

BEFORE THE STATE OF ALASKA OFFICE OF ADMINISTRATIVE HEARINGS¹

IN THE MATTER OF)
KODIAK AUTO AUCTION, INC.) OAH No. 05-0228-TAX
)
Corporate Income Tax for Tax Years 2001, 2002 & 2003)

DECISION AND ORDER

I. Introduction

This is a tax penalty case. Kodiak Auto Auction, Inc. (Kodiak) is appealing an assessment by the Taxation Division of the Alaska Department of Revenue, (Division) of a Failure-to-File penalty of \$5,533, a \$1,383 Failure-to-Pay penalty, a \$1,383 Negligence penalty, and a \$1,008 Underpayment penalty for late payment of Kodiak's 2001, 2002 and 2003 Alaska corporate income tax liability and late filing of the 2001, 2002 and 2003 Alaska corporate returns.²

Because Kodiak's reliance on its accountant's advice was negligent and not reasonable cause for the late filings and late payments, the Administrative Law Judge grants the Division's request to uphold its penalties.

II. Facts

A. History

On April 4, 2005, Kodiak, through its representative, Richard A. Lange, filed a letter explaining its position.

On April 19, a prehearing conference was held. At that conference, the parties agreed that there was no need for an evidentiary hearing. The parties agreed to a briefing schedule that provided for Division to file a brief, for Kodiak to respond with its position, and then for oral arguments.

On May 3, 2005, the Division filed a brief asking to deny this appeal and uphold the

¹ The Alaska Office of Administrative Hearings is the successor agency to the Office of Tax Appeals, effective July 1, 2005.

² These penalties were assessed under Alaska Statute 43.05.220.

Division's penalties based on the undisputed facts of this case.

On May 13, 2005, Kodiak filed a response to the Division's brief. Kodiak requested abatement of the penalties.

On June 6, 2005, oral arguments were held. At the end of oral arguments, the parties agreed to a schedule for supplemental briefing.

On June 30, 2005, the Division filed a supplemental brief.

B. Explanation of Late Filings and Late Payments

Kodiak is an Alaska corporation that has been doing business exclusively in Anchorage, Alaska since 1999. Kodiak did not have taxable income until 2001.

Kodiak timely filed corporate federal tax returns for 1999 through 2004, but did not file returns in Alaska. Kodiak had relied on the advice of its Montana accountant, Mr. Lange. Mr. Lange advised Kodiak that Alaska had no state corporate income tax. Mr. Lange had helped Al Williams, the owner of Kodiak, to incorporate and file Kodiak's corporate, as well as Mr. Williams' personal, tax returns.

On November 18, 2004, the Division sent Kodiak a letter inquiring about Kodiak's failure to file Alaska returns. Once Kodiak was aware of the filing requirement, the filings were brought up to date and the tax due was paid.

Kodiak explained that its failure to file was due to Mr. William's reliance on Mr. Lang's advice that there was no Alaska corporate income tax, and therefore no filing requirement. It is undisputed that Kodiak relied on the advice of its accountant. It is also undisputed that Kodiak did not receive any direct notice from the Division of the filing requirement until the November 18, 2004 letter.

III. Discussion

A. No Dispute of Fact

The relevant facts in this case are not in dispute. Kodiak and the Division agree that Kodiak was late in filing its paying the 2001, 2002 and 2003 Alaska corporate income tax returns and paying the tax due for those tax years. They also agree that the Division correctly calculated the penalty due. They agree about the facts surrounding the late filings and late payments. The only disagreement is whether, given these undisputed facts, Kodiak is entitled to a waiver of the

penalties.³

B. Failure-To-Pay & Failure-To-File Penalties

1. Legal Standard for Abatement

Kodiak would be entitled to a waiver of the failure to pay, and failure-to-file penalty, if the late filings and payments were due to reasonable cause and not willful neglect.⁴ In the context of this case, reasonable cause would mean that Kodiak took in good faith all steps and precautions reasonably necessary to ensure the timeliness of the filings and payments.⁵

2. Reliance on Out-of-State Accountant Was Not Reasonable Cause

Kodiak's reliance on its accountant's advice was not reasonable cause for late filings and payments. To avoid tax penalties, a taxpayer must anticipate the magnitude and complexity of its tax obligations.⁶ Kodiak's failure inquire with the Alaska Department of Revenue, or consult with an Alaska CPA, or even an out-of-state accountant who had experience working for Alaska businesses, were reasonable steps Kodiak should have taken to ensure timely filing of required returns and payment of Alaska taxes.⁷ Taking any one of these obvious steps during the years Kodiak conducted its business in Alaska, before it had reportable income, would have avoided the late filings and payments.

