Cite as Det. No. 21-0088, 41 WTD 401 (2022)

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

In the Matter of the Petition for Correction of Assessments of	)	D E T E R M I N A T I O N
	)	No. 21-0088
. . .	)	Registration No. . . .
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[1] RCW 82.04.460; RCW 82.04.462; RCW 82.32A.030; WAC 458-20-19402: APPORTIONABLE INCOME – ANNUAL RECONCILIATION FILING REQUIREMENT – CORRECTED TAX RETURN. Taxpayers earning apportionable income are required to file annual reconciliation returns by October 31 of the following year. This allows taxpayers to "true up" their reporting when complete information is available, and to avoid penalties on any additional tax due. A taxpayer's mistake or lack of knowledge that it had reportable apportionable income does not relieve it of the duty to file an annual reconciliation tax return.

[2] RCW 82.04.462; RCW 82.32.090; RCW 82.32.105; WAC 458-20-228: ANNUAL RECONCILATION – PENALTIES. Failure to timely file annual reconciliations by October 31 of the following year may result in penalties under RCW 82.32.090 if tax was underreported. The taxpayer's mistake or lack of knowledge that it had reportable apportionable income is not a basis for waiver of penalties.

[3] MANAGED AUDITS – MANAGED AUDIT AGREEMENT RESOLUTIONS. The Department may allow managed audits with taxpayers, and the parties may enter into managed audit agreement resolutions that allow a waiver of penalties and/or interest. Such managed audit agreements provide that the audits are subject to the Department's final review and possible correction, and that adjustments can be made. Managed audit agreement resolutions also specify that the agreements are contingent on the Department's final review process, including adjustments and additional 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. – Taxpayers that [facilitate third-party merchant sales] dispute the assessment of delinquent penalties related to their failure to timely file annual reconciliation returns to correct reporting of their apportionable income. Taxpayers say they initially did not believe they had apportionable income, so they did not report apportionable income on their original excise tax returns. Because they did not report apportionable income on their original returns, Taxpayers assert, there was no apportionable income to later reconcile, and thus no duty to file annual reconciliations. Absent a duty to file annual reconciliations, Taxpayers argue, penalties associated with failure to timely file annual reconciliations do not apply to them.

Taxpayers argue alternatively that penalties should be waived on the asserted grounds that Taxpayers entered into certain managed audit agreements with the Department, where the parties agreed on set amounts of tax, interest, and total penalties, which did not include delinquent penalties related to untimely filed annual reconciliations. We deny the petitions.[1]

ISSUES

1. Under RCW 82.04.460, RCW 82.04.462, RCW 82.32A.030, and WAC 458-20-19402, were Taxpayers required to file annual reconciliations of apportionable income during the audit periods?

2. Under RCW 82.32.090(1), RCW 82.04.462(4), and WAC 458-20-19402(602), were delinquent penalties properly assessed on additional tax due on Taxpayers' annual reconciliations of apportionable income, when Taxpayers failed to file the returns by the October 31st deadline of the following year for each annual tax period?

3. If delinquent penalties were properly assessed, have Taxpayers shown a basis under RCW 82.32.105 or WAC 458-20-228 upon which to waive them?

4. Are Taxpayers' managed audit agreements a basis on which delinquent penalties may be waived?

FINDINGS OF FACT

[Taxpayer] is the successor to five entities whose cases we address here. In alphabetical order, they are: 1) [Entity 1]; 2) [Entity 2]; 3) [Entity 3]; 4) [Entity 4]; and 5) [Entity 5] (Collectively, "Taxpayers").

During the audit period, Taxpayers . . . primarily made wholesale sales of their inventory to affiliated retailing entities, and timely filed excise tax returns for their wholesaling income [sourced] to Washington State.

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

Taxpayers also had a second source of revenue they received from [providing sales-related services for third-party merchants (Program)]. . . . Taxpayers' failure to report this . . . service income underlies the issues in these cases.

