

BEFORE THE ARIZONA DEPARTMENT OF REVENUE

In the Matter of
[REDACTED]
UTI # [REDACTED]

DECISION OF
HEARING OFFICER

Case No. 201000230-P

A hearing was held on February 3, 2011 in the matter of the protest of [REDACTED] (Taxpayers) to the denial by the Penalty Review Unit (Unit) of the Arizona Department of Revenue (Department) of Taxpayers' request for abatement of a late filing, late payment and extension underpayment penalties imposed for the 2008 tax year. This matter is ready for ruling.

FINDINGS OF FACT

1. Taxpayers requested an extension to October 15, 2009 to file their 2008 Arizona individual income tax return.
2. Taxpayers did not make any payments at the time they requested the extension to file their return.
3. Taxpayers took the information for the preparation of their return to their accountant in October 2009.
4. Taxpayers' individual income tax return for 2008 was completed by the accountant on October 13, 2009.
5. Taxpayers were out-of-town at that time.
6. The accountant attempted to file Taxpayers' 2008 return electronically (e-file).
7. The accountant informed Taxpayers that the federal and state returns were filed.
8. Taxpayers' e-filed return was rejected by the Internal Revenue Service (IRS) and was not received by the Department by the October 15, 2009 due date.
9. The accountant did not inform Taxpayers that the e-filed return was rejected by the IRS.

10. It is the practice of the IRS to acknowledge e-filed returns within 24 hours of the electronic filing.
11. No payment was included with the attempted e-filed return.
12. Because Taxpayers' 2008 return was not timely filed and the taxes due were not timely paid the Department imposed a late filing penalty in the amount of \$[REDACTED], a late payment penalty in the amount of \$[REDACTED] and an extension underpayment penalty in the amount of \$[REDACTED].
13. Taxpayers had timely filed their returns in prior years and for year 2009.
14. Taxpayers had not paid the amount of tax due with their timely filed returns in prior years.
15. In those prior years the Department would bill Taxpayers for the tax due, including interest and late payment and extension underpayment penalties.
16. Taxpayers entered into payment arrangements with the Department to pay the amounts that were due for the prior years.
17. Taxpayers were expecting the Department to bill them regarding their unpaid 2008 tax liability as in prior years.
18. When Taxpayers were not contacted by the Department regarding the underpayment of their 2008 tax liability by January 2010, Taxpayer [REDACTED] contacted the Department to inquire regarding their liability and to set up a payment plan.
19. Taxpayers were informed that the Department had no record of them filing a 2008 individual income tax return.
20. Taxpayer [REDACTED] contacted the accountant who told Taxpayer that she did file the return and sent Taxpayers the electronic evidence of the filing.
21. When Taxpayers confirmed that the e-filed return was rejected, Taxpayers filed paper returns on February 5, 2010.
22. Taxpayers paid the tax and interest due on the return by May 4, 2010.

23. Taxpayers' accountant requested a waiver of the penalties by letter dated May 11, 2010.
24. In her letter the accountant stated she was not aware that the e-filed return had been rejected until Taxpayer [REDACTED] contacted her.
25. Taxpayers' e-filed return was rejected by the Internal Revenue Service on October 15, 2009.
26. The Unit denied Taxpayers' request for penalty abatement.
27. Taxpayers timely requested a hearing before the Hearing Office.

CONCLUSIONS OF LAW

1. If a taxpayer fails to file his income tax return on or before the due date of the return or the due date as extended by the department, Arizona Revised Statutes (A.R.S.) § 42-1125(A) imposes a late filing penalty of four and one-half per cent of the tax required to be shown on such return for each month or fraction of a month elapsing between the due date of the return and the date on which it is filed.
2. The total late filing penalty cannot exceed twenty-five per cent of the tax found to be remaining due. A.R.S. § 42-1125(A).
3. If a taxpayer fails to pay the amount shown as tax on any return within the time prescribed, A.R.S. § 42-1125(D) imposes a late payment penalty of one-half of one per cent of the unpaid amount for each month or fraction of a month during which the failure continues.
4. The total late payment penalty cannot exceed ten percent of the amount due. A.R.S. § 42-1125(D).
5. The total late filing and late payment penalties cannot exceed twenty-five percent. A.R.S. § 42-1125(D).

6. The department may grant an automatic extension of time for filing an income tax return under title 43 if at least ninety per cent of the tax liability disclosed by the taxpayer's return for the reporting period is paid and if the request for extension is received or mailed on or before the date the return is otherwise due to be filed. A.R.S. § 42-1107(A).
7. If at least ninety per cent of the tax liability disclosed by the taxpayer's return for the reporting period has not been paid at the time of filing for the extension, the taxpayer is subject to a penalty of one-half of one per cent of the tax not paid for each thirty day period or fraction of a thirty day period elapsing between the date the return is otherwise due to be filed and the date the tax is paid. A.R.S. § 42-1107(A).
8. The total extension underpayment penalty cannot exceed twenty-five per cent. A.R.S. § 42-1107(A).
9. If a taxpayer is subject to both of the penalties prescribed under A.R.S. § 42-1107 and A.R.S. § 42-1125, the maximum combined penalty that may be imposed on the taxpayer under both sections shall not exceed twenty-five per cent of the tax found to be remaining due. A.R.S. § 42-1107(A).
10. The late filing, the late payment and the extension underpayment penalties may be abated only if the failure to timely comply "is due to reasonable cause and not due to wilful neglect." A.R.S. §§ 42-1125(A), 42-1125(D) and 42-2062.
11. "Reasonable cause" is generally defined to mean the exercise of "ordinary business care and prudence." *Daley v. United States*, 480 F. Supp. 808 (D.N.D. 1979).
12. Taxpayers acted diligently in trying to fulfill their filing obligation and reasonably relied on accountant's statement that their income tax return had been electronically filed. See, *Estate of Lee v. C.I.R.*, TC Memo 2009-84 (April 27, 2009).

