

Cite as Det. No. 18-0070, 39 WTD 001 (2020)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition for)	<u>D E T E R M I N A T I O N</u>
Review of)	
)	No. 18-0070
)	
...)	Registration No. . . .
)	

RULE 228; RCW 82.32.090: VOLUNTARY REGISTRATION – VOLUNTARY DISCLOSURE PROGRAM. The audit of an affiliated entity is a prohibited contact that will preclude eligibility for acceptance into the Voluntary Disclosure Program and attendant limitation of the audit period and possible waiver of penalties. A company that had established economic nexus for Washington taxes was properly denied entry to the voluntary disclosure program where an affiliated entity was under audit by the Department, which is a contact for enforcement purposes.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

Kreger, T.R.O. – Taxpayer, a subsidiary of a specialty retailer, protests the denial of its application to the Voluntary Disclosure Program because an affiliated entity doing business in Washington was being audited by the Department. The Taxpayer disputes that the audit of an affiliated entity constitutes a prohibited contact for purposes of the Voluntary Disclosure Program. We hold that because there was contact with an affiliated entity, the Taxpayer did not meet the requirements to participate in the Voluntary Disclosure Program. The Taxpayer’s petition is denied.¹

ISSUE

Does the audit of an affiliated entity constitute contact by the Department that precludes eligibility for entry into the Voluntary Disclosure Program?

FINDINGS OF FACT

. . . (Taxpayer) is a [out-of-state] corporation and a subsidiary of a specialty retailer offering clothing and accessory items for women, men, and children under a variety of different brand names (. . .). The Taxpayer is one of a number of subsidiary entities. Neither the Taxpayer nor any of the other subsidiary entities is organized, domiciled, or headquartered in Washington.

¹ Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

On February 16, 2017, the Taxpayer and four other subsidiary entities submitted applications to the Department's Voluntary Disclosure Program. The applications indicated that economic nexus had been established under RCW 82.04.067. The applications also disclosed that an affiliated entity that was conducting business in Washington and already registered with the Department was under audit. The Taxpayer's application was reviewed and denied by the Department on February 16, 2017. The reason for the denial was that the Department had initiated an audit of the registered affiliate in January 2017. The Taxpayer timely filed a petition seeking review of the denial of its application to the Voluntary Disclosure Program. While the Taxpayer was denied admission to the Voluntary Disclosure Program, as of the date of this determination, the Department has not initiated an audit of the Taxpayer's business activities and has not issued any assessment to the Taxpayer.

The Department sent a denial letter to the Taxpayer that states that the application was denied because the Department had previously contacted Taxpayer's affiliate. The Department's Audit Division issued notifications to the registered affiliate that state that the audit may include examination of affiliated entities. The Audit Division sent audit notice letters, titled "Confirmation of Excise Tax Audit Appointment," to two employees of the affiliated entity.² Each of these letters specifically states that:

This letter serves as an audit notification to [Taxpayer] and its affiliates. This audit includes not only the above listed business, but also applies to any affiliates, partners, subsidiaries, or other related entities doing business or providing services in Washington which may or may not be audited at the same time.

See Notification of Excise Tax Audit letters, dated January 9 and 13, 2017.

The penultimate paragraph in the letters is titled "Affiliates" and specifically states that "[a]s to any affiliates . . . subsidiaries . . . doing business or providing services in Washington, this correspondence is considered an enforcement contact by the Department of Revenue." *Id.*

ANALYSIS

The Washington tax system is based largely on voluntary compliance. The Revenue Act imposes on taxpayers the responsibility to inform themselves about applicable tax laws, register with the Department, and accurately and timely pay taxes. RCW 82.32A.005 and RCW 82.32A.030.

The Department has established a Voluntary Disclosure Program, which is administered by the Audit Division. This program allows taxpayers to enter into an agreement to voluntarily disclose taxable activities for the current year, plus the preceding four years, and the Department agrees to limit its review to this period and partially or fully waive applicable penalties. Det. No. 14-0397, 34 WTD 332 (2015).³ The information about the program is available on the Department's

² Specifically, the Department sent a letter dated January 9, 2017, to . . . and a letter dated January 13, 2017, to . . .

³ The Voluntary Disclosure Program enables a voluntarily registering business to be subject to audit for the same period of time as registered businesses. RCW 82.32.100 sets out a statute of limitations for taxpayers who have registered as the current tax year and the preceding four years. RCW 82.32.100 provides no statute of limitations for

website. *See* Department of Revenue webpage at <https://dor.wa.gov/doing-business/register-my-business/voluntary-disclosure-program> (last visited March 7, 2018). To be eligible to enter the Voluntary Disclosure Program and be eligible for the full benefits of that program a business must have:

- (1) Never registered with or reported taxes to the Department;
- (2) Never been contacted by the Department for enforcement purposes (e.g., audit or compliance contacts regarding registration or reporting requirements); and
- (3) Not engaged in evasion or misrepresentation in reporting tax liabilities.

Id.

In this case, it is the second requirement that is at issue. What is at issue, specifically, is whether the Department's initiation of an audit of an affiliated entity is a "contact for enforcement purposes" that will preclude qualification for the Voluntary Disclosure Program.

The Department's website specifically addresses the conditions under which contact with an affiliate will be considered contact with a taxpayer applying for voluntary disclosure.