The Department of Revenue's Audit Division (Audit) audited Taxpayers and found none of them had reported gross income they earned from the [Program] on their combined excise tax returns during the audit periods. Audit also found none of the Taxpayers timely filed annual reconciliations to report the income, or paid the additional tax due, for annual tax periods 2016 through 2018. Audit determined that the [Program] services income was taxable under the Service and Other Activities business and occupation (B&O) tax classification and attributed to Washington State a portion of that income for all Taxpayers.

Taxpayers did not report and pay a combined total of $. . .[2] in service and other activities B&O tax for the years 2016 through 2018. Each Taxpayer failed to [file their annual reconciliation returns and] pay the total amount of tax due for all periods at issue . . . . Accordingly, the Department imposed a 29% delinquent penalty on the amount of unpaid tax for each period.[3]

Taxpayers each filed a separate petition for review, with the common issue of whether delinquent penalties were properly assessed on additional tax due on apportionable income not timely reported and paid through annual reconciliation. Because the entities are under common ownership and the issues are the same, Taxpayers and the Department agreed to consolidate the cases for administrative purposes.

Taxpayers do not contest nexus, the apportionment methods used in the audit, or the amount of tax assessed. Taxpayers solely dispute the 29% delinquent penalties assessed on the additional tax due on their unreported apportionable income.

Taxpayers explain that because none of their [facilities] were located in Washington, and none of the tangible personal property related to the [Program] was located in Washington when those services were provided, they presumed that they had no apportionable income, or the related duty to file annual reconciliations.

None of the Taxpayers timely reported and paid excise taxes in the 24-month period immediately preceding any period on which penalties were imposed in the assessments.

We provide detail for each of the entities as follows.

[Entity 1]. The Department audited [Entity 1] for the periods from September 1, 2015,[ ] through December 31, 2018, Audit No. . . . .

Audit found in relevant part that [Entity 1] had not filed annual reconciliations for tax years 2016, 2017, and 2018, by the October 31st deadline of the following year for any of those tax periods. As a result, [Entity 1] failed to timely report a total of $. . . in additional tax for those periods.

[2] All figures are rounded unless otherwise noted.

[3] We note that although the audits covered tax year 2015, no penalties were assessed for that year for any of the Taxpayers.

The Department issued an assessment on February 21, 2020, Document No. . . . , totaling $. . . , which consisted of $. . . in service and other activities business and occupation (B&O) tax; $. . . in interest; $. . . in delinquent penalties (based on 29% of $. . . in unreported additional tax); and a payment credit of $. . . . [Entity 1] did not pay the balance, but timely filed a petition for review.

[Entity 2]. The Department audited [Entity 2] for the periods from September 1, 2015, through December 31, 2018, Audit No. . . . . Audit found in relevant part that [Entity 2] had not filed annual reconciliations for tax years 2016, 2017, and 2018 by the October 31st deadline of the following year for any of those tax periods. As a result, [Entity 2] failed to timely report a total of $. . . in additional tax for those periods.

The Department issued an assessment on February 21, 2020, Document No. . . . , totaling $. . . , which consisted of $. . . in service and other activities B&O tax, $. . . in interest, $. . . in delinquent penalties (based on 29% of $. . . in unreported additional tax), and a payment credit of $. . . .[4] [Entity 2] did not pay the balance of $. . . , but timely filed a petition for review.

[Entity 3]. The Department audited [Entity 3] for the periods from October 1, 2015, through December 31, 2018, Audit No. . . . . Audit found in relevant part that [Entity 3] had not filed annual reconciliations for tax years 2016, 2017, and 2018, by the October 31st deadline of the following year for any of those tax periods. As a result, [Entity 3] failed to timely report a total of $. . . in additional tax for those periods.

The Department issued an assessment on February 21, 2020, Document No. . . . , totaling $. . . , which consisted of $. . . in service and other activities B&O tax; $. . . in interest; $. . . in delinquent penalties (based on 29% of $. . . in unreported tax); and a payment credit of $. . . . [Entity 3] did not pay the remaining balance of $. . . , but timely filed a petition for review.