Reliance on the advice of an accountant or an attorney on a matter of tax law may be reasonable cause for a late tax payment when the advice is on an issue of tax law that a person who is not a tax professional could not ascertain himself without special training or effort.⁸ Reliance on an accountant cannot function as a substitute for compliance with an unambiguous statute.⁹ It would have taken no special effort or training for Kodiak to ascertain that it was

³ Kodiak's letters dated July 14, 2005 & May 5, 2005, and Division's Pre-Hearing Brief, & Supplemental Brief.

⁴ Alaska Statute 43.05.220(a).

⁵ See the examples of reasonable cause found in Alaska Regulation 15 AAC 05.200(c).

⁶ *State, Dep't of Revenue v. Dyncorp*, 14P.3d 981, 987 (Alaska 2000)

⁷ Taking the reasonable step of consulting an Alaska CPA would have prevented the late filing, but as discussed below, because this filing and timely payment requirements are clear and readily ascertainable by a layperson, reliance on this advice would not be reasonable cause even if it had it come from an Alaska tax expert.

⁸ *U.S. v. Boyle*, 469 U.S. 241, 251.

⁹ *U.S. v. Boyle*, 469 U.S. 241, 251.

required to pay income tax and file returns in Alaska. It is clear that under the case law regarding when reliance on an agent is “reasonable cause,” that reliance on the advice of even an Alaska CPA would not be reasonable cause for failure to file Alaska corporate income tax returns or timely pay the tax due.¹⁰

Based on the undisputed facts of this case, Kodiak’s late filings and payments were not due to reasonable cause. The Division correctly assessed a Failure-to-File penalty of \$5,533, and a \$1,383 Failure-to-Pay penalty.

C. Negligence Penalty

1. Legal Standard for Abatement

In its Prehearing Brief, the Division incorrectly implies that the negligence penalty imposed under AS 43.05.200(b), may only be abated if a taxpayer makes the “reasonable cause” showing required for abatement of the failure-to-pay, and failure-to-file penalties imposed under AS 43.05.200(b).¹¹

As discussed above, the reasonable cause standard requires showing that although the return was filed or the tax was paid late, the taxpayer took, in good faith, all steps and precautions reasonably necessary to ensure the timeliness of the filings or payments. The Division’s brief correctly characterizes the *Boyle* decision as having drawn a brighter line in determining when reliance on professional tax advice is “reasonable cause” for a late tax filing or payment. This line, however, is not a simple negligence test.

Abatement for the negligence penalty only requires a showing that the late filing or payment was not due to the taxpayer’s negligence. The Alaska Regulation for this penalty provides:

15 AAC 05.220. Additional penalty for negligence or intentional disregard

- (a) A negligence-or-intentional-disregard penalty will, in the department's discretion, be assessed in addition to a penalty for failure to file, failure to pay, or civil fraud.
- (b) If it is determined by the department that a tax deficiency or part of a tax deficiency is due to negligence or intentional disregard of a law or a regulation without intent to defraud, then a penalty of five percent will be assessed and collected. The penalty is computed on the total amount of the tax deficiency, even if the determination relates to only a part of the deficiency.

¹⁰ *U.S. v. Boyle*, 469 U.S. 241.

¹¹ Division’s Pre-Hearing Brief, page 3.

(c) Negligence is the failure to do something which a prudent and reasonable person, guided by those considerations which ordinarily regulate the conduct of human affairs, would do; it is also doing something which a prudent and reasonable person would not do.

(d) Intentional disregard of a law or a regulation without intent to defraud is the failure to comply with governing laws and regulations when the taxpayer has knowledge of the pertinent laws and regulations and does not have specific intent to evade the payment of tax. An error or honest difference of opinion does not constitute intentional disregard.

(e) Negligence or intentional disregard may be demonstrated by any relevant evidence, including but not limited to the following:

- (1) the taxpayer has substantially deviated from the statutes or regulations in reporting income or claiming deductions after being advised by the department of the proper methods of reporting;
- (2) the taxpayer has failed to keep adequate records;
- (3) the taxpayer has exaggerated deductions unsubstantiated by facts; or the taxpayer has not justified an understatement of income.

In the context of reliance on the advice of a tax professional, the difference between the standards for abatement of the penalty imposed under AS 43.05.200(a) and the penalty imposed under AS 43.05.200(b) are subtle. However, one could imagine a case where reliance on the advice of an out-of-state accountant regarding filing requirements might not be “reasonable cause,” but such reliance would not be negligent. If a resident of one state, with no business experience, suddenly inherited a relatively passive investment, such as income producing real estate, in another state, and missed a state or local tax deadline due to reliance on the advice of the taxpayer’s regular local accountant, there might be circumstances that would make it difficult to characterize that reliance as unreasonable, or negligent. Furthermore, If a taxpayer was told by an Alaska CPA that no return needed to be filed, reliance on that advice would probably not be negligent.

2. Reliance on Out-of-State Accountant Was Negligent

The undisputed facts in this case do not, unfortunately, allow any other characterization of Kodiak’s reliance. Kodiak is an Alaska corporation. Its business activities take place exclusively in Alaska. These activities are not passive investments. A reasonably prudent person conducting these business activities would become acquainted with the state and local laws affecting those activities, including state and local tax laws. It was not reasonable to conduct these activities for several years without investigating Alaska taxation of those activities based on reliance on the advice from a Montana CPA with no expertise in Alaska tax law.

D. Underpayment Penalty

The underpayment penalty may only be abated if the amount due is under \$500.¹² There is no dispute that the amounts due for each tax year exceeded \$500 in this case.

IV. Conclusion

Based on the undisputed facts in the record, the penalties assessed Kodiak by the Division must be upheld.

V. Order

The Division's a request to uphold its penalties is GRANTED. Kodiak's request for abatement of the tax penalties assessed in the amounts of \$5,533, \$1,383, \$1,383, and \$1,008 is DENIED. The Division's assessment of a Failure-to-File penalty of \$5,533, a \$1,383 Failure-to-Pay penalty, a \$1,383 Negligence penalty, and a \$1,008 Underpayment penalty for late filing and late payment of Taxpayer's 2001, 2002 and 2003 Alaska corporate income tax liability is AFFIRMED.

NOTICE

This is the hearing decision of the Administrative Law Judge under Alaska Statute 43.05.465(a). Unless reconsideration is ordered, this decision will become the final administrative decision 60 days from the date of service of this decision.¹³

A party may request reconsideration in accordance with Alaska Statute 43.05.465(b) within 30 days of the date of service of this decision.

When the decision becomes final, the decision and the record in this appeal become public records unless the Administrative Law Judge has issued a protective order requiring that specified parts of the record be kept confidential.¹⁴ A party may file a motion for a protective order, showing good cause why specific information in the record should remain confidential, within 30 days of the date of service of this decision.¹⁵

Judicial review of this decision may be obtained by filing an appeal in the Alaska Superior Court in accordance with Alaska Statute 43.05.480 within 30 days of the date this

¹² AS 43.20.030(c) & 26 U.S.C. § 6655(a) & (f).

¹³ Alaska Statute 43.05.465(f)(1).

¹⁴ Alaska Statute 43.05.470.

decision becomes final.¹⁶

DATED this 7th day of December 2005.

By: _____

Mark T. Handley
Administrative Law Judge

The undersigned certifies that
this date an exact copy of the
foregoing was provided to the
following individuals:

Richard Lange

Michael Barnhill, AAG
signature

Date
12.7.05

¹⁵ Alaska Statute 43.05.470(b).

¹⁶ Alaska Statute 43.05.465 sets out the timelines for when this decision will become final.