate. Affiliate recorded the property on its own books, and either consumed the property or depreciated it on its own federal income tax returns.

Taxpayer submitted a copy of a fountain beverage sales agreement it had with . . . dated October 1, 2014 (Beverage Contract), listing Taxpayer as the sole buyer. Other than the Beverage Contract, Taxpayer provided no other purchase contracts. Although Taxpayer provided examples of a few journal entries, it did not provide pre-consolidated trial balances, or an accounting download of all journal entries for any year, including detailed journal entries showing how the transactions “rolled up” to Taxpayer’s financials and federal tax returns. Taxpayer provided few purchase documents, and did not provide any that showed the entire purchase transaction. Taxpayer did not provide its federal tax returns.

Taxpayer provided no contracts or other proof that it was acting solely as an agent on behalf of Affiliate with regard to any payments to vendors, and did not provide documents indicating that it had no liability to those vendors other than that of an agent acting on behalf of Affiliate.

Taxpayer states that it has no written contracts with its affiliates, and has not provided any fee plan or other documents that would lay out the parent-affiliate relationships. Taxpayer did not provide records of any purchasing discussions relevant to the audit.

Audit indicates that it did not have sufficient documentation to show the flow of money through the business, including details of the revenue Taxpayer received and how it paid for the expenses it incurred on behalf of Affiliate. For the foregoing reasons, Audit concluded that Taxpayer had not shown that any of its costs should be excluded from its measure of gross income.

The Department issued an assessment on October 18, 2017, Document No. . . . , in the amount of \$ . . . . The total consisted of \$ . . . in Retailing B&O tax; \$ . . . in Service and Other Activities B&O tax; \$ . . . in interest; \$ . . . in delinquent penalties; and \$ . . . in assessment (substantial underpayment) penalties. Taxpayer did not pay the assessment, but timely filed a petition.

After Taxpayer filed its petition, it provided evidence that some of the costs associated with marketing and insurance that were included in the calculation of gross income had been duplicated in the audit. This occurred in large part because Taxpayer listed certain expenses as cost

allocations, and included the same expenses in the profit and loss statements for Affiliate's Washington restaurants. Audit had used both sources to determine Taxpayer's gross income.

Audit reviewed the assessment and agreed that duplications had occurred. The duplications were found by comparing Taxpayer's cost allocations to the profit and loss statements for Affiliate.

Audit agreed to the following adjustments to account for duplications, which will result in an anticipated reduction in gross income of approximately \$ . . .,<sup>2</sup> subject to verification:

<b>Account</b>	<b>Corporate Cost Allocation (From WP B)</b>	<b>Restaurants P&amp;L (From WP C2 )</b>	<b>Audit Agrees to Adjustment</b>
Auto Insurance	...	...	...
Corp. Marketing	...	...	...
Insurance - General Liability Fixed	...	...	...
Insurance - Property & Other	...	...	...
Marketing Supplies	...	...	...
<b>TOTALS</b>	...	...	...

Audit used sampling projections when calculating costs for retailing and service revenue, figures for which are contained in the category "Revenue from Asset Sampling Projection" (Workpaper A – income sum tab). Taxpayer asserts that certain costs for retailing are erroneously duplicated, because they are also included in the costs for services [that] Audit used when calculating the projection amount. Taxpayer provided a sample in its July 1, 2018, memorandum that shows apparent duplication errors when comparing Workpaper D2 – asset sample tab to Workpaper A. Audit has agreed to review this second duplication issue on remand.

After filing the petition, Taxpayer provided copies of invoices showing that Affiliate was the sole buyer for some expenditures, which were also billed directly to Affiliate. Audit has agreed that these invoices show that Taxpayer had no liability for these costs, and that they should be excluded from its measure of B&O tax.

Because no sample was taken during the audit to determine how many of the invoices listed only Affiliate as the liable party, Audit is amenable to giving Taxpayer the opportunity to provide further information to support an adjustment. The adjustment is predicated on Taxpayer providing proof by which to estimate a relative percentage of Affiliate's expenditures, or information to support a more accurate adjustment, based on all cost details and a sample of 250 cost items.