[Entity 4]. The Department audited [Entity 4] for the periods from September 1, 2015, through December 31, 2018, Audit No. . . . . Audit found in relevant part that [Entity 4] had not filed annual reconciliations for tax years 2016, 2017, and 2018, by the October 31st deadline of the following year for any of those tax periods, and as a result, failed to timely report a total of $. . . in additional tax for those periods.

The Department issued an assessment on February 21, 2020, Document No. . . . , totaling $. . . which consisted of $. . . in service and other activities B&O tax; $. . . in interest; $. . . in delinquent penalties (based on 29% of $. . . in unreported additional tax); and a payment credit of $. . . , leaving a balance of $. . . [Entity 4] did not pay the remaining balance of $. . . , but timely filed a petition for review.

[Entity 5]. The Department audited [Entity 5] for the periods from September 1, 2015, through December 31, 2018, Audit No. . . . . Audit found in relevant part that [Entity 5] had not timely filed annual reconciliations for tax years 2016, 2017, and 2018, by the October 31st deadline of the following year for any of those tax periods, and as a result, failed to timely report a total of $. . . in additional tax for those periods.

[4] . . . .

The Department issued an assessment on February 21, 2020, Document No. . . . , totaling $. . . , which consisted of $. . . in service and other activities B&O tax; $. . . in interest, $. . . in delinquent penalties (based on 29% of $. . . in unreported tax); and a payment credit of $. . . .[5] [Entity 5] did not pay the remaining balance of $. . . , but timely filed a petition for review.

Managed audit agreements

Prior to their audits, all Taxpayers entered into separate managed audit agreements with the Department[6] and later signed corresponding managed audit agreement resolutions.

Each of the managed audit agreements stated, in relevant part:

> - DOR agrees to waive the first $5,000 of net interest due plus the full 5% assessment penalty.
> - DOR and [Taxpayer] sign the Resolution Agreement.
> - [Taxpayer] will make payment when the Resolution Agreement is signed.
> - The audit will be submitted for final review and possible correction. If adjustments are made, a Revised Resolution Agreement will be necessary.

The managed audit agreements also stated in relevant part:

> - DOR has sole discretion to accept, modify or terminate this agreement at any time when terms and conditions are not met. DOR may terminate the agreement at any time during the process when terms or conditions are not met. . . .

The signed managed audit agreement resolutions indicate that the Department accepted from each Taxpayer a payment on an agreed-upon amount to pay for tax, penalties, and interest in the audits.

The managed audit agreement resolutions all contained the following language: "This resolution agreement is contingent on DOR's final review process. If the review determines adjustments should be made to the agreed-upon amount, a revised Resolution Agreement will be necessary."

ANALYSIS

1. Annual reconciliation filing requirement

Taxpayers state that they did not report apportionable income on their originally filed excise tax returns and argue that they had no duty to file annual reconciliations under RCW 82.04.462(4),

[5] . . . .

[6] Managed audits are an administratively created program, subject solely to the Department's discretion, that allow taxpayers to perform some, or all, of the audit functions within a certain time frame. Primary benefits include less disruption to the taxpayer's business, and the ability of taxpayer to manage its own resources. Taxpayers in the program also receive a waiver of the first $5,000 in interest and a waiver of the 5% substantial underpayment penalty. *See* Department of Revenue, *Managed audit program*, https://dor.wa.gov/education/audits/managed-audit-program (last accessed April 14, 2021).

because there was no apportionable income reported on the original returns to "correct" or reconcile, citing to language in that statute. On those grounds, they argue, no "annual reconciliation penalties" apply to them. We disagree with Taxpayers' premise that they did not have the duty to file annual reconciliations.[7]

RCW 82.32A.030 imposes certain responsibilities on taxpayers in this state, including the duty to file accurate excise tax returns and pay taxes in a timely manner, and the duty to provide accurate information on their tax returns. Taxpayers are also required under that statute to know their tax reporting obligations, and if unsure of those obligations, to contact the Department for instructions.

