Guidance for Waiver of Penalty and Interest

This document is intended to aid employees in making consistent and equitable determinations regarding waiver of penalty and interest charges. This document provides guidance for whether a penalty or interest charge may be waived; it does not set out procedures for handling cases.

Section 58.1-105 of the *Code of Virginia* allows reduction or full waiver of a penalty when that action is justified, but does not specify the conditions that would justify waiver. The agency has historically allowed waiver of penalty in cases involving extenuating circumstances, such as death of the taxpayer or preparer, or a natural disaster, as well as in other circumstances that would reasonably prevent a taxpayer from filing a return and or paying the tax due by the required due date. This material contains descriptions and examples of circumstances that would or would not result in waiver of penalty. For purposes of considering waiver, 760C and 500C charges are treated as penalties. The examples provided are not all-inclusive.

As discussed in detail later in this document, extenuating circumstances do not typically apply to the waiver of interest charges when the interest is associated with an underpayment or late payment of tax. As a general rule, interest is waived only in cases where an assessment is potentially invalid or the liability has been assigned to the wrong person (doubtful liability), or where the balance due cannot be collected (doubtful collectibility). In cases where a penalty is reduced or waived, interest associated with the penalty will also be reduced or waived.

All examples assume that the employee handling the request for waiver has confirmed that the assessment is correct, and that the determination falls within his or her signature threshold. As of June 30, 2017, the thresholds are:

Amount	**Authorized Signature**
Up to $2,000.00	Contact Center Representative; Collections Representative
$2,001 - $10,000	Management Analyst; Senior Management Analyst; Lead Management Analyst
$10,001 - $50,000	Manager, General Legal and Technical Services
$50,001 and above	Assistant Commissioner, General Legal and Technical Services

Penalty Waivers in General

The agency will generally allow waiver of penalty in the following situations:

- The death of the taxpayer, taxpayer’s spouse or other close family member, or death of the taxpayer’s preparer, provided the death occurred at a time that would reasonably prevent timely filing. (See Examples 1 and 2)

- Illness of a taxpayer, spouse or other close family member, or illness of the taxpayer’s tax preparer, provided the illness was serious and occurred at a time that would reasonably prevent timely filing. (See Examples 3 and 4)

- Floods, storms, or other natural disasters that prevent timely filing and/or payment, provided that the Tax Commissioner has issued an extension for affected taxpayers, or the Internal Revenue Service has provided an extension for affected taxpayers. (See Examples 5, 6 and 7)

- Loss of records due to fire, theft or other disasters provided the taxpayer makes an effort to reconstruct records and file the affected returns within a reasonable period of time. (See Examples 8 and 9)

- The filing date for the corresponding federal return was extended for special circumstances, such as military service in a combat zone, provided the taxpayer meets **all** of the eligibility requirements for the extension.

- *For 760C and 500C charges only*, the taxpayer received information after the due date for the final estimated tax payment that showed unanticipated income received during the year. In general, the waiver will be allowed only if the taxpayer made timely payments at least equal to the preceding year's income tax liability.

- *For pass-through entities only*, a partnership experienced a technical termination for federal purposes, which required a short year return, provided the return is filed by the extended due date for the original taxable year. (See Example 10)

- *For offers in compromise only*, reduction or waiver of the penalty is granted to settle a doubtful collectibility case.

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The agency does not routinely allow a one-time or first-time waiver of penalty, except in the case of a pass-through entity that meets certain criteria discussed later in this document. Although a good filing history is a factor that is considered in making a penalty waiver determination, filing history is not a basis for waiver on its own.

Extension Penalty

The agency will generally allow waiver of an extension penalty in the following situations, provided the taxpayer has a good filing and payment history, and does not have a history of similar requests:

- K-1 information needed for an accurate estimate of the taxpayer's liability was not received until after the original due date, provided the taxpayer does not have a regular history of claiming late receipt of K-1 information. (See Examples 11 and 12)

- A corporation or pass-through entity made an election to claim bonus depreciation after the original due date, and the resulting fixed-date conformity addition created a significant Virginia income tax liability. (See Example 13)

- A corporation was part of a complex merger or restructuring and was unable to obtain income information in time to make an accurate estimate of its tax liability. (See discussion under Examples)

- A corporation operating within an affiliated group did not receive accurate information for determining its apportionment factors until after the original due date, resulting in underpayment of tentative tax. (See discussion under Examples)

Late Filing Penalty

In addition to the general circumstances outlined above, the agency will usually waive the late filing penalty in the following situations:

- The taxpayer voluntarily filed delinquent returns after discovering the liability, without being notified by the Department of Taxation. This situation is more common for corporations and pass-through entities, but can occur with individual filers. The waiver would be allowed only in a case where the taxpayer had reason to believe that no return was required.

