

Cite as Det. No. 15-0283, 34 WTD 591 (2015)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for Correction of) D E T E R M I N A T I O N
Assessment of) No. 15-0283
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...) Registration No. . . .
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[1] RULE 228; RCW 82.32.105: CIRCUMSTANCES BEYOND THE CONTROL OF THE TAXPAYER – ACT OF FRAUD, EMBEZZLEMENT, OR THEFT – INTERNAL CONTROLS. A taxpayer must show safeguards or internal controls were in place to prevent fraud, embezzlement, or conversion, and must also prove that those safeguards or internal controls were reasonable, in order to prove that the failure to pay tax was due to circumstances beyond the taxpayer’s control.

[2] RULE 228; RCW 82.32.105: CIRCUMSTANCES BEYOND THE CONTROL OF THE TAXPAYER – ACT OF FRAUD, EMBEZZLEMENT, OR THEFT – PROOF REQUIRED. A taxpayer must demonstrate that the alleged criminal act or misconduct actually occurred in order to have a penalty waived.

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.

Weaver, A.L.J. – A taxpayer alleges she was a victim of embezzlement and petitions for a correction of assessment based upon the wrongful acts of her employee. Taxpayer's petition is denied.¹

ISSUE

Whether, under RCW 82.32.105 and WAC 458-20-228, a taxpayer whose bookkeeper was fired for allegations of embezzlement is eligible for the waiver of tax, interest, or penalties.

FINDINGS OF FACT

[Taxpayer] is a company located in . . . , Washington. Taxpayer's books and records were examined by the Audit Division of the Washington State Department of Revenue

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

(“Department”) for the period January 1, 2011 through December 31, 2014. The audit resulted in an assessment against Taxpayer in the amount of \$. . . That assessment is comprised of \$. . . in retail sales tax, \$. . . in retailing business and occupation (“B&O”) tax, \$. . . in service and other activities B&O tax, \$. . . in use tax/deferred sales tax, \$. . . in interest, and a five percent substantial underpayment penalty of \$. . . Taxpayer filed a timely appeal of this assessment.

On appeal, Taxpayer is seeking relief from the assessment because it claims its bookkeeper embezzled funds in excess of \$. . . since 2001. Taxpayer alleges that the bookkeeper used business funds to pay for a significant amount of personal purchases. In order to hide the misappropriation of funds, the bookkeeper allegedly kept chronically incomplete business records. Taxpayer also alleges that the bookkeeper started intentionally underreporting business income in 2014.

Taxpayer fired its bookkeeper and Taxpayer’s attorney has sent a demand letter for restitution to the bookkeeper. We are unaware that any legal proceedings, either criminal or civil, have been brought against the bookkeeper.

ANALYSIS

The five percent substantial underpayment of tax penalty was assessed in accordance with RCW 82.32.090, which provides:

If the department of revenue 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.... As used in this section, "substantially underpaid" means that the taxpayer has paid less than eighty percent of the amount of tax determined by the department to be due for all of the types of taxes included in, and for the entire period of time covered by, the department's examination, and the amount of underpayment is at least one thousand dollars.

RCW 82.32.090(2) (emphasis added). Here, the Audit Division assessed the five percent substantial underpayment penalty against Taxpayer because it paid less than eighty percent of the taxes due during the audit period.²

A taxpayer who pays a tax amount less than the tax amount properly due as a result of circumstances beyond its control is entitled to a waiver or cancellation of penalties. RCW 82.32.105(1). An “act of fraud, embezzlement, theft, or conversion on the part of the taxpayer’s employee” is a specifically enumerated circumstance that the Department considers to be beyond the control of the taxpayer under certain circumstances. WAC 458-20-228(9)(a)(ii)(F) (Rule 228).

The Department is an administrative agency, and its authority to waive or cancel interest and penalties is restricted to the authority granted by the Legislature. Det. No. 98-85, 17 WTD 417 (1998); Det. No. 99-285, 19 WTD 492 (2000). The Department is authorized to waive or cancel

² Taxpayer paid \$. . . in taxes during the audit period out of the total tax liability of \$. . . that Audit determined. Taxpayer paid 54.8% of its tax liability.

penalties if the taxpayer's payment of a tax less than that properly due was the result of circumstances beyond its control. RCW 82.32.105(1); Rule 228(9)(a). Rule 228(9)(a) specifically states that "circumstances that qualify for a waiver of a late payment of return penalty do not necessarily also justify waiver of the substantial underpayment assessment penalty." *Id.* In this case, the only penalty assessed was the substantial underpayment penalty.

Rule 228(9) defines "circumstances beyond the control of the taxpayer" and describes such circumstances as generally those that are immediate, unexpected, or in the nature of an emergency, where the taxpayer does not have time to obtain an extension of the due date. Taxpayer claims that its employee's embezzlement constitutes a circumstance beyond its control that caused its underpayment of taxes. Rule 228 provides guidance for waiving penalties when a delinquency was caused by acts of embezzlement.

The Rule provides that the employee's misconduct must be one that "the taxpayer could not immediately detect or prevent, provided that reasonable safeguards or internal controls were in place." Rule 228(9)(a)(ii)(F). Here the evidence before us is not sufficient to establish that Taxpayer qualifies for the penalty waiver due to the employee's misconduct because it has not shown that it had reasonable safeguards or internal controls in place to detect or prevent the embezzlement or the shoddy bookkeeping. *Id.* "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." Det. No. 06-0155, 26 WTD 73 (2007).

In Det. No. 00-112, 20 WTD 106 (2001), the Department waived late-penalties caused by an employee's embezzlement, where the managing shareholder of a closely held corporation became too ill to operate the business and his inexperienced and untrained spouse while learning the business hired a bookkeeper who embezzled from the company, although the wife was attempting to learn the computer systems of the business. In time, the spouse hired an outside accountant who alerted the spouse to the problems and the spouse took immediate action. The employee was charged with several counts of theft by the county prosecutor's office. In that case we said:

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.

20 WTD 106.

Unlike the taxpayer in 20 WTD 106, we do not have evidence that Taxpayer had any internal controls to scrutinize Taxpayer's books and records for the period while the employee was embezzling funds from the company. Further, we have only Taxpayer's statements that the employee's misconduct, i.e., shoddy recordkeeping and embezzlement, caused the underpayment of taxes and that the employee's conduct was a circumstance beyond its control which resulted in the imposition of the substantial underreporting penalty. A taxpayer must demonstrate that the

alleged criminal act or misconduct actually occurred in order to have a penalty waiver. 26 WTD 73; *see also* Det. No. 01-067, 20 WTD 525, 528 (2001) (“the circumstances must actually cause the late payments.”). Here, Taxpayer provided a copy of a statement describing the former employee’s unauthorized use of its funds and the destruction of the records, but that report was not signed or dated and there is no indication that it was filed with the police. Accordingly, we conclude that Taxpayer has not established that its underpayment of taxes was caused by a circumstance beyond its control.

The Department’s authority to waive interest is narrower than its authority to waive penalties. Specifically, RCW 82.32.105(3) reads, as follows:

- (3) The department shall waive or cancel interest imposed under this chapter if:
 - (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.

RCW 82.32.105(3). The facts of this case do not support the waiver of interest under either of those criteria. The Department’s ability to grant Taxpayer relief because of the bad acts of its bookkeeper is limited to the waiver of penalties. RCW 82.32.105; WAC 458-20-228(9)(a)(ii)(F). We are, therefore, not authorized to compromise the interest that has accrued as a result of the underpayment.

The only statutory basis for waiving tax is found in RCW 82.32A.020(2), which affords taxpayers:

The right to rely on specific, official written advice and written tax reporting instructions from the department of revenue to that taxpayer, and to have interest, penalties, and in some instances, tax deficiency assessments waived where the taxpayer has so relied to their proven detriment

(Emphasis supplied.)

Taxpayer’s failure to pay the taxes due in the assessment was not the result on written advice or instructions from the Department. Consequently, there are no grounds for us to compromise the actual tax due and owing.

DECISION AND DISPOSITION

Taxpayer’s petition is denied.

Dated this 21st day of October, 2015.