

1 FINANCE AND ADMINISTRATION CABINET

2 Department of Revenue

3 (Amendment)

4 103 KAR 1:040. Waiver of penalties.

5 RELATES TO: KRS 131.010~~(9)~~, 131.030~~(3)~~, 131.081~~(6)~~, 131.175, 131.180,  
6 131.440~~(2)~~~~(3)~~~~(4)~~, 133.180, 133.220, 138.885, 139.185, 141.180~~(7)~~, ~~141.180(8)~~, 141.340~~(2)~~,  
7 141.990, 142.357, 143.085.

8 STATUTORY AUTHORITY: KRS 131.130~~(1)~~, 131.175

9 NECESSITY, FUNCTION, AND CONFORMITY: KRS 131.175 authorizes the  
10 Commissioner of the Department of Revenue to waive the penalty, but not interest, if the failure  
11 to pay is due to reasonable cause. KRS 131.130~~(1)~~ authorizes the department to promulgate  
12 administrative regulations to administer Kentucky's tax laws. This administrative regulation  
13 establishes the criteria used to determine if the taxpayer has demonstrated reasonable cause to  
14 justify the waiver of penalties.

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

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

20 (2) Death or serious illness of taxpayer or immediate family. Penalties may be waived if the  
21 delay or failure to file a return or report or pay a tax was caused by the death or serious illness of

1 the taxpayer or a member of that taxpayer's immediate family. If the taxpayer is not an individual,  
2 the death or serious illness shall be that of an individual having sole authority to execute the return  
3 or a member of the individual's immediate family. The following factors shall be considered in a  
4 determination of the applicability of this subsection:

5 (a) Relationship of parties involved;

6 (b) Date of death;

7 (c) Date and nature of serious illness;

8 (d) Length of time from the date of death or serious illness to the date prescribed by law for  
9 filing a return, including any extension granted;

10 (e) Explanation of how the event prevented compliance; and

11 (f) Explanation of other business obligations that were impaired.

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

16 (a) Name of preparer;

17 (b)1. Date of preparer's death; or

18 2. Date and nature of preparer's serious illness;

19 (c) Length of time from the date of death or serious illness of the tax preparer to the date  
20 prescribed by law for filing a return, including any extension granted; and

21 (d) Explanation of how the death or serious illness prevented compliance.

22 (4) Unavoidable Absence of Taxpayer. Penalties may be waived if the delay or failure to file  
23 a return or report or pay a tax was caused by the unavoidable absence of the taxpayer. For a

1 corporation, partnership, estate, trust, or similar entity, the absence shall have been of an individual  
2 having sole authority to execute the return or report. The following factors shall be considered in  
3 a determination of the applicability of this subsection:

- 4 (a) Dates and reasons for the absence; and
- 5 (b) Explanation as to how the event prevented compliance.

6 (5) Destruction or unavailability of taxpayer records by a catastrophic event. Penalties may be  
7 waived if the delay or failure to file a return or report or pay a tax was caused by the destruction  
8 or unavailability of the taxpayer's records by a catastrophic event. The following factors shall be  
9 considered in a determination of the applicability of this subsection:

- 10 (a) Date and description of catastrophic event;
- 11 (b) Supporting documentation such as a copy of the police, fire, or insurance report;

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12 (c) Explanation of how the destruction or unavailability of records prevented compliance; and  
13 (d) Explanation of all other means explored to secure needed tax information.

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

- 18 (a) The records in the custody of a third party and the third party's identity;
- 19 (b) Explanation of why the records were needed to comply;
- 20 (c) Explanation of why the records were unavailable and what steps were taken to secure the  
21 records;
- 22 (d) Explanation of when and how the taxpayer became aware that the necessary records were  
23 unavailable;

1 (e) Supporting documentation such as copies of letters written and responses received in an  
2 effort to get the needed information; and

3 (f) Explanation of all means explored to secure the needed tax information.

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

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

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12 (a) The following factors shall be considered in determining undue hardship:

13 1. Nature of the tax which the taxpayer has failed to pay;

14 2. Amount and nature of the taxpayer's expenditures in light of the income the taxpayer could,  
15 at the time of the expenditures, reasonably have expected to receive prior to the date prescribed by  
16 law for the payment of the tax;

17 3. Reasonableness of the taxpayer's efforts to conserve sufficient assets in marketable form  
18 to satisfy the tax liability;

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19 4. Potential loss due to the sale of property at a sacrificed price. If a market exists, the sale of  
20 property at the current market price shall not be considered as resulting in an undue hardship;

21 5. Equity in assets, including repayment ability;

22 6. Family size;

23 7. Necessary living expenses, if a taxpayer is an individual, or necessary business expenses;

- 1 8. Income from all sources, both taxable and nontaxable, including income of the nonliable
- 2 spouse to the extent used for the necessary living expenses of a family;
- 3 9. Stability of income and anticipated increases or decreases;
- 4 10. Current status of business;
- 5 11. Possibility of payment through an installment agreement; and
- 6 12. Age and health of the taxpayer.