- The taxpayer discovered and corrected an error by filing tax-due amended returns for sales and use tax, employer withholding tax, or another non-income tax. This applies only in cases where the taxpayer was not notified of a discrepancy by the Department of Taxation, and where the error was corrected within a reasonable time – usually a year or less – after the original return was filed.

- The taxpayer can prove that an attempt was made to e-file by the due date, but the return was rejected, provided the return is either resubmitted or filed on paper within 10 days.

Late Payment Penalty

In addition to the general circumstances outlined above, the agency will usually waive the late payment penalty in the following situations:

- The taxpayer can prove that an attempt was made to e-pay by the due date, but the payment was rejected or there was a bank error, provided the payment is either resubmitted or paid by check within 10 days.

- The taxpayer was not aware that the tax due with an income tax return filed on extension must be paid on the date the return is filed, but the tax was paid by the extended due date and the taxpayer has not incurred similar penalties for previous years. This applies in cases where the return is filed before the extension expires.

One-Time Waiver for a Pass-Through Entity

To allow the agency to equitably address waiver requests for $1,200 penalty assessed for late filing, the following criteria have been established.

1. The request for waiver involves only one taxable year in the account; and
2. Either the period in question is the initial period of liability for the PTE, or this is the first instance of late filing of Form 502; and
3. There are no other penalty assessments or nonfilers outstanding in the PTE's other business tax accounts.

All criteria must be met for the assessment to qualify for waiver. The one-time waiver applies only to the late filing penalty of $1,200 assessed on a Form 502 that shows no withholding tax liability. For details on handling a one-time waiver case, see the procedure posted in TAXi.

Other Factors to Consider for Waiver of Penalty

IRS waiver: If the IRS has waived the corresponding federal penalty, this can work in the taxpayer's favor. However, an IRS waiver does not guarantee a Virginia waiver, especially if the taxpayer has a poor filing history. Both the request to the IRS and the IRS approval should be considered before a determination is made.

Errors made by professional preparers: The agency does not generally waive penalties caused by errors made by professional tax preparers, or resulting from negligence on the part of a tax professional. The taxpayer can take legal action against the preparer under these circumstances.

Embezzlement or other criminal activity of an employee: A case of criminal activity by an employee requires detailed information. The taxpayer must be able to provide evidence of a criminal complaint, and the outcome of the case if charges were filed, or at least an official status of the case if prosecution has not taken place. It is not uncommon for the discovery of embezzlement to take up to 18 months; therefore, it is not unusual for an embezzlement case to involve multiple tax years or periods. However, if the delinquencies related to embezzlement extend for more that 18 months, we also have to consider whether the company had adequate accounting controls in place. In some cases, waivers may be granted for only some of the periods requested, or may not be granted at all.

Employee negligence or misconduct: In cases of employee misconduct, multiple tax years or periods may be affected. These cases should be evaluated in the same manner as embezzlement and criminal cases.

Oversight: The agency usually does not waive penalties in cases of simple oversight, such as a taxpayer forgetting to mail a return.

Interest Waivers

As a general rule, the Department of Taxation does not waive interest charges that are associated with a tax liability because Section 58.1-105 of the *Code of Virginia* allows waiver of tax only in cases where an assessment is potentially invalid or liability is assigned to the wrong party (doubtful liability), or where the balance due cannot be collected (doubtful collectibility). The agency may waive interest under the following circumstances:

- The taxpayer can demonstrate that he or she never received an assessment prior to collection action, or was not aware of the assessment for an extended period after it was issued. In these cases, we may waive interest accrued during the period that the taxpayer was not aware of the liability.

