

BEFORE THE ALASKA OFFICE OF ADMINISTRATIVE HEARINGS

In the Matter of:)	
)	
KEYSTONE ASSOCIATES, INC.,)	
)	
Appellant.)	OAH No. 06-0556-TAX
)	
<u>2004 Corporation Net Income Tax</u>)	

DECISION

I. Introduction

Keystone Associates, Inc. (“Keystone”) appeals an informal conference decision by the Department of Revenue, Tax Division, assessing penalties totaling \$960.00 for omitting to file its 2004 Corporation Net Income Tax return, or to pay the tax owing, until approximately half a year after these items were due. The corporation contends that there was reasonable cause for delay in the filing and payment.

Because the record does not establish that Keystone had reasonable cause for its failure to comply with the filing and payment requirements, Keystone has failed to show that the penalties should be abated. Accordingly, the Tax Division’s assessment of \$192.00 for the Failure-to-Pay Penalty and \$768.00 for the Failure-to-File Penalty is affirmed.

II. Facts

Keystone Associates, Inc., is in the business of general contracting, based in Sitka.¹ The company has operated as a family business since 1977, and now does between one and four million dollars of business per year.² It employs four to eight people, excluding subcontractors.³ Connor Nelson is the corporation’s president. Valorie Nelson, his wife, is the corporation’s treasurer, who ordinarily pays the firm’s bills and posts to the general ledger.⁴

In September of 2003, Ms. Nelson was diagnosed with an advanced, life-threatening cancer.⁵ She was treated in Seattle. After six months of chemotherapy, she underwent major surgery in March of 2004, followed by additional chemotherapy.⁶ Keystone nonetheless apparently filed an Alaska Corporation Net Income Tax return for 2003 in 2004.

¹ Testimony of Connor Nelson; Letter of Appeal (Aug. 7, 2006).
² Testimony of Connor Nelson.
³ *Id.*
⁴ Testimony of Valorie Nelson.
⁵ *Id.*
⁶ *Id.*

By early 2005, Ms. Nelson was traveling to Seattle periodically for follow-up treatment.⁷ Her mental functioning was made less sharp by the chemotherapy.⁸ Notwithstanding her condition, Ms. Nelson arranged for both federal and state tax returns to be prepared by a Certified Public Accountant (CPA).⁹ Keystone's 2004 Alaska Corporation Net Income Tax, to the extent not paid through estimated tax, was due March 15, 2005, and its tax return was due April 15, 2005. Ms. Nelson was away for treatment at the time the payment was due in March.¹⁰ Though there was no explicit testimony on the point, Mr. and Ms. Nelson's testimony suggested that the corporation would ordinarily file its return in March along with the payment of the balance owing.¹¹

In Ms. Nelson's absence, it was Mr. Nelson's responsibility to file the tax returns and pay the taxes.¹² He filed the federal income tax return for 2004 but omitted to file the Alaska return, even though the CPA had prepared one on March 15, 2005.¹³ He also made no Alaska tax payment. Mr. Nelson was aware of the requirement to file a state return.¹⁴ He described his failure to file the Alaska return as an oversight.¹⁵ During the period of this oversight, Mr. Nelson was emotionally affected by his wife's illness; he describes it as the worst year of his life.¹⁶

Ms. Nelson did not discover the omission to file the state return and to pay the state tax until August or September of 2005, when she was updating the general ledger to prepare an interim financial statement.¹⁷ On October 19, 2005, Mr. Nelson signed the return that the CPA had prepared on March 15, 2005.¹⁸ The Tax Division received the return and payment of the balance owing on October 21, 2005.¹⁹

On June 5, 2006, the division assessed penalties of \$960, consisting of \$192 for late filing and \$768 for late payment. It also assessed interest on the late balance covering the period from March 15, 2005, when the tax should have been paid, until payment was received on October 21,

⁷ *Id.*

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.*

¹¹ Ms. Nelson returned from Seattle "in March" of 2005 and heard from Mr. Nelson that the corporation's taxes had been paid. She inferred from this information that the returns had also been filed.

¹² Testimony of Connor Nelson.

¹³ *Id.*; see also date of preparer's signature on 2004 return.

¹⁴ Testimony of Connor Nelson.

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ Testimony of Valorie Nelson.

¹⁸ 2004 Alaska Corporation Net Income Tax Return, p. 1.

¹⁹ Stipulated at hearing.

2005. Keystone paid the interest but contested the penalties. The division declined to abate the penalties in an informal conference. This appeal followed.

III. Discussion

The sole issue in this appeal is whether the two penalties should have been assessed. Keystone does not dispute that the penalties, if they were appropriate, have been calculated correctly.

Keystone bears the burden of establishing that the department erred in assessing the penalties.²⁰ It must show by a preponderance of the evidence that any questions of fact should be resolved in its favor.²¹ The independent judgment standard applies to questions of law in this appeal.²² The department's informal conference decision is entitled to deference only "as to a matter for which discretion is legally vested in the Department of Revenue."²³

A. Basis for Penalties

The department assessed two separate penalties against Keystone: (1) a Failure-to-Pay Penalty and (2) a Failure-to-File Penalty. The Failure-to-Pay Penalty arose from the obligation in AS 43.20.030(b) to pay the Alaska Corporation Net Income Tax at the same time the corresponding federal tax is due. The Failure-to-File Penalty arose from the obligation in AS 43.20.030(a) to file an Alaska Corporation Net Income Tax return within 30 days after the corresponding federal tax return is due. It is undisputed in this case that, for Keystone's 2004 return, these dates were March 15 and April 15, 2005, respectively, and that both the payment and the return were not submitted until more than six months later.

Both obligations fall within the civil penalty provision of AS 43.05.220, which imposes an escalating percentage-of-tax penalty of five percent per month for each month the taxpayer fails to file a return as required or to pay a tax balance due. The penalties are subject to a combined cap of 25 percent of the tax due. Because Keystone was more than six months overdue for each obligation, the full 25 percent maximum could have been assessed for either penalty alone or could have been divided between them. In this case, the division assessed a 20 percent penalty for failure to file and five percent for failure to pay, yielding the 25 percent maximum.

²⁰ AS 43.05.455(c).

²¹ AS 43.05.435(1); AS 43.05.455(c).

²² AS 43.05.435(2).

²³ AS 43.05.435(3).

B. Abatement

Keystone is a family corporation that essentially is run by a husband and wife. Ms. Nelson is the company's financial officer. With Ms. Nelson's memory affected by chemotherapy and with her absence from the state at key times in early 2005, it devolved to Mr. Nelson to take care of the tax filings. The essence of Keystone's argument is that, in light of Mr. Nelson's role as substitute and his emotional distress over his wife's illness, the company ought not to pay a penalty for his oversight, which Ms. Nelson corrected as soon as she noticed it.

The civil penalties imposed under AS 43.05.220 can be abated if two concurrent conditions are shown: "that the failure is due to reasonable cause and not to wilful neglect."²⁴ The division does not contend that there was wilful neglect in this instance;²⁵ the case, therefore, turns solely on whether the taxpaying corporation has shown "reasonable cause." Once the facts concerning the delayed filing and payment are established, whether they add up to "reasonable cause" requires application of law to the facts and does not implicate agency expertise.²⁶ No deference is given to the department's decision.²⁷ The independent judgment standard applies.²⁸

By regulation, the Department of Revenue has established that "reasonable cause" will be determined in accordance with section 6651 of the United States Internal Revenue Code and United States Treasury Regulation 301.6651-1(c), including the judicial interpretations of the same.²⁹ The state regulation also contains a non-exclusive list of circumstances that might constitute "reasonable cause" for a late filing or payment, none of them closely analogous to Keystone's situation.³⁰

²⁴ AS 43.05.220(a).

²⁵ If the issue is contested, the taxpayer must establish both reasonable cause and lack of willful neglect. *See, e.g., Tamberella v. Commissioner of Internal Revenue*, 2004 WL 388987, *3 (U.S. Tax Ct. 2004) (applying identical language in parallel federal statute). Conversely, "the absence of 'willful neglect' is not enough; the taxpayer must also show that the failure was due to reasonable cause." *Daron Industries, Inc., v. Commissioner of Internal Revenue*, 62 T.C. 847, 861 (U.S. Tax Ct. 1974).

²⁶ *Department of Revenue v. Dyncorp*, 14 P.3d 981, 984-985 (Alaska 2000) (explaining that no special deference was owed to the department's decision at the administrative appeal stage because the reasonable cause determination rested on the application of established law to undisputed facts).

²⁷ *See id.*; also AS 43.05.435(3).

²⁸ AS 43.05.435(2). The charge to exercise independent judgment, however, does not allow the administrative law judge to find "reasonable cause" based on personal judgment or opinion about whether imposition of a penalty seems unfair under the circumstances. Rather, the administrative law judge exercises independent judgment about what the law means and, in so doing, considers applicable case precedents. *In re Western Queen Fisheries, LLC*, OAH No. 05-0775-TAX (Aug. 9, 2006). Moreover, the law encourages promotion of "consistency among legal determinations" in tax appeals such as this. AS 43.05.475(b).

²⁹ 15 AAC 05.200(b).