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

- 9 1. Dischargeability of tax liability in bankruptcy;
- 10 2. Collectability of the tax, penalty, and interest directly from the taxpayer, as determined
- 11 from the taxpayer's financial statements;

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- 12 3. Availability of sources of funds for payment not under the control of the taxpayer; and
- 13 4. Past and current compliance with Department of Revenue filing and payment requirements.

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

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

1 (a) Unfamiliarity of the taxpayer with the tax laws, and actual reliance by the taxpayer on the  
2 advice of the tax advisor;

3 (b) Supporting documentation of full disclosure by the taxpayer of all relevant facts provided  
4 to the tax advisor or other professional retained and advice received, including:

5 1. A copy of the advice requested;

6 2. A copy of the advice provided; and

7 3. A statement from the tax advisor explaining the circumstances; and

8 (c) Exercise of reasonable care and prudence by the taxpayer in determining whether to secure  
9 further advice.

10 (11) Reliance on substantial legal authority. Penalties may be waived if the delay or failure to  
11 file a return or report or pay a tax was caused by reliance on substantial legal authority for the

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12 particular tax treatment of an item of gross income, deduction, exemption, credit, or basis. The  
13 following factors shall be considered in a determination of the applicability of this subsection:

14 (a) Actual reliance by the taxpayer at the time of failure to file the return or report or to pay  
15 the tax; and

16 (b) Conspicuous, full disclosure by the taxpayer in the return, if a return was filed, of the  
17 position that is contrary to the Department of Revenue's position, including all copies of or citation

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18 to the Internal Revenue Code, the Kentucky Revised Statutes, final and temporary regulations of

19 the Internal Revenue Service and the Department of Revenue, Revenue Rulings, Revenue

20 Procedures, and Private Letter Rulings of the Internal Revenue Service, case law interpreting the

21 previous items, or any other relevant legal authority which provides that the tax treatment is more

22 likely than not correct.

23 (12) Ignorance of Reporting Requirements. Ordinary business care and prudence shall require

1 that a taxpayer be aware of tax obligations. Penalties may be waived in isolated cases if a taxpayer  
2 is not aware of the reporting requirements. Ignorance of the law may be considered in conjunction  
3 with other facts and circumstances including limited education or the lack of previous tax and  
4 penalty experience.

5 (13) ~~[Tax modernization. For taxable periods beginning after December 31, 2004 and before~~  
6 ~~January 1, 2006, the penalty for any declaration underpayment, as provided in KRS 131.180 and~~  
7 ~~141.990(3) shall be waived if the declaration underpayment is directly related to the changes to~~  
8 ~~the tax laws pursuant to 2005 Ky. Acts ch. 168, and the taxpayer made a good faith effort to comply~~  
9 ~~with 2005 Ky. Acts ch. 168.~~

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

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


- 19 (a) Request reduction or waiver of any penalty, in writing; and  
20 (b) Provide all supporting documentation necessary to substantiate reasonable cause.
- 21 (2) Time of request. A taxpayer shall:  
22 (a) Attach a statement requesting waiver for reasonable cause to a return; or  
23 (b) Request waiver after notice of assessment.

1       (3) Request by representative of taxpayer. A request from a taxpayer's representative shall be  
2 considered a request by the taxpayer if the taxpayer has provided a properly signed power of  
3 attorney or the Department of Revenue is satisfied by any other written statement that the  
4 representative has been authorized to act for the taxpayer.



103 KAR 1:040

APPROVED BY AGENCY:

  
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DANIEL P. BORK, COMMISSIONER  
Department of Revenue  
Finance and Administration Cabinet

10-12-2018  
\_\_\_\_\_  
Date

## PUBLIC HEARING AND PUBLIC COMMENT PERIOD

A public hearing on this administrative regulation will be held on November 26, 2018 at 10:00 a.m. in Room 8A, State Office Building, 501 High Street, Frankfort KY 40601. Individuals interested in being heard at this hearing shall notify this agency in writing by five (5) workdays prior to the hearing, of their intent to attend. If no notification of intent to attend the hearing is received by that date, the hearing may be cancelled. This hearing is open to the public. Any person who wishes to be heard will be given an opportunity to comment on the proposed administrative regulation. A transcript of the public hearing will not be made unless a written request for a transcript is made. If you do not wish to be heard at the public hearing, you may submit written comments on the proposed administrative regulation. Written comments will be accepted through November 30, 2018. Send written notification of intent to be heard at the public hearing or written comments on the proposed administrative regulation to the contact person.

CONTACT PERSON: Lisa Swiger, Revenue Tax Policy/Research Consultant II, Department of Revenue, 501 High Street, Station 1, Frankfort, Kentucky, 40601, (502) 564-9526 (telephone), (502) 564-3875(fax), Lisa.Swiger@ky.gov(email).

## REGULATORY IMPACT ANALYSIS AND TIERING STATEMENT

Regulation No. 103 KAR 1:040

Contact Person: Lisa Swiger  
Phone Number: (502) 564-9526  
Email: Lisa.Swiger@ky.gov

(1) Provide a brief summary of:

(a) What this administrative regulation does: This regulation provides guidance to taxpayers regarding the factors the Department of Revenue considers when waiving penalties for reasonable cause under the administrative authority granted to the agency by statute.

