

**103 KAR 1:040. Waiver of penalties.**

RELATES TO: KRS 131.010(9), 131.030(3), 131.081(6), 131.175, 131.180, 131.440(3)(d), 133.180, 133.220, 138.885, 139.185, 141.180(7), 141.180(8), 141.340(2), 141.990, 142.357, 143.085.

STATUTORY AUTHORITY: KRS 131.130(1)

NECESSITY, FUNCTION, AND CONFORMITY: KRS 131.175 authorizes the Commissioner of the Department of Revenue to waive the penalty, but not interest, if the failure to pay is due to reasonable cause. KRS 131.130 authorizes the department to promulgate administrative regulations to administer Kentucky's tax laws. This administrative regulation establishes the criteria used to determine if the taxpayer has demonstrated reasonable cause to justify the waiver of penalties.

Section 1. Enumeration of Circumstances Constituting Reasonable Cause. The Department of Revenue shall employ the criteria established in this section to determine if the taxpayer has demonstrated reasonable cause to waive penalties.

(1) Erroneous advice by Department of Revenue. The taxpayer may demonstrate good cause for reliance on erroneous written advice from the department in accordance with KRS 131.081(6).

(2) Death or serious illness of taxpayer or immediate family. Penalties may be waived if the delay or failure to file a return or report or pay a tax was caused by the death or serious illness of the taxpayer or a member of that taxpayer's immediate family. If the taxpayer is not an individual, the death or serious illness shall be that of an individual having sole authority to execute the return or a member of the individual's immediate family. The following factors shall be considered in a determination of the applicability of this subsection:

- (a) Relationship of parties involved;
- (b) Date of death;
- (c) Date and nature of serious illness;
- (d) Length of time from the date of death or serious illness to the date prescribed by law for filing a return, including any extension granted;
- (e) Explanation of how the event prevented compliance; and
- (f) Explanation of other business obligations that were impaired.

(3) Death or serious illness of taxpayer's tax return preparer. Penalties may be waived if the delay or failure to file a return or report or pay a tax was caused by the death or serious illness of the taxpayer's tax return preparer. The following factors shall be considered in a determination of the applicability of this subsection:

- (a) Name of preparer;
- (b) 1. Date of preparer's death; or  
2. Date and nature of preparer's serious illness;
- (c) Length of time from the date of death or serious illness of the tax preparer to the date prescribed by law for filing a return, including any extension granted; and
- (d) Explanation of how the death or serious illness prevented compliance.

(4) Unavoidable Absence of Taxpayer. Penalties may be waived if the delay or failure to file a return or report or pay a tax was caused by the unavoidable absence of the taxpayer. For a corporation, partnership, estate, trust, or similar entity, the absence shall have been of an individual having sole authority to execute the return or report. The following factors shall be considered in a determination of the applicability of this subsection:

- (a) Dates and reasons for the absence; and
  - (b) Explanation as to how the event prevented compliance.
- (5) Destruction or unavailability of taxpayer records by a catastrophic event. Penalties may be waived if the delay or failure to file a return or report or pay a tax was caused by the destruction or unavailability of the taxpayer's records by a catastrophic event. The following factors shall be considered in a determination of the applicability of this subsection:

- (a) Date and description of catastrophic event;
- (b) Supporting documentation such as a copy of the police, fire, or insurance report;
- (c) Explanation of how the destruction or unavailability of records prevented compliance; and
- (d) Explanation of all other means explored to secure needed tax information.

(6) Inability to obtain records in custody of third party. Penalties may be waived if the delay or failure to file a return or report or pay a tax was caused by the inability to obtain taxpayer's records in the custody of a third party. The following factors shall be considered in a determination of the applicability of this subsection:

- (a) The records in the custody of a third party and the third party's identity;
- (b) Explanation of why the records were needed to comply;
- (c) Explanation of why the records were unavailable and what steps were taken to secure the records;
- (d) Explanation of when and how the taxpayer became aware that the necessary records were unavailable;
- (e) Supporting documentation such as copies of letters written and responses received in an effort to get the needed information; and
- (f) Explanation of all means explored to secure the needed tax information.

(7) Employee Theft or Defalcation. Penalties may be waived if the delay or failure to file a return or report or pay a tax was caused by employee theft or defalcation. The employee theft or defalcation shall be directly related to the financial records or funds required to file a return or report or pay a tax.

(8) Undue hardship. Penalties may be waived if the enforcement of the penalty or fee would constitute an undue hardship on the taxpayer, and if waiver of the penalty or fee would facilitate collection of the tax liability. A taxpayer shall demonstrate that reasonable care and prudence was exercised in providing for payment of the tax, but the taxpayer was unable to pay the tax.