The remaining issues in dispute include: 1) Whether certain expenditures constitute non-taxable advances and reimbursements; 2) whether parent companies are liable for taxes imposed under

<sup>2</sup> Taxpayer asserts in its memorandum dated July 1, 2018, that the error figure is slightly larger; however, this issue can be resolved on remand, when Audit revises the assessment.

Title 82, RCW, on goods and services they provide to wholly-owned affiliates who are separate legal entities; 3) whether the disputed transactions are “imputed income” not subject to B&O tax; and 4) whether delinquent and substantial underpayment penalties were properly assessed, and, if so, whether Taxpayer [has] shown a basis for waiving them.

## ANALYSIS

### 1. Advances and reimbursements

The B&O tax is imposed for the act or privilege of engaging in business activities in this state. RCW 82.04.220. Service activities not taxed elsewhere in Chapter 82.04, RCW are taxable at a rate of 1.5% times the gross income of the business. RCW 82.04.290(2).<sup>3</sup> “Gross income of the business” is defined in RCW 82.04.080(1) as:

[T]he value proceeding or accruing by reason of the transaction of the business engaged in and includes gross proceeds of sales, compensation for the rendition of services, . . . fees, . . . and other emoluments however designated, all without any deduction on account of the cost of, . . . labor costs, interest, . . . or any other expense whatsoever paid or accrued . . .

RCW 82.04.080(1) (emphasis provided).

However, it is well settled that “amounts that merely ‘pass through’ a business in its capacity as an agent cannot be attributed to the business activities of the agent.” *City of Tacoma v. William Rogers Co.*, 148 Wn.2d 169, 175, 60 P.3d 79, 82 (2002). Thus, a taxpayer may receive a payment from a client or customer under circumstances where the payment is being collected pursuant to an agency relationship, where the taxpayer facilitates that payment to a third party, with no liability other than that of an agent.

The Department has long recognized and implemented this principle in Rule 111. Rule 111 allows reimbursements to be excluded from gross income only “when the customer or client alone is liable for the payment of the fees or costs and when the taxpayer making the payment has no personal liability therefore, either primarily or secondarily, other than as agent for the customer or client.”

Courts have interpreted Rule 111 as requiring the taxpayer to prove that the advance in question was made pursuant to an agency relationship, and prove that the taxpayer's liability to pay the advance constituted solely agent liability. *Washington Imaging Services, LLC v. Dep’t of Revenue*, 171 Wn.2d 548, 555, 252 P.3d 885 (2011); *Rho Co. v. Dep’t of Revenue*, 113 Wn.2d 561, 782 P.2d 986 (1989); *City of Tacoma v. Wm. Rogers Co.*, 148 Wn.2d 169, 60 P.3d 79 (2002). *See also* Det. No. 12-0102, 32 WTD 250 (2013).

In other words, by requiring the taxpayer to prove that its liability is solely agent liability, Rule 111 distinguishes payments a taxpayer makes towards its own costs of doing business, from those where it acts solely as an agent in collecting and remitting money to a third party on behalf of its client. RCW 82.04.080(1); Rule 111; *See, e.g., Washington Imaging Services*, 171 Wn.2d 548.

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<sup>3</sup> There is no dispute that Taxpayer provided services taxable under the Service and Other Activities B&O Tax Classification.

Here, Taxpayer's invoices in dispute show that the vendors billed Taxpayer directly in its own name, indicating that Taxpayer had primary liability for payment. Similarly, the Beverage Contract is between Taxpayer and the beverage company, and does not include Affiliate as a liable party. Taxpayer has provided no contracts or other documents showing that the affiliates and vendors understood that Taxpayer was acting solely as an agent on the affiliates' behalf with regard to vendor payments.

Moreover, Taxpayer concedes that the costs in dispute are its own. Because Taxpayer had primary liability for the payments, it was not solely liable as an agent acting on Affiliate's behalf with regard to those payments, and therefore does not meet the criteria in Rule 111. *Washington Imaging Services; Wm. Rogers Co.*, 148 Wn.2d 169. *See also* 32 WTD 250. Accordingly, these costs should be included in Taxpayer's gross income, pursuant to RCW 82.04.080(1), and we deny the petition as to those transactions.

## 2. Parent company contributions to wholly-owned separate legal entities

Taxpayer argues that as a parent corporation, there are no tax consequences for its contribution of goods and services to a wholly-owned subsidiary. However, in the context of Washington tax law, this assertion is not supported by statute, administrative rule, or case law. RCW 82.04.030 defines "person" as:

[A]ny individual, receiver, administrator, executor, assignee, trustee in bankruptcy, trust, estate, firm, copartnership, joint venture, club, company, joint stock company, business trust, municipal corporation, political subdivision of the state of Washington, corporation, limited liability company, association, society, or any group of individuals acting as a unit, whether mutual, cooperative, fraternal, nonprofit, or otherwise and the United States or any instrumentality thereof.

Based on this definition and other related B&O tax statutes, Washington courts have respected as distinct the different persons engaging in business in Washington State, even though those persons may be affiliated with each other. *See, e.g., Impecoven v. Dep't of Revenue*, 120 Wn.2d 357, 841 P.2d 752 (1992) (independent contractor insurance agents affiliated with broker are not one "person" for B&O tax purposes and not a "group of individuals acting as a unit" under RCW 82.04.030); *Nordstrom Credit, Inc. v. Dep't of Revenue*, 120 Wn.2d 935, 845 P.2d 1331 (1993) (subsidiary formed by parent to finance parent's accounts receivable engaged in arms-length transaction with parent and was a separate "person" for B&O tax purposes); [*Rena-Ware Distributions, Inc. v. State*, 77 Wn.2d 514, 518, 463 P. 2d 622 (1970) ("Mere common ownership of stock, the same officers, employees, etc., does not justify disregarding the separate corporate identities unless a fraud is being worked upon a third person.")].

Contrary to Taxpayer's assertion that a parent [company] is free to make contributions to its affiliate without tax consequences, Washington law treats affiliated entities as different persons, each subject to B&O tax on their taxable activities. *See* RCW 82.04.220. There is no authority for interpreting "person" as including two affiliated entities, such as Taxpayer and Affiliate, and excluding from B&O tax the transactions between the two, including the parent's contributions to the affiliate.

In Det. No. 16-0158, 36 WTD 038 (2017), we addressed the issue of transactions between related but separate legal entities. In that case, the taxpayer underwrote title insurance policies for a related entity, and also earned management fee income for providing corporate and financial services for the related entity. As we stated in that case:

The question of whether transactions between related entities are taxable is not new. As Excise Tax Advisory (“ETA”) 3134.2009 states:

The Department has addressed the question of transactions between related entities on many occasions. In an effort to simplify the information available to taxpayers, the Department has consolidated these excise tax advisories into a single document.

WAC 458-20-203 (Rule 203) states:

Each separately organized corporation is a "person" within the meaning of the law, notwithstanding its affiliation with or relation to any other corporation through stock ownership by a parent corporation by the same group of individuals.

Each corporation shall file a separate return and include therein the tax liability accruing to such corporation. This applies to each corporation in an affiliated group, as the law makes no provision for filing of consolidated returns by affiliated corporations or for the elimination of intercompany transactions from the measure of tax. . . .

The principles of Rule 203 apply to all business organizations including, but not limited to, limited liability companies (LLC), limited partnerships, and joint ventures. . . . [see also RCW 82.04.030].

While intra-company transactions are not taxable (See WAC 458-20-201), business transactions between different persons are subject to taxation unless there is a specific deduction or exemption. The fact that entities are related does not change the fact that they are separate persons for tax purposes. Rule 203. *Washington Sav-Mor Oil Co. v. Tax Comm.*, 58 Wn.2d 518 (1961).

[See also ETA 3194.2015 (“Compensation for services is subject to B&O tax regardless of whether the services are provided by an affiliate or by an unrelated person.”).]

Here, for Washington State tax purposes, notwithstanding Taxpayer’s treatment of its transactions with Affiliate as “intra-company transactions,” Taxpayer is a separate taxable person from Affiliate, and therefore Taxpayer and Affiliate must each file a separate combined excise tax return. RCW 82.04.030; RCW 82.32A.030; Rule 203. As we stated in 36 WTD 38, “The state [B&O] tax makes no provision for consolidating returns of affiliated corporations or eliminating inter-company transactions from taxation. Det. No. 86-309, 2 WTD 83 (1986).”

Expenses for goods and services provided to affiliated companies are properly included within the Service and Other Activities B&O tax measure. *See* Det. Nos. 85-308A & 86-20A, 1 WTD 415 (1986). As we conclude in 36 WTD 038:

A business must bear the tax consequences that come with its choice of form. *American Sign & Indicator v. State*, 93 Wn.2d 427, 610 P.2d 353 (1980); *Sav-Mor Oil v. State Tax Commission*, 58 Wn.2d 518, 364 P.2d 440 (1961); Det. No. 89-447, 8 WTD 175 (1989). Thus, transactions between separate, but affiliated entities are taxable.

Here, Taxpayer improperly consolidated the returns of itself and Affiliate, and filed the returns solely under the tax reporting account of Affiliate. If Taxpayer had filed its own returns as required under Washington law, it would have included all of the income it received from Affiliate. Taxpayer also would have listed all expenses it incurred during the course of providing services to Affiliate—all of which are subject to B&O tax under RCW 82.04.080 and RCW 82.04.220. Taxpayer concedes that it received management fees from Affiliate, thereby treating Affiliate as a separate legal entity. However, Taxpayer implies that it did not treat Affiliate as a separate legal entity in the transactions at issue here. As we discuss above, this is not borne out by the evidence.

### 3. Imputed income

Taxpayer argues, alternatively, that it never received reimbursement from Affiliate for the expenses it paid on their behalf, was not required to do so by contract, and, therefore, it never received taxable income. Taxpayer asserts that the payments were never entered as a charge against Affiliate, and contends that there was no accrual for reimbursement of the allocations, costs, and expenses, because Taxpayer and Affiliate did not intend for these amounts to be reimbursed. Instead, Taxpayer argues, it simply accounted for these costs for internal management purposes, and thus they are nontaxable imputed income.

In support of its argument, Taxpayer refers to *Weyerhaeuser Co. v. Dep't of Revenue*, 106 Wn.2d 557, 723 P.2d 1141 (1986). In *Weyerhaeuser*, the taxpayer entered into “lump sum” timber contracts that did not provide for payment of interest. The taxpayer entered imputed interest on its own books for internal accounting purposes, and to comply with requirements of the New York Stock Exchange and the U.S. Securities and Exchange Commission. The court held that the Department could not segregate and tax a portion of the purchase price of timber and treat that segregated portion as “interest” when the contract did not provide for interest. *Id.* at 565-66.

Taxpayer also refers to our decision in Det. No. 91-319, 11 WTD 511 (1992), where the taxpayer made adjustments with regard to certain management fees on its federal tax returns, pursuant to Internal Revenue Code § 482.<sup>4</sup> Section 482 authorizes the Internal Revenue Service to distribute, apportion, or allocate gross income between two or more related entities to prevent evasion or to clearly reflect income of the businesses. 11 WTD 511. We agreed with the taxpayer that B&O tax should not be imposed solely based on an adjustment made pursuant to § 482 when there is no consideration proceeding or accruing to the taxpayer.<sup>5</sup>

<sup>4</sup> [In 11 WTD 511, there were no actual management fees charged by Parent to Affiliate.]