RCW 82.04.460 addresses apportionable income, and states:

> [A]ny person earning apportionable income taxable under this chapter and also taxable in another state must, for the purpose of computing tax liability under this chapter, apportion to this state, in accordance with RCW 82.04.462, that portion of the person's apportionable income derived from business activities performed within this state.

RCW 82.04.460(1) (emphasis added).

Taxpayers do not dispute that they earned apportionable income taxable in Washington State and other states during the audit periods. Therefore, Taxpayers were subject to RCW 82.04.460 and had the duty to report their apportionable income in accordance with RCW 82.04.462.

RCW 82.04.462 requires persons earning apportionable income to report that income using the "receipts factor." The statute describes the receipts factor as follows:

> The numerator of the receipts factor is the total gross income of the business of the taxpayer attributable to this state during the tax year from engaging in an apportionable activity, and the denominator of the receipts factor is the total gross income of the business of the taxpayer from engaging in an apportionable activity everywhere in the world during the tax year.

RCW 82.04.462(3)(a).

RCW 82.04.462(4) provides two ways for taxpayers to calculate the receipts factor:

> [(1)] A taxpayer may calculate the receipts factor for the current tax year based on the most recent calendar year for which information is available for the full calendar year. [(2)] If a taxpayer does not calculate the receipts factor for the current tax year based on the previous calendar year information as authorized in this subsection, the business must use current year information to calculate the receipts factor for the current year. . . .

[7] We also believe Taxpayers misunderstand the term "annual reconciliation penalty" and the related functions of RCW 82.04.462(4) and will address those subjects below.

WAC 458-20-19402 (Rule 19402), the Department's administrative rule that addresses single factor receipts apportionment, implements and interprets RCW 82.04.462(4) in Rule 19402(601) and (602).

Rule 19402(601) reflects the statute, and further explains the two ways a taxpayer may report apportionable income. It states:

> (a) Taxpayers required to use this rule's apportionment method may report their taxable income based on their apportionable income for the reporting period multiplied by the receipts factor for the most recent calendar year the taxpayer has available.
>
> (b) If a taxpayer does not calculate its taxable income using (a) of this subsection, the taxpayer must use actual current calendar year information.

RCW 82.04.462(4), in addition to setting out the way taxpayers must report apportionable income, also imposes the duty to file annual reconciliations of that income.

RCW 82.04.462(4) requires that whether a taxpayer uses the method described in Rule 19402(601)(a) or the method in Rule 19402(601)(b), ". . . [it] must correct the reporting for the current tax year when complete information is available to calculate the receipts factor for that year, but not later than October 31st of the following tax year. . . ." (Emphasis added.)

Rule 19402(602) reflects the statute, and adds:

> Regardless of how a taxpayer reports its taxable income under subsection (601)(a) or (b) of this rule, when the taxpayer has the information to determine the receipts factor for an entire calendar year, it must file a reconciliation and either obtain a refund or pay any additional tax due.

(Emphasis added.)

Taxpayers state they were not aware they had apportionable income to report when they filed their original returns. However, regardless of whether Taxpayers knew they had apportionable income when they originally filed, that does not change the fact that they indeed earned such income, and therefore had the corresponding duty under RCW 82.04.460(1), RCW 82.04.462(4), and Rule 19402(602) to report that income through the annual reconciliation process. Accordingly, we must deny the petitions as to this issue.

2. Delinquent penalties

The Department must impose interest and penalties when the conditions for imposing them are met. RCW 82.32.090; Det. No. 17-0075, 36 WTD 592 (2017); Det. No. 01-193, 21 WTD 264 (2002).

RCW 82.32.090(1) imposes delinquent penalties as follows:

> If payment of any tax due on a return to be filed by a taxpayer is not received by the department of revenue by the due date, there is assessed a penalty of [9%] of the amount of the tax; and if the tax is not received on or before the last day of the month following the due date, there is assessed a total penalty of [19%] of the amount of the tax under this subsection; and if the tax is not received on or before the last day of the second month following the due date, there is assessed a total penalty of [29%] of the amount of the tax under this subsection. No penalty so added may be less than five dollars.