(b) The necessity of this administrative regulation: The authority to waive penalties could be exercised capriciously, and this regulation sets forth objective factors the department considers when making waiver determinations.

(c) How this administrative regulation conforms to the content of the authorizing statutes: KRS 131.175 grants the department the authority to waive penalties if the "failure to file or pay timely is due to reasonable cause." This regulation sets forth the factors the department will consider to grant penalty relief.

(d) How this administrative regulation currently assists or will assist in the effective administration of the statutes: KRS 131.175 is silent with regard to the definition of "reasonable cause" as it relates to penalty waivers, and this regulation provides guidance regarding factors the department considers in granting relief.

(2) If this is an amendment to an existing administrative regulation, provide a brief summary of:

(a) How the amendment will change this existing administrative regulation: The two substantive amendments requested in this administrative regulation are: (1) update statutory section references due to changes that resulted from the passage of HB 487/2018GA, and (2) remove references to penalty relief related to 2004 and 2005 tax modernization. All returns filed for 2004 and 2005 are beyond the statute of limitations, and references to penalty relief for those returns are no longer needed.

(b) The necessity of the amendment to this administrative regulation: References to statutory sections of the Kentucky Revised Statutes that are no longer valid must be removed to avoid taxpayer confusion. References to penalty relief for periods well outside the statute of limitations are not helpful and do not provide meaningful guidance to taxpayers.

(c) How the amendment conforms to the content of the authorizing statutes: Removing obsolete code section references will bring the regulation into conformity with existing statutes. Failure to remove the erroneous references will cause the regulation to reference non-existent statutes. Penalty relief granted for 2004 and 2005 tax modernization was authorized by statute, but relief is no longer needed due to the expiration of the statute of limitations.

(d) How the amendment will assist in the effective administration of the statutes: Removing inaccurate code section references and obsolete guidance will avoid taxpayer and administrative agency confusion.

(3) List the type and number of individuals, businesses, organizations, or state and local governments affected by this administrative regulation: All taxpayers in the Commonwealth who fail to file or pay timely will benefit from clear penalty relief guidance. State and local governments that provide similar penalty relief and rely on the department's objective standards will also benefit from clear guidance.

(4) Provide an analysis of how the entities identified in question (3) will be impacted by either the implementation of this administrative regulation, if new, or by the change, if it is an amendment, including:

(a) List the actions that each of the regulated entities identified in question (3) will have to take to comply with this administrative regulation or amendment: No actions are required.

(b) In complying with this administrative regulation or amendment, how much will it cost each of the entities identified in question (3): No cost to any entity.

(c) As a result of compliance, what benefits will accrue to the entities identified in question (3): Less confusion as a result of clear penalty relief guidance.

(5) Provide an estimate of how much it will cost the administrative body to implement this administrative regulation:

(a) Initially: Current budget funding and staff will implement this amendment.

(b) On a continuing basis: None.

(6) What is the source of the funding to be used for the implementation and enforcement of this administrative regulation: Current departmental staff and funding.

(7) Provide an assessment of whether an increase in fees or funding will be necessary to implement this administrative regulation, if new, or by the change if it is an amendment: No increase in fees or funding is needed to implement this administrative regulation.

(8) State whether or not this administrative regulation established any fees or directly or indirectly increased any fees: No fees were established with this amendment.

(9) TIERING: Is tiering applied? (Explain why or why not) Tiering is not applied. All taxpayers requesting a waiver of penalties will be treated the same.

FISCAL NOTE ON STATE OR LOCAL GOVERNMENT

Regulation No. 103 KAR 1:040

Contact Person: Lisa Swiger  
Phone Number: (502) 564-9526  
Email: Lisa.Swiger@ky.gov

1. What units, parts or divisions of state or local government (including cities, counties, fire departments, or school districts) will be impacted by this administrative regulation? The Finance and Administration Cabinet, Department of Revenue.

2. Identify each state or federal statute or federal regulation that requires or authorizes the action taken by the administrative regulation. KRS 131.130(1) and 131.175

3. Estimate the effect of this administrative regulation on the expenditures and revenues of a state or local government agency (including cities, counties, fire departments, or school districts) for the first full year the administrative regulation is to be in effect.

(a) How much revenue will this administrative regulation generate for the state or local government (including cities, counties, fire departments, or school districts) for the first year? No revenue will be generated by the corrections to statutory references listed herein.

(b) How much revenue will this administrative regulation generate for the state or local government (including cities, counties, fire departments, or school districts) for subsequent years? None.

(c) How much will it cost to administer this program for the first year? A cost cannot be determined because staff and department resources that have already been budgeted will be used.

(d) How much will it cost to administer this program for subsequent years? No additional costs will be incurred in subsequent years.

Note: If specific dollar estimates cannot be determined, provide a brief narrative to explain the fiscal impact of the administrative regulation.

Revenues (+/-): \$0

Expenditures (+/-): \$0

Other Explanation: