

**SANITIZED DECISION – DOCKET NO. 05-153 P – ROBERT W. KIEFER, JR., ALJ –  
SUBMITTED for DECISION on SEPTEMBER 22, 2005 – ISSUED on MARCH 22, 2006**

**SYNOPSIS**

**PERSONAL INCOME TAX – WAIVER OF ESTIMATED TAX UNDERPAYMENT “PENALTY”** – To waive additions to tax that were assessed pursuant to W. Va. Code § 11-10-18a, by reason of a taxpayer’s failure to make any quarterly estimated tax payments during the course of the applicable tax year, the taxpayer has the burden of proving that he satisfied the statutory requirements for waiver of such additions to tax. *See* W. Va. Code § 11-10-18a(e).

**PERSONAL INCOME TAX – WAIVER OF ADDITIONS TO TAX** – In light of the fact that the taxpayer’s certified public accountants have failed to timely prepare and file tax returns for “S” corporations in which the taxpayer has an ownership interest and upon whose income his West Virginia personal income tax liability is based, for both the tax year under consideration and for prior tax years, without the State Tax Commissioner having previously assessed additions to tax against him, and the taxpayer having filed an application for automatic extension of time to file his tax return, the additions to tax for failure to file his tax return by the due date thereof are waived. However, no such waiver will be allowed for future tax years.

**FINAL DECISION**

On January 30, 2005, the Internal Auditing Division (“the Division”) of the West Virginia State Tax Commissioner’s Office (“the Commissioner” or “the Respondent”) issued a personal income tax assessment against the Petitioner. This assessment was issued pursuant to the authorization of the State Tax Commissioner, under the provisions of Chapter 11, Articles 10 and 21 of the West Virginia Code. The assessment was for calendar year 2003, for interest in the amount of , computed through January 30, 2005, additions to tax in the amount of, and an estimated tax underpayment “penalty” (additions) in the amount of, for a total assessed personal income tax liability. Written notice of this assessment was served on the Petitioner.

Thereafter, by mail postmarked March 22, 2005, the Petitioner timely filed with this tribunal, the West Virginia Office of Tax Appeals, a petition for reassessment. W. Va. Code §§ 11-10A-8(1) [2002] and 11-10A-9(a)-(b) [2002].

Subsequently, notice of a hearing on the petition was sent to the Petitioner and a hearing was held in accordance with the provisions of W. Va. Code § 11-10A-10 [2002].

### FINDINGS OF FACT

1. The Petitioner is an individual who resides in the State of Ohio.
2. The Petitioner is a shareholder in at least two Subchapter “S” corporations that engage in business in the State of West Virginia.<sup>1</sup>
3. Petitioner’s income that is attributable to and taxable in West Virginia is derived solely from the “S” corporations doing business in West Virginia.

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<sup>1</sup> The Petitioner testified that he is or was a shareholder in two Subchapter “S” corporations that do business in the State of West Virginia. The Petitioner did not identify by name the two corporations to which he was referring. During the course of the hearing, at least three corporations were mentioned by name: Business one, Business two and Business three.

From the Petitioner’s testimony, any of the three corporations identified by name could be doing business in West Virginia. The Petitioner testified that Business one provides services on the Ohio River. Since, where it borders West Virginia, the Ohio River is located almost entirely in West Virginia, revenue generated by the corporation will primarily be attributed to West Virginia. The Petitioner’s testimony indicated that Business two mined coal in West Virginia, and that the revenue it generated should be attributed to West Virginia. The Petitioner also testified that Business three developed a parcel of real estate in West Virginia. Therefore, the income from that corporation would be attributed to West Virginia. This lack of clarity in the testimony makes it somewhat unclear exactly which corporations result in the Petitioner having income that is taxable in West Virginia for tax year 2003.

The Petitioner’s testimony suggests that he is the sole shareholder in at least one of the three corporations. However, the Petitioner could be the sole shareholder in two of the corporations, or all three. It is also possible that the Petitioner could be a partial shareholder in as many as two of the corporations.

Regardless of the lack of clarity respecting this evidence, it appears that the amount of the Petitioner’s income derived from the West Virginia corporations is not disputed. So long as there is no dispute between the parties respecting the amount of the Petitioner’s income to be attributed to West Virginia, then the lack of clarity respecting these facts is not crucial to this decision.

4. The Petitioner testified that he cannot determine his individual taxable income from the “S” corporations, taxable in West Virginia for any given tax year, until such time as the taxable income for each of the “S” corporations is determined for that particular tax year.

5. The Petitioner testified that the tax returns for the “S” corporations for any given tax year must be completed before his personal income tax return can be prepared for that tax year.

6. The “S” corporations’ income tax returns and the Petitioner’s personal income tax returns are prepared by a certain certified public accounting (“C.P.A.”) firm in Ohio.

7. At the end of each tax year, the Petitioner’s bookkeepers prepare the necessary financial information related to the “S” corporations. Either the bookkeepers or the Petitioner then forward the same to the C.P.A. firm.

8. The C.P.A. firm then prepares income tax returns for each of the “S” corporations.

9. The Petitioner testified that the tax returns for the “S” corporations are seldom, if ever, completed by their March 15 due date.

10. Upon completion of the income tax returns for the “S” corporations, the C.P.A. firm completes the Petitioner’s personal income tax returns.

11. The Petitioner testified that his personal income tax returns are seldom, if ever, completed and filed by the April 15 due date.

12. He testified that he is usually required to file a request for an extension of time to file his personal income tax returns, both state and federal.

13. The Petitioner testified that on more than one occasion he has requested that the C.P.A. firm prepare the tax returns for the “S” corporations and his personal income tax returns in a more timely manner.

14. The C.P.A. firm prepared the Petitioner's West Virginia Nonresident/ Part-Year Resident Income Tax Return for tax year 2003.

15. The Petitioner testified that he made no quarterly estimated tax payments during calendar year 2003 because, during the course of the year, he did not know whether the corporations, when considered together, generated a total net income which would constitute income to him.

16. The Petitioner filed a request for an automatic extension to file his 2003 West Virginia Nonresident/Part-Year Resident Income Tax Return.

17. The Petitioner testified that he did not make an estimated payment in April, 2004, with his request for extension, because he did not know if he owed any tax for 2003. He maintains that he did not know whether he owed any tax because it had not been determined whether the "S" corporations had a combined net income which was to be attributed to him.

18. The Petitioner testified that his 2003 West Virginia Nonresident/Part-Year Resident Income Tax Return was not completed until March, 2005, although the return was signed by his preparer on October 14, 2004, by the Petitioner on October 15, 2004, and was received by the State Tax Commissioner no later than October 20, 2004. See State's Exhibit No. 2.

19. In October, 2004, at the time he filed his return, the Petitioner remitted the full amount of tax due for 2003, which was due on his 2003 West Virginia Nonresident/Part-Year Resident Income Tax Return.

20. The Petitioner testified that he did not know his personal income taxable in West Virginia for 2003 until October, 2004, because the tax return for one of the "S" corporations was not completed until that time, and that this is the reason that he did not make an estimated tax payment with his request for extension of the return-filing deadline.

21. The Petitioner testified that one of the “S” corporations operated at a loss during tax year 2003, thereby reducing the total net income generated by the corporations.

22. The Petitioner testified that the 2003 corporation income tax return for that “S” corporation was not filed until March, 2005, and that his personal income tax return was filed without knowing whether that “S” corporation generated income or a loss.

23. The Petitioner testified that the last mentioned “S” corporation income tax return, filed in March, 2005, was exceptionally late.

24. The Petitioner testified that the “S” corporations had combined net income in 2003, and that all of the income was generated by a certain one of the “S” corporations. The other two “S” corporations generated operating losses, which partially offset some of the income generated by the “S” corporation having net income for the year 2003.