³⁰ *See* 15 AAC 05.200(c) (identifying three groups of circumstances that may constitute reasonable cause and making clear that the groups are not all-inclusive). The list includes the circumstance in which the taxpayer "took in

The cited federal tax statute provides for assessment of penalties for late filings and late payments but relieves the taxpayer of liability for such penalties when the taxpayer's tardiness is "due to reasonable cause and not due to willful neglect," thus using the identical phrasing as AS 43.05.220.³¹ The cited Treasury Regulation states, in pertinent part:

If the taxpayer exercised ordinary business care and prudence and was nevertheless unable to file the return within the prescribed time, then the delay is due to a reasonable cause. A failure to pay will be considered to be due to reasonable cause to the extent that the taxpayer has made a satisfactory showing that he exercised ordinary business care and prudence in providing for payment of his tax liability and was nevertheless either unable to pay the tax or would suffer an undue hardship ... if he paid on the due date.^[32]

The hardship dimension of the Treasury Regulation is not relevant here because there is no contention that Keystone did not have the liquidity to pay its taxes on time or otherwise would have suffered harm had it done so. Instead, Keystone must show that in spite of ordinary business care and prudence it was *unable* to make a timely filing or payment.

The cases interpreting the federal standard set two hurdles that are difficult for Keystone to clear. First, the cases insist that for a corporation (unlike an individual taxpayer), one person's illness is generally not enough to render the taxpayer unable to comply. Even if the officer who usually oversees the tax returns is incapacitated, the taxpaying corporation must prove that another responsible officer was also "unable" to provide the oversight.³³ Second, the cases insist that if the taxpayer was able to continue with its business affairs despite illness, the taxpayer was not "unable" to file a return or make a tax payment.³⁴

In this case, the history of Ms. Nelson's difficult illness arouses compassion. Nonetheless, there was not enough proof offered to show that the other corporate officer, Mr. Nelson, was "unable," on account of his concern and attention to his wife's welfare, to file the

good faith all steps and precautions reasonably necessary to ensure the timeliness of the filing or payment" but the filing or payment was still late.

³¹ 26 U.S.C. § 6651(a)(1)-(3).

³² 26 C.F.R. § 301.6651-1(c)(1) (underlining added).

³³ See, e.g., *Parker Tree Farms, Inc. v. Commissioner of Internal Revenue*, 1983 WL 14342 (U.S. Tax Ct. 1983) [at text following note 26] (serious illness of CEO who normally oversaw tax preparation did not provide reasonable cause where corporation did not show that CEO's son, a vice president, could not have overseen the tax filings); *Daron Industries, supra*, 62 T.C. at 861 ("the duty to file return was the corporate obligation of the taxpayer and not the individual responsibility of [the financial officer]"); accord Internal Revenue Manual § 120.1.1.3.1.2.4.

³⁴ See, e.g., *Jordan v. Commissioner of Internal Revenue*, 2005 WL 3081646, *3 (U.S. Tax Ct. 2005) (no reasonable cause despite taxpayer's illness causing memory problems, where taxpayer "was able to continue his life insurance business"); *Tabbi v. Commissioner of Internal Revenue*, 1995 WL 570441, *17 (U.S. Tax Ct. 1995) (grave illness and death of child not reasonable cause where taxpayer "continued to operate his real estate business").

return or make the payment. Moreover, there was no evidence at all that Keystone was unable to continue its business during the period when the return and payment were due; on the contrary, the company appears to have continued with its business affairs, and it was in overseeing those affairs that Ms. Nelson eventually discovered the mistake. Because the Department of Revenue is committed by its own regulation to determine “reasonable cause” in accord with United States Treasury Regulation 301.6651-1(c), as interpreted, and because Keystone’s circumstances, insofar as they were demonstrated at the hearing, do not fit within the parameters of the Treasury Regulation, it is not possible to abate the \$960 tax penalty that has been assessed for Keystone’s late filing and payment.

IV. Conclusion

The Department of Revenue’s assessment of \$1238.49 in interest and penalties against Keystone Associates, Inc. (of which \$960.00 remains unsatisfied) is affirmed. Accordingly, Keystone Associates, Inc., is hereby ordered to pay the balance of the assessment to the State of Alaska, through the Department of Revenue, Tax Division, within ten days after the effective date of this decision.

DATED this 15th day of October, 2008.

By: Signed
Terry L. Thurbon
Chief Administrative Law Judge

NOTICE

This is the decision of the Administrative Law Judge under AS 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.³⁵

A party may request reconsideration in accordance with AS 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.³⁶ A party may file a motion for a protective

³⁵ AS 43.05.465(f)(1).

³⁶ AS 43.05.470.

order, showing good cause why specific information in the record should remain confidential, within 30 days of the date of service of this decision.³⁷

Judicial review of this decision may be obtained by filing an appeal in the Alaska Superior Court in accordance with AS 43.05.480 within 30 days after the date on which this decision becomes final.³⁸

Certificate of Service

The undersigned certifies that on October 15, 2008, this Decision & Order was mailed to the following: Valorie Nelson for Keystone Associates, Inc.; Martin A. Bassett, Appeals Officer.

Signed _____
Neil Roberts

³⁷ AS 43.05.470(b).

³⁸ AS 43.05.465 sets out the timelines for the decision becoming final.