RCW 82.32.090(1). Here, Taxpayers [did not report] their [apportionable] income and related excise tax, and in all cases failed to pay the tax due for all periods at issue, on or before the last day of the second month following the respective payment due date for each period. Therefore, the Department was required by RCW 82.32.090(1) to assess a 29% delinquent penalty on the unpaid tax.

Under RCW 82.04.462(4), the penalties imposed by RCW 82.32.090 will not apply to taxpayers with apportionable income who correct their receipts factor by October 31st of the year immediately following the current year. It states:

> . . . [A] taxpayer must correct the reporting for the current tax year when complete information is available to calculate the receipts factor for that year, but not later than October 31st of the following tax year. Interest will apply to any additional tax due on a corrected tax return. . . . Penalties as provided in RCW 82.32.090 will apply to any such additional tax due only if the current tax year reporting is not corrected and the additional tax is not paid by October 31st of the following tax year.

RCW 82.04.462(4) (emphasis added).

This is [also stated] in Rule 19402(602), which says in relevant part: "If the reconciliation is completed prior to October 31st of the following year, no penalties will apply to any additional tax that may be due." [8]

It appears Taxpayers misunderstand the function of RCW 82.04.462(4) with regard to the assessment of penalties. RCW 82.04.462(4) does not impose penalties—it instead refers to the provisions of RCW 82.32.090. As such, there is no "annual reconciliation penalty" separately imposed by RCW 82.04.462(4). "Annual reconciliation penalty" is simply a term of art sometimes used to refer to the delinquent penalty in RCW 82.32.090(1) when it is assessed on additional tax due in those instances where the additional tax was not reported and paid by the extended October 31st deadline.

[8] We note that Rule 19402(602) erroneously states that annual reconciliation returns and payment must be received "prior to" October 31st. However, the statute provides that such returns and payment are timely if received on or before October 31st. This discrepancy did not affect the cases here.

With regard to penalties, RCW 82.04.462(4) merely allows taxpayers more time to "true up" their reporting of apportionable income, and pay any additional tax liability, without incurring delinquent penalties on the additional tax due—so long as they do it by the October 31st deadline.

Here, Taxpayers [did not report any apportionable income and] failed to file annual reconciliations for calendar years 2016, 2017, and 2018 by the October 31st deadline of the following year for each period, as required by RCW 82.04.462(4). Therefore, Taxpayers did not meet the requirements to avail themselves of the benefit of the extended filing period in RCW 82.04.462(4).

As we have discussed, RCW 82.04.462(4) provides that if the current year reporting is not corrected and any additional tax paid by October 31st of the following year, "[p]enalties as provided in RCW 82.32.090 will apply." *See also* WAC 458-20-19402(602). As we have noted, assessment of the delinquent penalty is mandatory. RCW 82.32.090(1); 36 WTD 592; 21 WTD 264. Therefore, delinquent penalties were properly assessed.

. . . .

Having determined that the delinquent penalties were properly assessed, we turn now to address whether we can waive them.

3. Penalty waivers

The Department has limited authority to waive or cancel penalties. RCW 82.32.105; 36 WTD 592. The Department may waive or cancel delinquent penalties in two situations.

First, under RCW 82.32.105(1), the penalty must be waived if the late filing and payment were caused by "circumstances beyond the control of the taxpayer." RCW 82.32.105(1). "The taxpayer bears the burden of establishing that the circumstances were beyond its control and directly caused the late payment." WAC 458-20-228(9)(a)(i) (Rule 228). (Rule 228 is the administrative rule that addresses penalties and penalty waivers.)