<sup>5</sup> However, we also gave the caveat that “it appears likely that something else may be occurring to cause the IRS to make an adjustment under section 482 of the Internal Revenue Code to prevent evasion or to clearly reflect income.

First, as we discuss above, contrary to Taxpayer's assertion that it never recorded payments, there are actual journal entries showing that Taxpayer entered its costs as accounts receivable, and that Affiliate made corresponding entries as accounts payable on its own books. Similarly, Affiliate treated its acquisitions of tangible personal property from Taxpayer as purchases, and depreciated these items on its federal tax returns.

Next, Taxpayer's reliance on *Weyerhaeuser* and 11 WTD 511 is misplaced. Unlike *Weyerhaeuser*, there is no question in this case that actual revenue was received and actual costs were incurred, either by Taxpayer or Affiliate. Unlike 11 WTD 511, Taxpayer is not asserting that it made adjustments pursuant to Internal Revenue Code § 482, but instead that it did not record reimbursements on its own books as reimbursements, and never charged Affiliate for the costs. As we discuss above, the evidence does not bear this out.

Finally and most importantly, however, is that Taxpayer appears to misunderstand the basis for and applicability of the B&O tax. Taxpayer cites RCW 82.04.080, which defines "gross income of the business," and highlights in bold the phrase "the value proceeding or accruing by reason of the transaction of the business engaged in and includes gross proceeds of sales, compensation for the rendition of services."

However, Taxpayer does not take into account the language farther down in the paragraph, which states that gross income includes "value proceeding or accruing . . . all without deduction on account of the cost of tangible personal property sold, cost of materials used, labor costs, interest, discount, delivery costs, taxes, or any other expense whatsoever paid or accrued . . ." RCW 82.04.080(1) (emphasis added). . . .

. . . In this case, the invoices billed directly and solely to Affiliate indicate that these were not Taxpayer's own costs. Costs are also not included in the measure of B&O tax in Rule 111 situations when a taxpayer is simply facilitating payment to a third party on behalf of its client. However, as we concluded above, Taxpayer has not met the Rule 111 requirements for the expenditures at issue.

To clarify, B&O tax applies to all of the income and charges in dispute. The only issue remaining here is to what extent Taxpayer can show that some expenses were solely those of Affiliate.

Taxpayer discusses the shared bank account, arguing that the Department improperly inferred from the profit and loss statements and the shared bank account that Affiliate reimbursed Taxpayer for costs Taxpayer incurred. The significance of the shared bank account is simply that it makes it more difficult to discern whether it was Taxpayer, rather than Affiliate, who paid any particular expense. Audit has agreed to give Taxpayer the opportunity to provide additional records to show what portion of the expenses were solely those of Affiliate.

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For instance, if charges (accruals) are reflected in the books, there is taxable income." 11 WTD 511. We stated that, although the adjustment alone did not warrant inclusion in income, the *reason* for the adjustment might.

#### 4. Penalties

##### Legal Basis for Late Payment Penalty

The following table illustrates when the Department is obligated to impose the late payment penalty pursuant to RCW 82.32.090(1):

<b>If payment is not received by the . . .</b>	<b>Then the Department must assess a total penalty of . . .</b>
Due date . . .	9% penalty on the amount of the tax
Last day of the month following the due date . . .	19% penalty on the amount of the tax
Last day of the 2 <sup>nd</sup> month following the due date . . .	29% penalty on the amount of the tax

Here, the Audit Period ran from January 1, 2013 through June 30, 2017. During this time, no taxes were reported and paid. The taxes remain unpaid. Therefore, Taxpayer did not pay the tax due by the last day of the second month following the due date for any of the tax periods. Accordingly, the Department was required to impose delinquent penalties of 29% on the unpaid balance.

##### Legal Basis for the Substantial Underpayment Penalty

If 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 to be due. RCW 82.32.090(2). “Substantially underpaid” means that:

- (1) The taxpayer has paid less than eighty percent of the amount of tax determined by the Department to be due for all taxes included in the Department’s examination, and
- (2) The amount of underpayment is at least one thousand dollars.