25. The Petitioner testified that the net income generated by the one “S” corporation was from the sale of property. The income was generated in the third and fourth quarters of 2003. He testified that this rendered it impossible for him to determine the correct amount of quarterly estimated payments and, consequently, to make said payments.

26. The Petitioner further testified that he was unable to determine the amount of his income by April 15, 2004, so that he could not make an estimated tax payment with his application for an automatic extension of time to file his 2003 income tax return.

## **DISCUSSION**

Two separate issues are presented in this matter. The first is whether the Petitioner is entitled to waiver of additions to tax (denominated “estimated tax penalty” in the assessment) that were assessed by reason of his failure to make quarterly estimated tax payments during the course of the tax year. The second is whether the Petitioner is entitled to waiver of additions to

tax which were assessed as a result of the Petitioner's failure to file his return and pay the tax due by the statutory due date, without reference to any extension of time to file his return.

The State Tax Commissioner assessed additions to tax against the Petitioner pursuant to W. Va. Code § 11-10-18a, because he failed to make quarterly estimated tax payments over the course of tax year 2003, as required by W. Va. Code §§ 11-21-55 & -56.<sup>2</sup> The Petitioner maintains that he is entitled to a waiver of these additions to tax. The Petitioner argues that since he did not know whether he would have any tax liability for 2003 and, if he did, what his tax liability would be, he should not have been required to make quarterly payments. It follows that if he was not required to make quarterly payments, he should not have been assessed additions to tax for failure to make such payments.

The Petitioner's argument in this respect ignores what is, or should be, a realistic approach to a periodic determination of the net income of the Petitioner's businesses and, consequently, his income for a particular year. The Petitioner maintains that during the course of the tax year he did not know if he was going to have income and, if so, how much income he would receive from the corporations. This argument requires one to believe that the Petitioner's corporations did not track their revenues and expenses on an ongoing basis. One must further believe that the Petitioner did not and could not reasonably determine whether each of the corporations was generating income or loss, or the approximate amount thereof. This is inconsistent with sound business practices. Simply stated, this contention is not realistic. With a reasonable degree of diligence, the Petitioner could have determined whether or not the corporations were going to generate income for 2003, and could have reasonably estimated the

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<sup>2</sup> The addition to tax assessed under this section is shown on the assessment as an "estimated tax penalty." This is a misnomer. However, the Petitioner has not questioned this and this Office is of the opinion that this incorrect description is certainly not fatal to this portion of the assessment.

amount of income that was going to be attributed to him, if any. He could have made estimated payments based on a reasonable estimate of his income, as he was required to do by statute.

The Petitioner maintained that most of the income attributed to him was derived late in the tax year because the event that generated most of the income, the sale of property owned by the one “S” corporation, occurred late in the year. Therefore, he argued, making estimated payments in the first two or three quarters was problematic. The Tax Commissioner responded that the Petitioner could have made a larger estimated tax payment for the fourth quarter to compensate for the greater income in the fourth quarter. He maintains that this is the purpose of quarterly tax payments, and a large fourth quarter tax payment, if appropriate, would have sufficed. The Tax Commissioner is correct in this respect. The Petitioner’s argument does not justify his failure to make any estimated tax payments for the year, especially for the third and fourth quarters.