- The Department has agreed to waive penalties on bills that are over 30 days old. Although the initial bill in a case like this would have shown only interest on the underlying tax, any interest accrued after 30 days would be partially accrued on the outstanding penalty. Therefore, the portion of interest accrued on the penalty would be waived as part of the penalty waiver.

Examples

General

Death of the taxpayer, taxpayer's spouse or other close family member, or death of the taxpayer's preparer, provided the death occurred at a time that would reasonably prevent timely filing.

Example 1. A joint income tax return for 2014 was filed on January 19, 2016, reflecting tax due of $4,500, which was paid. An assessment was issued for late filing penalty of $1,350 (30%), plus interest on the tax due. The husband responded to the assessment with a request for waiver of penalty. He explained that his wife, who had handled the couple's tax matters, passed away unexpectedly on October 5, 2015. Along with the responsibilities for handling her estate, the taxpayer had to locate the tax records and get the help of an accountant. The taxpayers have an excellent filing and payment history.

The taxpayer's spouse died just before the federal and Virginia extended due dates for filing the 2014 return. It would not be reasonable to assume that the surviving spouse could locate records and engage an accountant in time to file the Virginia return by November 1. It appears that the taxpayer acted as promptly as possible to file the return. The penalty should be waived.

Example 2. A joint income tax return for 2012 was filed on January 19, 2016, reflecting tax due of $4,500, which was paid. An assessment was issued for late filing penalty of $1,350 (30%), plus interest on the tax due. The husband responded to the assessment with a request for waiver of penalty. He explained that his wife, who had handled the couple's tax matters, passed away unexpectedly on October 5, 2014. Along with the responsibilities for handling her estate, the taxpayer had to locate the tax records and get the help of an accountant. The taxpayers have an excellent filing and payment history.

The taxpayer's spouse died almost a year after the extended due date for the 2012 return, and the taxpayer delayed another 15 months before filing the return. The information presented does not indicate any extenuating circumstances prior to the death of the spouse, or offer any explanation for the additional delay in filing. Unless the taxpayer can provide an acceptable explanation for the original failure to file the return and the extended delay in filing after his wife passed away, the request for waiver should be denied.

Illness of a taxpayer, spouse or other close family member, provided the illness was serious and occurred at a time that would reasonably prevent timely filing.

Example 3. A joint income tax return for 2014 was filed on January 19, 2016, reflecting tax due of $4,500, which was paid. An assessment was issued for late filing penalty of $1,350 (30%), plus interest on the tax due. The husband responded to the assessment with a request for waiver of penalty. He explained that his wife, who had handled the couple's tax matters, passed away on October 5, 2015, after a lengthy illness that began with a cancer diagnosis in January 2013. When he began gathering records for preparation of the 2015 return, he discovered that the 2014 return had not been filed. His request for waiver includes documentation of his wife's medical treatments and death. The taxpayers have an excellent filing and payment history.

The taxpayer's wife was unable to handle the couple's tax matters because of her illness. Because he was not accustomed to handling tax matters, it is unlikely that the taxpayer would have thought to check on tax filings for 2014. It appears that he filed as promptly as possible to file the return after discovering the delinquency. The penalty should be waived.

Example 4. A joint income tax return for 2012 was filed on January 19, 2016, reflecting tax due of $4,500, which was paid. An assessment was issued for late filing penalty of $1,350 (30%), plus interest on the tax due. The husband responded to the assessment with a request for waiver of penalty. He explained that he and his wife suffered from serious medical conditions that required surgeries, one in 2012 and one in 2013. Although documentation was provided to support his claim, no explanation was provided for the extended delay in filing the return. The taxpayers have an excellent filing and payment history.

From the information presented, it is likely that the taxpayers could not file their 2012 return by the extended due date of November 1, 2013. However, they have not documented any illnesses or other extenuating circumstances extending beyond 2013 that would explain the extended delay in filing. Unless they can provide an acceptable explanation for not filing the return prior to 2016, the request for waiver should be denied.

Floods, storms, or other natural disasters that prevent timely filing and/or payment, provided that the Tax Commissioner has issued an extension for affected taxpayers, or the Internal Revenue Service has provided an extension for affected taxpayers.

Example 5. The taxpayer, who is a resident of South Carolina, filed a 2014 nonresident income tax return on February 16, 2016. The return reflected total tax liability of $63,000 and tax due of $5,000, which was paid. An assessment was issued for late filing penalty of $1,500 (30%), plus interest on the tax due. The taxpayer requests waiver of the penalty, explaining that the IRS extended the 2014 due date to February 16, 2016 because of flooding throughout the state in October 2015.

Although the taxpayer did not provide supporting documentation, the IRS extension can be verified online. The penalty should be waived.

Example 6. The taxpayer, who is a resident of South Carolina, filed a 2014 nonresident income tax return on March 10, 2016. The return reflected total tax liability of $63,000 and tax due of $5,000, which was paid. An assessment was issued for late filing penalty of $1,500 (30%), plus interest on the tax due. The taxpayer requests waiver of the penalty, explaining that the IRS extended the 2014 due date to February 16, 2016 because of flooding throughout the state in October 2015.

Although the taxpayer did not provide supporting documentation, the IRS extension can be verified online. Since Virginia law sets the extended due date for filing an individual income tax return at 30 days after the expiration of a federal extension, the return was timely filed. The penalty should be waived.

Example 7. The taxpayer, who is a resident of South Carolina, filed a 2014 nonresident income tax return on June 10, 2016. The return reflected total tax liability of $63,000 and tax due of $5,000, which was paid. An assessment was issued for late filing penalty of $1,500 (30%), plus interest on the tax due. The taxpayer requests waiver of the penalty, explaining that the IRS extended the 2014 due date because of flooding throughout the state in October 2015.

Although the taxpayer did not provide supporting documentation, the IRS extension can be verified online. The IRS extended the due date to February 16, 2016. Virginia law sets the extended due date for filing an individual income tax return at 30 days after the expiration of a federal extension. The Virginia return was filed more than 30 days after February 16, 2016. Unless the taxpayer can provide an acceptable explanation for the additional delay in filing, the request for waiver should be denied.

Loss of records due to fire, theft or other disasters provided the taxpayer makes an effort to reconstruct records and file the affected returns within a reasonable period of time.

Example 8. A corporation filed its calendar year 2014 Form 500 on May 12, 2016, nearly seven months after the extended due date of October 15, 2015. The return shows total tax liability of $23,000 and net tax due of $4,200, which was paid. An assessment was issued for late filing penalty of $1,260 (30%), plus interest on the tax due. The company requested waiver of penalty, stating that a fire on its premises in February 2015 destroyed paper records and damaged computers and backup files. The company was able to reconstruct its records with help from an outside firm but, due to the extensive damage to the computer records, the process took nearly a year. Once the records were recreated, another few weeks were needed to have returns prepared. The request includes detailed documentation about the fire, as well as a statement from the firm that assisted in reconstructing the records. The statement includes a timeline of the reconstructions, showing that the taxpayer contracted with the firm in April 2015, and the work was completed in March 2016. The corporation has a good filing and payment history.

The fire and associated damage are well documented, and the taxpayer has provided proof that records were not available until March 2016. It is reasonable that the return preparation took a few weeks. The penalty should be waived.

Example 9. A corporation filed its calendar year 2014 Form 500 on October 25, 2016, more than a year after the extended due date of October 15, 2015. The return shows total tax liability of $23,000 and net tax due of $4,200, which was paid. An assessment was issued for late filing penalty of $1,260 (30%), plus interest on the tax due. The company requested waiver of penalty, stating that a fire on its premises in February 2015 destroyed paper records and damaged computers and backup files. The company was able to reconstruct its records with help from an outside firm but, due to the extensive damage to the computer records, the process took nearly a year. Once the records were recreated, another few weeks were needed to have returns prepared. The request includes detailed documentation about the fire, as well as a statement from the firm that assisted in reconstructing the records. The statement includes a timeline of the reconstructions, showing that the taxpayer contracted with the firm in April 2015, and the work was completed in March 2016. The corporation has a good filing and payment history.

The fire and associated damage are well documented, and the taxpayer has provided proof that records were not available until March 2016. Although it could be reasonably expected that final return preparation might take a few weeks after the records were completed, the taxpayer filed six months after the outside firm completed its work. No explanation has been provided for the delay. Unless the corporation can provide an acceptable explanation for the additional delay in filing, the request for waiver should be denied.

