

06-0574
Audit
Signed 10/24/2006

BEFORE THE UTAH STATE TAX COMMISSION

PETITIONER,)		
)	ORDER	
)		
Petitioner,)		
)	Appeal No.	06-0574
v.)		
)	Account No.	#####
AUDITING DIVISION OF THE)		
UTAH STATE TAX COMMISSION,)	Tax Type:	Withholding/Penalty & Interest
)		
Respondent.)	Judge:	Phan

Presiding:

Jane Phan, Administrative Law Judge

Appearances:

For Petitioner: PETITIONER REPRESENTATIVE, Attorney at Law

For Respondent: RESPONDENT REPRESENTATIVE, Assistant Attorney General

STATEMENT OF THE CASE

This matter came before the Commission for an Initial Hearing pursuant to Utah Code Sec. 59-1-502.5. Petitioner is appealing penalties and interest assessed with a withholding tax audit for the period of April 1, 1987 through December 31, 2003. Petitioner did not contest the amount of the underlying withholding tax. The penalties assessed were 10% failure to file and 10% failure to pay penalties pursuant to Utah Code 59-1-401. The penalties totaled \$\$\$\$\$. Interest assessed with the audit was \$\$\$\$\$ and continues to accrue on the unpaid balance.

APPLICABLE LAW

Upon making a record of its actions, and upon reasonable cause shown the commission may waive, reduce or compromise any of the penalties or interest imposed under this part. Utah Code Sec. 59-1-401(11).

DISCUSSION

Petitioner argues that the penalties and interest should be waived based on the embezzlement of nearly \$\$\$\$ in federal and state withholding and income tax deposits by Petitioner's accountant. The embezzlement occurred and was undetected over the sixteen-year period at issue.

Petitioner's representative argues that Petitioner relied on one accountant during this entire period, a ACCOUNTANT 1. It is Petitioner's assertion, which Respondent does not refute, that ACCOUNTANT 1 would assist Petitioner in preparing the monthly payroll and employment tax withholding returns and Petitioner would give him checks for the payment that were to be deposited at Petitioner's (X) Account at COMPANY. However, ACCOUNTANT 1 would instead take the checks to the bank, discard the withholding tax returns, and have the bank deposit the funds into his own personal business account. Petitioner and the bank are currently in litigation over whether the bank is liable for allowing ACCOUNTANT 1 to deposit these checks into his personal account when they were not made out to him or endorsed over to him. Additionally the same type of embezzlement was occurring with Petitioner's estimated income tax checks.

Petitioner asserts that the embezzlement continued over the sixteen-year period and was not discovered because ACCOUNTANT 1 very carefully and cunningly kept it hidden. Petitioner argues that ACCOUNTANT 1 understood that certain returns must be filed as they are "red flags" regarding taxes and also when federal and state government agencies would not coordinate with each other. So he compiled W-2's and forwarded them to Petitioner's employees annually which would have been accurate based on wages the employee received and apparently corresponded with the checks that Petitioner issued for the tax payments, but were then taken by ACCOUNTANT 1. The employees used these W-2's to file their own individual income tax returns. As far as Petitioner is aware no employee ever had an issue with the IRS based on inaccurate W-2

forms. ACCOUNTANT 1 would then prepare federal 941 reports for inclusion in Petitioner's file, so it looked like these were being filed. However, he never filed any 941 reports with the IRS, nor did the IRS ever receive any withholding tax payments. So as far as the IRS knew, Petitioner had an FEIN number but did not have any employees. Apparently the IRS never cross-referenced the W-2's submitted by the employees when they filed their personal income tax returns to a 941 report from PETITIONER. As far as the Utah state withholding account records, the indication was also that there were no employees. Again the same embezzlement and cover-up was occurring with Petitioner's Utah individual income tax returns.

The embezzlement came to light after ACCOUNTANT 1 died in November 2003. Petitioner then retained ACCOUNTANT 2, CPA, as his new accountant late in November 2003. By December 2003 ACCOUNTANT 2 discovered some irregularities and the embezzlement began to be understood by Petitioner.