W. Va. Code § 11-10-18a(e) provides three exceptions to the assessment of additions to tax for failure to make estimated tax payments. Two of the three exceptions are: (1) Where the amount of tax shown on the return less the amount withheld is less than six hundred dollars; and (2) Where the Petitioner had no tax liability for the prior year and the liability for the year in question is less than five thousand dollars. The first exception is inapplicable because the Petitioner owed more than six hundred dollars. The second exception is inapplicable because the Petitioner owed more than five thousand dollars.<sup>3</sup>

The third exception, W. Va. Code § 11-10-18a(e)(3), provides:

(3) *Waiver in certain cases.* – No addition to tax shall be imposed under subsection (a) of this section with respect to any underpayment if and to the extent the tax commissioner determines that by reason of casualty, disaster or other

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<sup>3</sup> Also, it has not been demonstrated by any evidence that the Petitioner did not have any West Virginia personal income tax liability for tax year 2002. In fact, the testimony of the Petitioner tends to indicate that he did have a tax liability for tax year 2002.

unusual circumstances the imposition of such addition to tax would be against equity and good conscience.

The Tax Commissioner has apparently made no determination that there was a casualty, disaster or other unusual circumstance to justify the waiver of the addition to tax for failure to make estimated tax payments. Importantly, there is no evidence in the record showing a casualty, disaster or other unusual circumstance to justify the waiver under this subsection.

W. Va. Code § 11-10-18(d) provides a mechanism whereby the Petitioner could have avoided additions to tax for underpayment of quarterly estimated payments, regardless of his ability to reasonably estimate the amount of tax he owed for 2003. W. Va. Code § 11-10-18(d)(1) provides that a taxpayer can avoid additions to tax if he makes estimated tax payments in an amount that is equal to the tax that he owed for the prior year. This provision provides protection to a taxpayer, regardless of whether or not he knows his tax liability for the taxable year in question. If the quarterly estimated payments based on the prior year's tax result in an underpayment, the taxpayer would pay the deficiency with his return. If the quarterly estimated payments result in an overpayment, the taxpayer would be entitled to a refund. Thus, for tax year 2003, the Petitioner could have avoided the assessment of additions to tax for underpayment of estimated tax by making quarterly payments in an amount equal to one-quarter of the amount of tax he owed for tax year 2002. He did not have the option of failing to make estimated payments because he could not reasonably estimate the amount of tax due.

Considering the statutory requirements, and considering the facts and circumstances presented by this matter, there can be no waiver of the addition to tax assessed under W. Va. Code § 11-10-18a.

The second issue is whether the Petitioner is entitled to a waiver of additions to tax that were assessed under W. Va. Code § 11-10-18(a)(1) & (2). The Petitioner's 2003 West Virginia



personal income tax return was due on April 15, 2004. The return was filed on October 15, 2004, and received by the State Tax Commissioner on October 20, 2004. The Petitioner was assessed additions to tax in the amount.

As with waiver of additions to tax for failure to make quarterly estimated tax payments, the Petitioner maintains that he is entitled to waiver of additions to tax for failure to make an estimated payment of the amount due with his extension. He also maintains that he is entitled to a waiver of additions to tax because it was his C.P.A.'s who were responsible for late filing of his return.

In response to the Petitioner's first contention, the Tax Commissioner maintains that W. Va. Code St. R. § 110-21-57.1.1.5 provides that the failure of the Petitioner to make an estimated tax payment with his request for an automatic extension revokes any extension to file the return. The Tax Commissioner is correct in this regard. The Petitioner did not make a payment with his request for automatic extension of time to file his tax return. Therefore, any grant of the automatic extension to file was revoked. Thus, the due date of the Petitioner's return was April 15, 2004. Consequently, his argument that he filed the return pursuant to the extension is without merit.

The Petitioner contends that he is entitled to waiver of additions to tax because his certified public accountants failed to timely prepare tax returns for the "S" corporations, which, in turn, resulted in the late filing of his personal income tax return. The Petitioner maintains that his bookkeepers provide the necessary accounting information to his C.P.A.'s in a timely manner, but that each year his C.P.A.'s prepare the returns late, according to their own schedule and priorities, thereby resulting in the failure of the returns to be filed by the statutory due date. The Petitioner testified that he has asked his C.P.A.'s to prepare the returns so that they may be

filed in a timely manner, but that they have not done so. He maintains that he cannot compel his C.P.A.'s to prepare and file the returns in a timely manner. According to him, he is, in effect, at the mercy of his C.P.A.'s and that he should not bear the financial burden for their failure to act promptly.

