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16 of 18 DOCUMENTS

NAME: RE * * *

NUMBER: HEARING NO. 40,820

COURT: COMPTROLLER OF PUBLIC ACCOUNTS OF THE STATE OF TEXAS

CITE: 2002 Tex. Tax LEXIS 93

DATE: April 2, 2002

PANEL: [*1]

ROY G. SCUDDAY, Administrative Law Judge

COUNSEL: ELIAS V. LORENZANA, JR., Representing Administrative Hearings Section

OPINIONBY: SCUDDAY

TAXPAYER NO: * * *

AUDIT OFFICE: * * *

REPORT PERIOD: 1996 THROUGH 1999

* * *, Representing Petitioner

FRANCHISE TAX/RDT

COMPTROLLER'S DECISION

PRELIMINARY DISCUSSION:

At Petitioner's request, the Comptroller's Decision in this case is based on a review and consideration of the written submissions of the parties.

Unless otherwise indicated, all Section references are to Title 2, Texas Tax Code Annotated, and all Rule references are to sections of Title 34, Texas Administrative Code.

PETITIONER'S CONTENTION:

Petitioner contends that penalty should be waived.

FINDINGS OF FACT:

1. * * * (Petitioner) is a wholly owned subsidiary of * * *, (COMPANY A), and is based in * * *, Ohio. Petitioner has a location in * * *, Texas.

2. Petitioner was audited for franchise tax compliance for the report years 1996 through 1999. As a result, on May 10, 2000, the Comptroller sent Petitioner a Texas Notification of Audit Results showing an amount due that included tax, penalty, and interest through the date of the Notice. Petitioner paid the [*2] tax and interest amounts and requested redetermination of the penalty assessment. The audit was subsequently amended resulting in a slightly larger assessment, including a larger penalty amount.

3. The sole tax adjustment made in the audit was the throwback of sales to Texas in the calculation of Texas receipts used to apportion the earned surplus for the report years. The subsequent audit amendment was a result of adjustments for federal taxable income for IRS audit changes for the 1996 report year.

4. COMPANY A prepares Petitioner's franchise tax returns. Upon filing Petitioner's 1999 franchise tax return on November 16, 1999, in which return it included throwback sales in the Texas receipts, COMPANY A realized it had not properly included throwback sales in Petitioner's prior returns. Four days later, Petitioner was notified of the current audit that was to be started on February 7, 2000, and, as a result, did not proceed to amend its prior returns but let the audit make the necessary adjustments for the throwback sales.

5. COMPANY A is a large, sophisticated taxpayer with an internal tax accounting department that timely filed Petitioner's returns and remitted tax that was due. [*3] Petitioner is itself a sophisticated taxpayer with sales in 1998 of \$ *** and total assets of approximately \$ ***. Petitioner was previously audited for the report years 1992 through 1995, in which audit no errors were found. The percentage of error in the current audit is 67.62%, and the audit showed over \$ *** in taxes due. Petitioner's records were complete for the audit period.

6. On the Audit Questionnaire returned by Petitioner prior to the start of the audit, Petitioner indicated that it first provided service or shipped products into Texas on November 29, 1989, and that it had a manufacturing plant, real and personal property, a stock of goods and inventory, leased property, and employees in Texas.

7. Although the Audit Plan indicates that the auditor discussed penalty and interest with **, a tax accountant with COMPANY A who had been designated as the contact person for the audit, at the April 6, 2000 exit conference, Ms. ** * asserts that the auditor did not discuss penalty waiver and that she did not know that penalty had been assessed until the Notification was issued.

8. Contrary to Petitioner's assertion to the contrary, **, a Dispute Resolution Officer [*4] reviewed Petitioner's request for penalty waiver, and recommended denial of waiver, which recommendation was approved on January 5, 2001. Ms. ** * proceeded to contact Ms. ** * by telephone to advise her of the waiver denial.

DISCUSSION AND CONCLUSIONS OF LAW:

Petitioner's contention should be denied.

Comptroller Rule 3.5(c) sets forth factors that are considered in waiving penalty as follows:

Penalty. When reviewing a penalty waiver request under subsection (a) of this rule or in a contested case, the following factors regarding a taxpayer's account will be considered:

- (1) the taxpayer's audit history;
- (2) the tax issues involved;
- (3) a change in comptroller policy during the audit period;
- (4) size and sophistication of the taxpayer;
- (5) whether tax was collected but not remitted;
- (6) whether returns were timely filed;
- (7) completeness of records;
- (8) delinquencies in other taxes; and
- (9) reliance on advice provided by the comptroller's office which caused imposition of penalty and interest.

Petitioner argues that it exercised reasonable diligence in reporting and paying the franchise tax; that only the one error regarding throwback sales was included in the [*5] audit, and that error was discovered by Petitioner through COMPANY A, not by the auditor; that throwback sales are a difficult factual and legal issue; that its returns were timely filed; that its records were complete; and that it is not delinquent in other taxes. The Administrative Hearings Section responds that Petitioner had related companies whose tax returns were also prepared by COMPANY A that did address the throwback issue; that the throwback issue was inadvertently missed by the auditor of the prior audit; that Petitioner has admitted that its failure to include the throwback sales was a mistake of fact, not the result of ignorance of the law; that Petitioner had been filing Texas sales tax returns since 1991, indicating that it knew it had Texas receipts; and that COMPANY A is a large and sophisticated taxpayer and Petitioner itself, with revenues over \$ 400 million and assets over \$ 200 million, is not a small company. The AHS argues that all these factors, together with the fact that the audit error rate is 67.62%, clearly show a lack of reasonable diligence.

Petitioner argues that the error rate should not be considered because it is not listed in Rule 3.5, and that [*6] inordinate weight should not be given to the size of Petitioner or its parent company. First, the factors set forth in the rule are not exclusive, and the Comptroller has long considered the audit error rate to be a factor in determining whether to exercise her discretion to waive penalty. (See Comptroller Decision No. 33,362 (1995) and the cases cited therein.) I agree with the AHS that the factor that carries substantial weight in this case is the fact that Petitioner's overall error rate for the current audit was 67.62%, resulting in a failure to pay over \$ 800,000 in taxes. These unreported taxes were due on throwback sales, an issue that Petitioner admits it knew about, and seeks to excuse by arguing that it inadvertently overlooked the fact that it had a Texas location even though it was reporting Texas sales tax for that location. These factors, especially in view of the fact that Petitioner is a large, sophisticated taxpayer and relies on the internal tax accounting department of COMPANY A for which the timely filing of returns and keeping of records would be expected as a matter of course, show a lack of reasonable diligence to comply with the tax laws. Accordingly, I recommend [*7] that penalty not be waived.

RECOMMENDATION:

The audit liability should be upheld in its entirety.

SIGNED April 2, 2002.

ROY G. SCUDDAY, Administrative Law Judge

ORDER OF THE COMPTROLLER

The above decision of the Administrative Law Judge, resulting in Taxpayer's liability as set out in Attachment "A" which is incorporated by reference, is approved and adopted in all respects. This decision becomes final twenty-three (23) days from the date of this Order, and the total sum of the interest amount is due and payable within twenty (20) days thereafter.

If a rehearing is desired, a Motion for Rehearing must be filed with the Administrative Law Judge no later than twenty-three (23) days after the date of this Order, and must state the grounds upon which the motion is based.

RENDERED and ISSUED April 2, 2002.

CAROLE KEETON RYLANDER, Comptroller of Public Accounts of the State of Texas

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