Second, solely with regard to delinquent penalties, the penalties may be waived if the taxpayer has timely filed and paid tax in the 24 months immediately preceding the period for which the penalty was assessed, sometimes called the "24-month penalty waiver." RCW 82.32.105(2); Rule 228(9)(b).[9]

Circumstances beyond the taxpayer's control. Rule 228 explains that "[c]ircumstances 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)(a)(ii). The circumstances must directly cause the late payment. *Id*. The same rule section gives examples of circumstances that are generally considered beyond the control of the taxpayer, including:

[9] . . .

- The payment was mailed on time but to the wrong governmental agency,
- Erroneous written information from the Department,
- Death or serious illness of the taxpayer or a family member,
- Unplanned unavoidable absence of the taxpayer or key employee,
- Destruction of the business or records by fire or other casualty, and
- An act of fraud or conversion by the taxpayer's employee or contract helper which the taxpayer could not immediately detect or prevent,

Rule 228(9)(a)(ii).

Here, none of the examples listed in Rule 228(9)(a)(ii) apply, nor does the general proposition that the payments were late because the circumstances were "immediate, unexpected, or in the nature of an emergency." Rule 228(9)(a)(iii) also provides examples of circumstances that are *not* considered beyond the control of the taxpayer, including:

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

We have consistently held that a taxpayer's lack of knowledge does not qualify it for a waiver of penalties, because it is not a circumstance beyond the taxpayer's control. *See* Det. No. 17-0309, 37 WTD 218 (2018); Det. No. 14-0155, 33 WTD 496 (2014); Det. No. 06-0088, 26 WTD 201 (2007). *See also* Det. No. 01-096, 22 WTD 126 (2003) ("'Lack of knowledge' is not a 'circumstance beyond the control of the taxpayer' because the law, regulations, and Department publications explaining all tax laws are publicly available . . . .").

Here, Taxpayers were assessed penalties as a result of their lack of knowledge of a tax liability. This is specifically identified in Rule 228(9)(a)(iii) as *not* being a circumstance beyond the control of the taxpayer. Because Taxpayers have not presented evidence of circumstances beyond their control that caused the late payments, the Department lacks the authority to waive penalties under RCW 82.32.105(1) and Rule 228(9)(a).

24-month penalty waiver. Finally, Taxpayers do not qualify for the 24-month penalty waiver under RCW 82.32.105(2) and Rule 228(9)(b), because they did not timely report and pay their taxes in the 24-month period immediately preceding any tax period in the audits on which delinquent penalties were assessed.[10]

Taxpayers argue that by assessing the delinquent penalty in circumstances like theirs, the Department is interpreting the statute in a way that discourages taxpayers from correcting their tax reporting. This, Taxpayers argue, goes contrary to legislative intent. We disagree. Taxpayers' proposed interpretation goes contrary to the Legislature's mandate that taxpayers comply with

[10] . . .

Washington's tax laws, including the statutory duties on the part of all taxpayers in this state to know their tax reporting obligations and to timely file and pay tax due on their excise tax returns. *See* RCW 82.32A.030; RCW 82.32.045.

Based on the foregoing, we must deny the petitions as to the penalty waiver requests.

4. Managed audit agreements

Taxpayers assert that they entered into the managed audit agreements and executed the managed audit agreement resolutions in good faith, and that delinquent penalties were not included in the amounts they paid pursuant to the resolutions. However, the managed audit agreements clearly provide that the audits are subject to the Department's final review and possible correction, and that adjustments can be made. Similarly, the managed audit agreement resolutions also specify that the agreements are contingent on the Department's final review process and adjustment.

Here, the Department found during final review that Taxpayers had not filed annual reconciliations during the audits. As we discuss above, the Department can make further adjustments to the managed audits pursuant to the managed audit agreements and the corresponding resolutions. Also, as we address above, the Department is required by statute to assess delinquent penalties when the circumstances for them arise. RCW 82.32.090(1); 36 WTD 592; 21 WTD 264. Accordingly, we must deny the petitions as to this issue.

DECISION AND DISPOSITION

Taxpayers' petitions are denied.

Dated this 6th day of May 2021.