The audit was the result of Petitioner voluntarily coming forward to Respondent and letting Respondent know that he had discovered the money meant to pay the Utah taxes had been embezzled. Petitioner told Respondent prior to any action on the part of Respondent. The amount of tax at issue in the audit is based on the returns that Petitioner has been able to put together and file after the embezzlement had been discovered.

Petitioner points out that the Utah Tax Commission had performed an IFTA Audit of Petitioner about ten years ago. The audit was appealed and the matter proceeded to an administrative hearing. At that time auditors had visited with Petitioner to audited the fuel tax records. They would have been aware that Petitioner had employees. However, they never noticed that Petitioner was not filing any state withholding returns or paying any withholding tax payments.

Petitioner argues that the embezzlement provides reasonable cause for waiver of penalties.

Petitioner's representative points out that penalties are imposed to encourage timely compliance with the tax laws. In this case Petitioner thought he had been complying. He had been writing checks and filling our tax forms.

Respondent does not dispute any of the facts indicated above. Respondent does point out, however, that a lawsuit is pending with COMPANY, and there is a possibility that Petitioner will recover some of the embezzled funds as well as damages that might include the penalties. Respondent's representative also argues that the interest is assessed based on time value of money and the Tax Commission simply did not have the use of the funds for all these years.

Petitioner had wanted to have a decision issued on penalties relating to the underpayment of his individual income tax for the years at issue, but the amounts of the tax have not yet been established. Respondent argued the Commission needs to wait to make a determination on the penalties and interest for the income tax until after the penalties and interest have been assessed.

Upon review of the facts and the arguments in this matter, this case is unusual and unique in that the embezzlement went on for a period of more than sixteen years. Certainly Petitioner has the responsibility to oversee actions of accountants and see that taxes are paid. On the other hand, this embezzlement was cleverly concealed, from not only Petitioner, but also the IRS and the State Tax Commission. Had either agency discovered this sooner it would have brought the embezzlement out into the open. Generally when embezzlement occurs the Commission would waive penalties up to only the first three periods or some other limited amount, because the business owner is responsible to review accounts and oversee employees and agents to make sure taxes are paid. However, these circumstances are usual enough for the Commission to conclude that there is cause for waiver of a larger portion of the penalties. The Commission finds cause for waiver of one-half the penalties assessed in this matter.

Interest is assessed when taxes are not paid or underpaid to compensate the state for the time value of money. Interest is generally waived only in the event the Tax Commission, or Tax Commission employee error gave rise to the late payment or underpayment. The Commission does not find such an error under the circumstances presented in this case.

DECISION AND ORDER

Based upon the foregoing, the Commission finds that sufficient cause has been shown to reduce the penalties assessed with the withholding tax audit for the period at issue to \$\$\$\$\$. Sufficient cause has not been show for waiver of the interest. This decision does not apply to any individual income tax penalties and those penalties need to be addressed separately, after they have been assessed. It is so ordered.

This decision does not limit a party's right to a Formal Hearing. However, this Decision and Order will become the Final Decision and Order of the Commission unless any party to this case files a written request within thirty (30) days of the date of this decision to proceed to a Formal Hearing. Such a request shall be mailed to the address listed below and must include the Petitioner's name, address, and appeal number:

Utah State Tax Commission
Appeals Division
210 North 1950 West
Salt Lake City, Utah 84134

Failure to request a Formal Hearing will preclude any further appeal rights in this matter.

DATED this _____ day of _____, 2006.

Jane Phan
Administrative Law Judge

Appeal No. 06-0574

BY ORDER OF THE UTAH STATE TAX COMMISSION:

The Commission has reviewed this case and the undersigned concur in this decision.

DATED this _____ day of _____, 2006.

Pam Hendrickson
Commission Chair

R. Bruce Johnson
Commissioner

Marc B. Johnson
Commissioner

D'Arcy Dixon Pignanelli
Commissioner

NOTICE: Failure to pay the balance due as a result of this order within thirty days from the date hereon may result in an additional penalty.

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