



OCTOBER 2010

DRS Issues Guidance on Waiver of Civil Penalties

The Connecticut Department of Revenue Services (DRS) has issued guidance regarding the waiver of penalties. Policy Statement 2010(1) represents the first published guidance by DRS on the matter since it promulgated regulations in 1988 and 1989. The regulations provided little guidance to practitioners on DRS procedures and standard of review. Policy Statement 2010(1) addresses questions and concerns regarding the waiver of civil penalties until the DRS promulgates new regulations.

The Policy Statement consolidates the existing two-pronged "reasonable cause and not intentional or due to neglect" standard for waiver of penalties into a single "reasonable cause" standard. It also provides some detail regarding the process for waiver requests and appeals from adverse decisions on such requests.

THE REASONABLE CAUSE STANDARD

Under the existing regulations, Sections 12-2-11 and 12-3a-1 of the Regulations of Connecticut State Agencies, "the commissioner may waive penalties, in whole or in part, when it is proven to his satisfaction that the failure to pay any tax on time was due to reasonable cause and was not intentional or due to neglect." The regulations identify specific examples that may result in a waiver of penalties, some of which fall under the "reasonable cause" prong and others under the "not intentional or due to neglect" prong.

Policy Statement 2010(1) does the following:

- It eliminates the existing two-pronged analysis (reasonable cause and not intentional or due to neglect) in favor of a single reasonable cause requirement. The Policy Statement refers to the Internal Revenue Service interpretation of similar language in the Internal Revenue Code and states that the DRS used the federal jurisprudence as its guide. Under the reasonable cause standard, the Commissioner assesses the facts and circumstances of each waiver request individually.
- It states that the main consideration in granting penalty relief is whether "the taxpayer could have anticipated or otherwise foreseen the event that caused the noncompliance." A taxpayer's ignorance of law, mistake, forgetfulness, or oversight will not, in and of itself, establish reasonable cause. Furthermore, in a departure from the existing regulations,

penalty relief based on the reliance of advice from a tax advisor will be limited to issues "considered technical or complicated" and will not apply to a taxpayer's responsibility to file, pay, or deposit taxes.

- It requires that a taxpayer who seeks a penalty waiver provide to the DRS a completed and properly executed Form DRS-PW, Request for Waiver of Civil Penalty, that includes the following:
 - an explanation of the facts and circumstances that caused the taxpayer not to comply with the law;
 - whether the taxpayer complied with other financial responsibilities (e.g., mortgage, credit card payments) during the time of noncompliance;
 - what attempts the taxpayer made to comply with the tax law once the facts and circumstances changed; and
 - whether the taxpayer complied with its tax obligations within a reasonable time after the facts and circumstances changed.

PENALTY WAIVER PROCESS AND APPEAL PROVISIONS

The existing regulations provide that for penalties in excess of \$500 the Commissioner makes a recommendation of waiver to the Penalty Review Committee, which approves or ratifies the Commissioner's recommendation, and that the Commissioner has unilateral authority to waive all or part of the penalty equal to or less than \$500. However, there is no guidance in the regulations as to what occurs in the case of an unfavorable action by the Commissioner or the Penalty Review Committee.

Policy Statement 2010(1) provides for a notification process and guidance for a taxpayer to appeal a negative decision. The notification process results in three possible outcomes:

- If the Commissioner waives a penalty of \$500 or less, the DRS will send the taxpayer a notification of the Commissioner's decision.
- If the Commissioner recommends waiving a penalty over \$500, the DRS will send the taxpayer notification confirming that the Commissioner's recommendation was referred to the Penalty Review Committee, which will notify the taxpayer once it acts on the Commissioner's recommendation.
- If the Commissioner does not waive all or a portion of a penalty of \$500 or less or does not recommend the waiver of all or a portion of a penalty over \$500, the DRS will send the taxpayer notification of the Commissioner's decision.

A taxpayer disagreeing with the Commissioner may appeal that decision by filing a timely appeal to the Connecticut Superior Court. While Policy Statement 2010(1) does not deal with the question of appeal rights in the case of a denial of waiver by the Penalty Review Committee, Section 12-3a of the Connecticut General Statutes provides for an appeal to the Superior Court for the judicial district of New Britain within one month after such action is delivered or mailed. The Policy Statement also sets forth penalty provisions which the Commissioner will not waive. These include certain criminal penalties and willful violations. Civil penalties assessed at audit are also prohibited from being waived, according to the Policy Statement, but may be challenged by filing an administrative appeal with the DRS.

SUMMARY

In summary, the DRS' new guidance on civil penalty waiver accomplishes two things: First, it eliminates the current two-pronged analysis for penalty waiver in favor of a single reasonable cause standard. Second, it provides greater detail concerning notification and appeals provisions regarding requests for penalty waiver. When compared to the current DRS policy, however, the implementation of Policy Statement 2010(1), and presumably the corresponding regulations to be promulgated by DRS in early December 2010, will likely have a negative impact on taxpayers in two significant ways.

First, under the existing regulations, reasonable cause could be established when the taxpayer reasonably relied upon the advice of a competent tax advisor, despite the taxpayer's failing to file a return or underreporting of tax. Policy Statement 2010(1) has limited the instances under which a taxpayer may rely upon the advice of a tax advisor to only those circumstances in which the issues are considered "technical or complicated."

Second, while providing new guidance about the taxpayer's ability to appeal an adverse determination, Policy Statement 2010(1) also lists the specific penalties that the Commissioner will not waive, including the "fraud and intent to evade" and negligence penalties imposed regarding an audit. The effect of this change in procedure is that taxpayers who are assessed these penalties at audit do not have the option of paying the tax and seeking a waiver. They must now seek administrative review before the Appellate Division. Therefore, the waiver procedures appear to apply only to automatically imposed penalties, such as the failure to file or pay, while discretionary penalties must be appealed administratively and later to Superior Court.

For more information please contact a member of our State Tax Group.

Richard Tomeo (860) 275-8278 rtomeo@rc.com	Jack Shaughnessy (860) 275-8314 jshaughnessy@rc.com	Felicia Hoeniger (860) 275-8309 fhoeniger@rc.com
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Christine Bromberg (860) 275-8353 cbromberg@rc.com	Scott Sebastian (860) 275-8386 ssebastian@rc.com
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