- (a) The following factors shall be considered in determining undue hardship:
  1. Nature of the tax which the taxpayer has failed to pay;
  2. Amount and nature of the taxpayer's expenditures in light of the income the taxpayer could, at the time of the expenditures, reasonably have expected to receive prior to the date prescribed by law for the payment of the tax;

3. Reasonableness of the taxpayer's efforts to conserve sufficient assets in marketable form to satisfy the tax liability;
4. Potential loss due to the sale of property at a sacrificed price. If a market exists, the sale of property at the current market price shall not be considered as resulting in an undue hardship;
5. Equity in assets, including repayment ability;
6. Family size;
7. Necessary living expenses, if a taxpayer is an individual, or necessary business expenses;
8. Income from all sources, both taxable and nontaxable, including income of the nonliable spouse to the extent used for the necessary living expenses of a family;
9. Stability of income and anticipated increases or decreases;
10. Current status of business;
11. Possibility of payment through an installment agreement; and
12. Age and health of the taxpayer.

(b) The following factors shall be considered in determining if waiver of a fee or penalty facilitates collection of the tax liability:

1. Dischargeability of tax liability in bankruptcy;
2. Collectability of the tax, penalty, and interest directly from the taxpayer, as determined from the taxpayer's financial statements;
3. Availability of sources of funds for payment not under the control of the taxpayer; and
4. Past and current compliance with Department of Revenue filing and payment requirements.

(9) Human error. Penalties may be waived if the delay or failure to file a return or report or pay a tax was caused by human error and the delay or failure is the first occurrence over the last twelve (12) calendar months if the taxpayer is a monthly or quarterly filer, or twenty-four (24) months if the taxpayer is an annual filer, and Department of Revenue records show that the taxpayer took appropriate steps to eliminate the delinquency in a timely manner.

(10) Erroneous advice by tax advisor. Penalties may be waived if the delay or failure to file a return or report or pay a tax was caused by the receipt of erroneous advice from a tax advisor or other professional on whom a taxpayer had a reasonable right to rely. The taxpayer shall establish the presence of the following three (3) factors for the Department of Revenue to consider the applicability of this subsection:

- (a) Unfamiliarity of the taxpayer with the tax laws, and actual reliance by the taxpayer on the advice of the tax advisor;
- (b) Supporting documentation of full disclosure by the taxpayer of all relevant facts provided to the tax advisor or other professional retained and advice received, including:
  1. A copy of the advice requested;
  2. A copy of the advice provided; and
  3. A statement from the tax advisor explaining the circumstances; and
- (c) Exercise of reasonable care and prudence by the taxpayer in determining whether to secure further advice.

(11) Reliance on substantial legal authority. Penalties may be waived if the delay or failure to file a return or report or pay a tax was caused by reliance on substantial legal authority for the particular tax treatment of an item of gross income, deduction, exemption, credit, or basis. The following factors shall be considered in a determination of the applicability of this subsection:

- (a) Actual reliance by the taxpayer at the time of failure to file the return or report or to pay the tax; and
- (b) Conspicuous, full disclosure by the taxpayer in the return, if a return was filed, of the position that is contrary to the Department of Revenue's position, including all copies of or citation to the Internal Revenue Code, the Kentucky Revised Statutes, final and temporary regulations of the Internal Revenue Service and the Department of Revenue, Revenue Rulings, Revenue Procedures, and Private Letter Rulings of the Internal Revenue Service, case law interpreting the previous items, or any other relevant legal authority which provides that the tax treatment is more likely than not correct.

(12) Ignorance of Reporting Requirements. Ordinary business care and prudence shall require that a taxpayer be aware of tax obligations. Penalties may be waived in isolated cases if a taxpayer is not aware of the reporting requirements. Ignorance of the law may be considered in conjunction with other facts and circumstances including limited education or the lack of previous tax and penalty experience.

(13) Tax modernization. For taxable periods beginning after December 31, 2004 and before January 1, 2006, the penalty for any declaration underpayment, as provided in KRS 131.180 and 141.990(3) shall be waived if the declaration underpayment is directly related to the changes to the tax laws pursuant to 2005 Ky. Acts ch. 168, and the taxpayer made a good faith effort to comply with 2005 Ky. Acts ch. 168.

(14) Miscellaneous. If the cause for penalty waiver submitted by the taxpayer does not fall within the other reasonable cause guidelines provided in this section, the Department of Revenue may decide that the written statements submitted by the taxpayer establish a reasonable cause for noncompliance with the applicable tax statute. A cause for noncompliance which appears to a person of ordinary prudence and intelligence as a reasonable cause for delay in filing a return or paying a tax and which clearly negates negligence, willful disregard of administrative regulations, or fraud may be accepted. The facts and circumstances of each case shall be considered.

Section 2. Taxpayer's Support for Reasonable Cause. (1) Responsibility for request. The taxpayer shall:

- (a) Request reduction or waiver of any penalty, in writing; and
- (b) Provide all supporting documentation necessary to substantiate reasonable cause.

(2) Time of request. A taxpayer shall:

- (a) Attach a statement requesting waiver for reasonable cause to a return; or
- (b) Request waiver after notice of assessment.

(3) Request by representative of taxpayer. A request from a taxpayer's representative shall be considered a request by the taxpayer if the taxpayer has provided a properly signed power of attorney or the Department of Revenue is satisfied by any other written statement that the representative has been authorized to act for the taxpayer. (32 Ky.R. 810; Am. 33 Ky.R. 376; eff. 9-1-2006.)