*Id.* The Department is required to impose penalties when the conditions for imposing them are met. RCW 82.32.090(1). *See also:* Det. No. 01-193, 21 WTD 264 (2002); Det. No. 99-279, 20 WTD 149 (2001); Det. No. 87-235, 3 WTD 363 (1987).

Here, Taxpayer paid \$0 in taxes during the Audit Period, and had unreported and unpaid tax totaling \$ . . . , which is an amount greater than \$1,000. Therefore, substantial underpayment penalties were properly assessed.

However, we note that after correction of the duplication errors we discussed above, and possible reduction of tax based on proof that some costs were solely those of Affiliate, the amount of the delinquent penalties and substantial underpayment penalties will be reduced accordingly.

##### Legal Basis for Waiver of Penalties

The Department has authority to waive penalties only in limited circumstances. RCW 82.32.105. Waiver of late payment penalties and substantial underpayment penalties is required when the

Department finds that a taxpayer's failure to pay on time or in the proper amount was the result of circumstances beyond the taxpayer's control. RCW 82.32.105(1). These are circumstances that generally 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. *Id.*

In order to justify a waiver of penalties, a taxpayer bears the burden of establishing:

- (1) The circumstances were beyond its control, and
- (2) Those circumstances "directly caused" the delinquent payment or substantial underpayment.

Rule 228(9)(a)(i). Some common examples of situations that are beyond a taxpayer's control are:

- 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 accountant; or
- Destruction of the business or records by fire or other casualty.

Rule 228(9)(a)(ii). Some common examples of situations that are *not* beyond a taxpayer's control are:

- Financial hardship;
- A misunderstanding or lack of knowledge of a tax liability;
- Mistakes or misconduct on the part of employees or other persons contracted with the taxpayer; and
- Reliance upon unpublished, written information from the department that was issued to and specifically addresses the circumstances of some other taxpayer.

Rule 228(9)(a)(iii). The Department may also waive late payment penalties, but not substantial underpayment penalties or unregistered business penalties, if the taxpayer can show a previous history of compliance. To qualify, the Department must determine if:

- (1) The taxpayer has requested the penalty be waived,<sup>6</sup> and
- (2) The taxpayer has timely filed and remitted payment on all tax returns due for that tax program for a period of 24 months immediately preceding the period covered by the return for which the waiver is being requested.

RCW 82.32.105(2)(b). The Department can waive the late payment penalty on the first return due under this provision when the taxpayer has obtained a tax registration endorsement with the Department before doing business in this state. Rule 228(9)(a)(i)(B).

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<sup>6</sup> Under RCW 82.32.105(2)(a), the taxpayer must file under one of these statutes: RCW 82.32.045; RCW 82.23B.020; RCW 82.27.060; RCW 82.29A.050; RCW 84.33.086; RCW 82.14B.030.

Here, the late payment and substantial underpayment penalties were the result of Taxpayer's misunderstanding or lack of knowledge that it was required to file nonconsolidated combined excise tax returns with this state. Misunderstanding or lack of knowledge of tax-reporting requirements is not a circumstance beyond the control of Taxpayer, and therefore Taxpayer has shown no basis under RCW 82.32.105(1) for waiver of late payment and substantial underpayment penalties.

Taxpayer registered its business on August 27, 2009, many years prior to the Audit Period. Because Taxpayer was registered with the Department prior to and during the Audit Period, and failed to timely file any tax return for the 24 consecutive months prior to any period in the Audit Period, it has not shown a basis for relief under RCW 82.32.105(2)(b).

Accordingly, we must deny the petition as to the Taxpayer's request for waiver of penalties.

#### DECISION AND DISPOSITION

We deny the petition as to the Rule 111 issue, imputed income, and penalties, and grant it with regard to expenses incurred by and paid solely by Affiliate. We are remanding the case to the Audit Division (Operating Division) for adjustment to the assessment. Adjustment will also include correction of duplication errors.

Dated this 9th day of November 2018.