The Petitioner's testified that he filed his personal income taxes late in prior years because he could not compel his C.P.A.'s to prepare and file them by the due date. There is nothing in the record to show that this ever resulted in the Petitioner being assessed with additions to tax for this failure to timely file his returns and pay the tax due. Thus, it is possible that the Petitioner believed that the failure of his C.P.A.'s to prepare and file his returns was excusable, and should not be the basis for assessment of additions to tax.

In light of the Petitioner's C.P.A.'s' failure to timely prepare and file the "S" corporations' income tax returns and the Petitioner's personal income tax returns for prior tax years without being assessed additions to tax, this Office is of the opinion that the additions should be waived for tax year 2003. The failure to timely file the returns lies with the Petitioner's C.P.A.'s. This is a deficiency which has been ongoing and which the Petitioner has apparently tried to get corrected in the past. The Petitioner had no reason to believe that he would be assessed additions to tax in 2003 when, so far as the evidence shows, they had not been assessed for prior years. Under these circumstances, it would be unfair to penalize the Petitioner for the failure of his C.P.A.'s to act in a timely manner.

However, this is the only time that this Office will accept this reason as good cause for waiver additions to tax.<sup>4</sup> The Petitioner and his C.P.A.'s are now on notice that their failure to

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<sup>4</sup> Since the due date for the 2005 corporate tax returns has passed, and the due date for the Petitioner's personal income tax return is looming, this excuse may be satisfactory for 2005. If the Petitioner files an application for automatic extension, this decision clearly puts him on notice that he must make an estimated payment with the request. He also knows the standard he must satisfy in making his estimated payment. As is indicated by the this

timely file returns will result in the assessment of additions to tax. If, in the future, the Petitioner's C.P.A.'s fail to timely prepare and file returns, this Office will not look favorably on any request for the waiver of additions to tax. If, in the future, additions to tax are assessed against the Petitioner because of the failure of his C.P.A.'s to timely prepare and file returns, then the Petitioner should look to his C.P.A.'s for relief from such assessment.

### **CONCLUSIONS OF LAW**

Based upon all of the above it is **DETERMINED** that:

1. In a hearing before the West Virginia Office of Tax Appeals on a petition for reassessment wherein the Petitioner seeks a waiver of additions to tax, the burden of proof is upon the petitioner-taxpayer to show that it is entitled to such waiver. *See* W. Va. Code § 11-10A-10(e) [2002].

2. With respect to waiver of additions to tax which were assessed pursuant to W. Va. Code § 11-10-18a, by reason of his failure to make quarterly estimated tax payments during the course of the relevant tax year, the Petitioner has failed to carry his burden of proving that he satisfied the statutory requirements for waiver of additions to tax.

3. On the other hand, the Petitioner has carried his burden of proof with respect to waiver of additions to tax for failure to timely file his personal tax return, by reason of the fact that it was the fault of his C.P.A.'s that his 2003 West Virginia Nonresident/Part-Year Resident Income Tax Return was not timely filed.

### **DISPOSITION**

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decision, a delay such as occurred with respect to the 2003 personal income tax return will not justify a waiver of additions to tax.

**WHEREFORE**, it is the **FINAL DECISION** of the **WEST VIRGINIA OFFICE OF TAX APPEALS** that the personal income tax assessment issued against the Petitioner for tax, for the year 2003, of, for interest in the amount of, computed through January 30, 2005, additions to tax in the amount of, and estimated tax underpayment penalty” (additions) in the amount of, for a total assessed personal income tax liability of \$, should be and is hereby **MODIFIED** in accordance with the above Conclusions of Law for interest in the amount of and estimated tax underpayment “penalty” of , for a **total revised** liability of . However, the regular additions to tax in the amount of are **VACATED** in full.