***For pass-through entities only*, a partnership experienced a technical termination for federal purposes, which required a short year return, provided the return is filed by the extended due date for the original taxable year.**

Example 10. A partnership formed in 2010 filed timely calendar year returns for 2010, 2011, 2012, and 2013. Due to a sales of assets, the partnership experienced technical termination under federal law on August 10, 2014. The termination required that a short-year return for January 1, 2014 through August 10, 2014 be filed by December 15, 2014. The corresponding Virginia return was due on January 15, 2015. The partnership mistakenly filed both of its short-year returns, for the years ended August 10, 2014 and December 31, 2014, on October 15, 2015, which was the extended due date for December return only. The entity has a good filing and payment history.

This is a common filing error seen at both the federal and Virginia levels. Because the partnership filed both returns on a date consistent with the due date for its usual calendar year filing, the penalty should be waived.

Extension Penalty

K-1 information needed for an accurate estimate of the taxpayer's liability was not received until after the original due date, provided the taxpayer does not have a regular history of claiming late receipt of K-1 information.

Example 11. Taxpayers filed a joint individual income tax return for 2015 on October 17, 2016, with payment for the full tax liability of $23,000. An assessment is issued for an extension penalty of $2,760 (12%), plus interest on the tax due. The taxpayers request waiver of the penalty, stating that their primary source of income is from a pass-through entity that did not furnish a Schedule K-1 until late September 2016. The taxpayers have an excellent filing and payment history.

The taxpayers have an excellent history of compliance and paid the balance of tax due with their return at the time of filing. A review of the return supports their claim that their primary source of income was from an S corporation. A review of the corporation's return is inconclusive, but there is no evidence to contradict the taxpayers' claim of late receipt of Schedule K-1. The penalty should be waived.

Example 12. Taxpayers filed a joint individual income tax return for 2015 on October 17, 2016, with payment for the full tax liability of $23,000. An assessment is issued for an extension penalty of $2,760 (12%), plus interest on the tax due. The taxpayers request waiver of the penalty, stating that their primary source of income is from a pass-through entity that did not furnish a Schedule K-1 until late September 2016. The taxpayers' account shows two previous waivers of extension penalties for 2010 and 2012 for similar circumstances involving the same pass-through entity.

A review of the return supports their claim that their primary source of income was from an S corporation. A review of the corporation's return is inconclusive, but there is no evidence to contradict the taxpayers' claim of late receipt of Schedule K-1. However, the taxpayers have encountered this situation before, and they should have made estimated payments to offset any potential tax liability. The request for waiver should be denied.

A corporation or pass-through entity made an election to claim bonus depreciation after the original due date, and the resulting fixed-date conformity addition created a significant Virginia income tax liability.

Example 13. A corporation filed its 2015 calendar year return on September 15, 2016, with payment for the full tax liability of $18,000. An assessment was issued for extension penalty of $1,800 (10%), plus interest on the tax due. The corporation requests waiver of the penalty, stating that the tax liability was created by a fixed-date conformity addback for bonus depreciation. Since the bonus depreciation election was not made until after the original due date, April 15, 2016, the corporation could not have anticipated the tax liability. The corporation has a good filing and payment history.

A review of the 2015 Form 500 shows that the corporation reported a net operating loss of $35,000, and a bonus depreciation addback of $350,000. After allocation and apportionment, its Virginia taxable income was $300,000, all of which was created by the addback. It is not uncommon for the bonus depreciation election to be made well after the end of a taxable year, so the corporation's claim is reasonable. The penalty should be waived.

A corporation was part of a complex merger or restructuring and was unable to obtain income information in time to make an accurate estimate of its tax liability.

A corporation operating within an affiliated group did not receive accurate information for determining its apportionment factors until after the original due date, resulting in underpayment of tentative tax.

It is difficult to present examples of these circumstances because the situations are complex and varied. In general, we look for circumstances that seem reasonable. The question we need to consider as we review the case is whether the company had adequate controls in place to ensure tax compliance. Companies that encounter the circumstances outlined above usually have internal accounting staffs and external accounting support, so they must experience extreme circumstances to receive a waiver of penalty.