13. Taxpayers have provided sufficient evidence to show they exercised ordinary business care and prudence and thus established reasonable cause for the late filing of their Arizona individual income tax return for 2008.
14. Taxpayers timely filed their returns in prior years but had not paid the amount of tax due with their timely filed returns.
15. Taxpayers have provided insufficient evidence to establish reasonable cause for the late payment of their Arizona individual income tax liability for 2008.
16. Taxpayers have provided insufficient evidence to establish reasonable cause for their failure to pay at least ninety per cent of the tax liability disclosed by their tax return at the time of filing for their extension.
17. The Section properly imposed the late payment penalty under A.R.S. § 42-1125(D) and the extension underpayment penalty under A.R.S. § 42-1107.

DISCUSSION

Taxpayers timely requested an extension of time to October 15, 2009 to file their 2008 individual income tax return. Taxpayers had not paid at least ninety percent of their tax liability at the time they requested the extension.

Taxpayers' tax return was prepared by their accountant who had agreed to file the return electronically (e-file) because Taxpayers were out-of-town. The accountant timely submitted the return for e-filing and informed Taxpayers that the return had been filed. Unbeknownst to the Taxpayers, the e-filed return was rejected and their federal and state returns were not timely filed.

Taxpayers did not submit payment of the tax due at the time the accountant attempted to e-file the return. In past years Taxpayers would timely file their return without payment and would wait for the Department to bill them so they could enter into a payment arrangement. Because Taxpayers believed their return was timely e-filed, they were waiting for a billing from the Department.

When Taxpayers were not billed by the Department for their underpayment of their 2008 tax liability by January 2010, Taxpayer [REDACTED] contacted the Department to inquire regarding their liability and to set up a payment plan. It was at that time Taxpayers first learned that their e-filed return had been rejected. Taxpayers filed a paper tax return on February 5, 2010 and paid the tax due by May 4, 2010. Because Taxpayers had not timely filed their return or paid their tax liability, the Department imposed a late filing, late payment and extension underpayment penalties. Taxpayers requested an abatement of the penalties.

Taxpayers have not shown reasonable cause for their failure to timely pay the tax or to pay at least ninety percent of the tax liability at the time they requested an extension of time to file their return. Therefore Taxpayers' request for abatement of the late payment penalty and the extension underpayment penalty is denied.

Taxpayers have shown reasonable cause for their failure to timely file their return. It is true that the general rule is that the failure to make a timely filing of a tax return or pay the tax is not excused by a taxpayer's reliance on an agent, and this reliance does not constitute reasonable cause. *United States v. Boyle*, 105 S. Ct. 687 (1985). However the situation presented here involves the electronic filing of the return which is often done through Authorized IRS *e-file* Providers, practitioners who are accepted into the electronic filing program.¹

No cases have been cited to us and we are not aware of any cases addressing this situation. The United States Tax Court did address a somewhat analogous situation in *Estate of Lee v. C.I.R.*, *supra*. In that case a failure to timely file returns penalty wasn't upheld against an estate for a return that was filed well after the original 6-month extension period, but before expiration of supposed second extension period that estate planning attorney/tax attorney told executor estate had been given even

¹ The Hearing Officer has taken notice of the fact that the IRS encourages taxpayers to use e-file, whether it is done by the taxpayer or the taxpayer's tax professional. See, e.g., <http://www.irs.gov/efile/article/0,,id=118449,00.html#QA#QA>

though the attorney was wrong and no second extension was allowed. The Tax Court found that the executor acted diligently in trying to fulfill filing obligation and reasonably relied on attorney's advice about the second extension.

United States v. Boyle does recognize that reasonable cause requires the taxpayer to demonstrate that he exercised ordinary business care and prudence but nevertheless was unable to file the return within the prescribed time. In this case Taxpayers were out-of-town and made the effort to make sure their return was timely filed. The accountant did attempt to timely file the return and Taxpayers were assured by their accountant that the return was in fact electronically filed. Taxpayers' returns had been timely filed in the past and they had no reason to question their accountant. Taxpayers made the initiative to contact the Department when they had not received a billing and filed their return when they learned that one had not been filed.

Under the facts and circumstances of this particular case, Taxpayers have demonstrated that they exercised ordinary business care and prudence to file their return timely but were not able to. Therefore Taxpayers' request for abatement of the late filing penalty is granted. It should be noted that this is a very unusual case and the general rule remains that the failure to make a timely filing of a tax return or pay the tax is not excused by a taxpayer's reliance on an agent.

Based on the foregoing, the Unit's denial of the late payment penalty and the extension underpayment penalty is upheld.

The Unit's denial of the late filing penalty is reversed.

DATED this 31st day of March, 2011.

ARIZONA DEPARTMENT OF REVENUE
HEARING OFFICE

[REDACTED]
Hearing Officer

Original of the foregoing sent by
certified mail to:

[REDACTED]

Copy of the foregoing delivered to:

Arizona Department of Revenue
Penalty Review Unit