If the Department has contacted you for enforcement purposes (e.g., a phone call, written correspondence, etc.) and has asked for information regarding any affiliates and related entities, then they, too, are considered to have been contacted and would not qualify for the program. It does not matter whether the affiliates or related entities were identified by name.

A contact with a business is considered a contact with a business' affiliates and related entities if 1) the contact is for enforcement purposes, 2) the contact makes it clear that it is intended to reach both the business and its affiliates and related entities; and 3) the contact requires the business and its affiliates and related entities to take action(s) in response to the contact.

Id. The Department's website defines "affiliate" and "affiliated" as follows:

The term "affiliate" means a person that is "affiliated" with another person; and "affiliated" means under common control; and "control" means the possession, directly or indirectly, of more than 50 percent of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting shares, by contract, or otherwise. Under these definitions, "affiliates" would include "subsidiaries." (RCW 82.04.29005; RCW 82.04.645).

While it does not specifically reference the Voluntary Disclosure Program, WAC 458-20-228 (Rule 228), the Department's administrative rule addressing the timely filing of returns, acceptable methods of payment, and the grounds for waiver of penalties and interest, does provide a definition

the assessment of taxes against an unregistered taxpayer, but the Department's policy is to limit assessments against unregistered taxpayers to seven years. Det. No. 87-171, 3 WTD 153 (1987).

of voluntary registration. In detailing possible penalties that may be imposed, Rule 228 defines “voluntarily register” as meaning:

[T]o properly complete and submit a master application to any agency or entity participating in the unified business identifier (UBI) program for the purpose of obtaining a UBI number, all of which is done before any contact from the department.

Rule 228(5)(b).

Voluntary registration under the rule will provide a basis for waiver of the late payment and unregistered penalties imposed by RCW 82.32.090(1) and (4). *Id.*

The Taxpayer asserts that because each of the affiliated entities at issue is a separate “person” or “company” as defined by RCW 82.04.030, the contact with the affiliated entity initiating an audit should not be considered a prohibited enforcement contact.⁴ The Taxpayer also asserts that nowhere in the Voluntary Disclosure Program information or in the provisions of Rule 228 is the initiation of an audit specifically referenced or characterized as an enforcement action. Finally, the Taxpayer argues that the denial of the admission to the Voluntary Disclosure Program in this case is contrary to the underlying intent of the policy to encourage voluntary compliance and to have taxpayers to initiate contact with the Department.

We agree with the Taxpayer that the separate treatment of separately incorporated entities is a key attribute of our tax structure. Indeed, we have previously characterized this separate treatment as fundamental to Washington’s tax system. *See* Det. No. 02-0154R 24 WTD 134 (2005). However, the fact that the entities are treated separately does not alter the application of the eligibility provisions that the Department has established for the Voluntary Disclosure Program and does not preclude defining contact with an affiliate or related entity as contact with a taxpayer as quoted above.

Likewise, the provision of Rule 228 addressing what constitutes voluntary registration does not preclude the notice of an audit being characterized as an enforcement contact. Indeed, the language of Rule 228 is broader than the Voluntary Disclosure Program provisions, as it requires that the completed business license application be submitted “prior to any contact” from the Department. Rule 228(5)(b). Thus, under the rule, any contact could impede registration being considered “voluntary,” not just enforcement contacts.

The Voluntary Disclosure Program is not created by statute or rule, but, rather, is a discretionary program provided by the Department to encourage voluntary registration. We find no authority or support for the proposition that the requirements the Department has established for this program are not enforceable or are otherwise improper.

⁴RCW 82.04.030 provides:

“Person” or “company”, herein used interchangeably, means any individual, receiver, administrator, executor, assignee, trustee in bankruptcy, trust, estate, firm, copartnership, joint venture, club, company, joint stock company, business trust, municipal corporation, political subdivision of the state of Washington, corporation, limited liability company, association, society, or any group of individuals acting as a unit, whether mutual, cooperative, fraternal, nonprofit, or otherwise and the United States or any instrumentality thereof.

In this case, the audit letters on their face expressly define themselves as enforcement contacts. The letters also meet the three components of an enforcement contact detailed on the Department's Voluntary Disclosure Program webpage, as quoted above.

The first component is that the contact must be for enforcement purposes. An audit fits within the scope of an enforcement activity, as the purpose of the examination is to verify the correct reporting and payment of tax liabilities and issue an assessment that will identify any underpaid liabilities or provide a credit for overpayments, thereby enforcing the application of the appropriate tax laws to the taxpayer. The second component is met because the contact letter itself makes it clear that it is intended to reach both the business being contacted as well as its affiliates and related entities. As detailed above, the audit letters state that the notification applies not only to the listed taxpayer, but also to affiliates and subsidiaries. Finally, the third component is that the contact must require the business and its affiliates and related entities to take action in response to the contact. The audit notices in this case detail a number of actions to be taken to prepare for review of taxable activities. The audit notices again state that these required actions are also applicable to affiliates, which fulfills the requirement that an action be taken. Therefore, in this case, an enforcement contact occurred prior to the Taxpayer applying to the Voluntary Disclosure Program, which rendered Taxpayer ineligible for the program.

We conclude that issuance of a notice of audit to an affiliated entity is an enforcement contact that will preclude eligibility for the Voluntary Disclosure Program and that the Taxpayer's application for the Voluntary Disclosure Program was properly denied.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 8th day of March 2018.