

Penalty Waiver Policy

North Carolina Department of Revenue

I. Introduction

This document describes the penalty waiver policy of the North Carolina Department of Revenue and supersedes all prior documents. It applies to requests for waiver of civil penalties considered by the Department on or after March 1, 2007. The North Carolina General Statutes require the Department of Revenue to impose certain civil penalties on taxpayers who do not comply with the tax laws and give the Secretary of Revenue the authority to waive or reduce all of these penalties.

Civil penalties serve two important purposes. First, they increase voluntary compliance with the tax laws because the prospect of owing more money as a result of a failure to comply provides an incentive for compliance. Second, they promote a fair tax system because they provide the mechanism to treat taxpayers who comply with the law differently than taxpayers who do not comply.

II. The Core Penalties

Various statutes throughout Chapter 105 of the General Statutes establish penalties the Department must assess for noncompliance. The most frequently applied penalties are the core penalties. The core penalties are:

Penalty	Statute
Failure to File	105-236(3)
Failure to Pay	105-236(4)
10% Negligence	105-236(5)a.
25% Large Tax Deficiency for Individual Income Tax	105-236(5)b.
25% Large Tax Deficiency for Taxes Other Than Individual Income Tax	105-236(5)c.

III. Waiver Criteria

Two categories of criteria apply to the waiver of penalties. They are:

- General Waiver Criteria
 - Three Automatic Reasons
 - Good Compliance Record Reason
- Special Circumstances

The category of general waiver criteria consists of three automatic reasons to waive a penalty and one conditional reason of good compliance record. The general waiver criteria apply to the core penalties with the exceptions noted below.

The category of special circumstances applies in limited circumstances to all penalties and consists of all other reasons to waive penalties. It applies to penalties that are subject to the general waiver criteria but do not meet those criteria and to penalties that are not subject to the good compliance record reason. Waiver of a penalty based on the category of special circumstances is the exception rather than the rule.

Exceptions:

- The failure to pay penalty on trust taxes withheld or collected and not remitted such as sales and withholding.
- Penalties assessed for taxes that are not reported at regularly recurring intervals. Examples of taxes that are not reported at regularly recurring intervals include estate tax, gift tax and the unauthorized substances tax. The good compliance record reason in the general waiver criteria does not apply to these taxes because these taxes lack the compliance history that is the basis of the good compliance record reason.
- Penalties assessed as the result of a taxpayer engaging in tax strategies whereby income that would otherwise be taxable in North Carolina is shifted out-of-state or in other tax shelter activities that reduce or eliminate North Carolina state taxes will not be waived for any reason.

IV. General Waiver Criteria

A. Automatic Reasons Under General Waiver Criteria

The three automatic reasons for waiver of a penalty under the general waiver criteria are listed in the chart below. These reasons are considered automatic because if one of them applies, all penalties are waived in their entirety regardless of the taxpayer's compliance record or current status and the number of penalties that have been waived for that taxpayer in the past.

<i>Automatic Reasons</i>	<i>Waiver Period</i>
Death of the taxpayer, the taxpayer's immediate family member, or the taxpayer's tax preparer	Three months following the date of death
Serious, sudden illness of the taxpayer, the taxpayer's immediate family member, or the taxpayer's tax preparer	Three months following the date the illness began
Natural disaster, such as a tornado or hurricane, or an accident, such as a fire, that destroyed property, records, or both	For disasters addressed in a memo from the Secretary or the Governor, the period set in the memo. For other disasters and for accidents, three months from the date of the disaster or accident

An immediate family member is any of the following:

- A parent, child or a spouse. This applies whether or not the individual lives in the same household as the taxpayer.
- Someone who is not a parent, a child, or a spouse and who lives in the same household as the taxpayer. An individual in this category can be an aunt, a grandparent, a grandchild, a sibling or an unrelated individual.

Penalties Subject to Automatic Reasons

Waiver for automatic reason must apply to the facts. For some penalties, automatic reasons are unlikely to be the cause of the action by the taxpayer that resulted in the penalty (for example, bad check or funds transfer penalty, civil fraud penalty and misuse of a certificate of resale).

B. Good Compliance Record Reason Under General Waiver Criteria

The good compliance record reason allows every taxpayer one "free penalty pass" for each tax type every three years. Its purpose is to recognize that everyone makes mistakes and sometimes has difficulty complying with the tax laws.

Good compliance record is the one conditional reason within the category of general waiver criteria. It is a conditional reason because the taxpayer must meet six conditions to qualify for a waiver under this reason. One of these conditions involves a "look-back" period.

The "look-back" period is a three-year period that consists of the taxpayer's most recent compliance history. It ends on the date a request for penalty waiver is being considered by the Department and it starts three years before it ends.

The six conditions a taxpayer must meet to qualify for a waiver under the reason of good compliance record are:

(1) No Tax Returns or Reports Due: The taxpayer must have filed all tax returns and tax reports due. This condition is not tied to the look-back period or the tax type.

(2) No Other Outstanding Liabilities: The taxpayer must have paid any tax, penalty that is not waivable, and interest due for the period for which the penalty waiver is requested as well as any amount shown due on a notice of collection received for a tax period that is different from the tax period for which the penalty waiver is requested. Outstanding liabilities that are the subject of a review do not count; these liabilities are in dispute. This condition is not tied to the look-back period or the tax type.

(3) No Prior Waivers: The taxpayer has received no 100% penalty waiver for that tax type based on good compliance record during the "look-back" period. A waiver during the look-back period based on an automatic reason or on special circumstances does not count. An abatement of a penalty during the look-back period does not count. A penalty is abated when it was imposed in error.

(4) Not Same Mistake: The error or practice that resulted in the penalty at issue is not the same or similar to one previously committed by the taxpayer. The previous error or practice may be outside the look-back period.

(5) No Tax Avoidance/Income Shifting: Penalties are not assessed as the result of a taxpayer engaging in tax strategies whereby income that would otherwise be taxable in North Carolina is shifted out-of-state or in other tax shelter activities that reduce or eliminate North Carolina state taxes.

(6) Provided All Requested Documentation: The taxpayer must have provided all information requested by Department personnel.

For a taxpayer who is an individual and is married, both the taxpayer and the taxpayer's spouse must meet the conditions to qualify for waiver under the good compliance record reason if the tax for which the penalty was imposed is a tax for which both spouses are jointly liable. Thus, for spouses who file a joint individual income tax return, both spouses must meet the conditions.

Sometimes a taxpayer is individually liable for one tax, such as sales and use tax, and is jointly liable for another tax, such as individual income tax. For these taxpayers, their compliance record for both their individual liabilities and their joint liabilities must be considered. A taxpayer who files a sales and use tax return late and is assessed failure to file and failure to pay penalties is not eligible for waiver based on good compliance record if the taxpayer has an outstanding income tax liability arising from a joint return filed with the taxpayer's spouse.

V. Action When Taxpayer Has Good Compliance Record

If a taxpayer meets all of the good compliance record conditions, the taxpayer is eligible for waiver of the penalty in its entirety. The taxpayer is eligible for waiver if, during the "look-back" period, the taxpayer has not received a 100% penalty waiver based on a good compliance record for that tax type.

VI. Penalties Grouped for Waiver Under General Waiver Criteria

All penalties that are subject to the general waiver criteria and are assessed for the same filing period are treated as one for purposes of applying the good compliance record reason. Thus, if a taxpayer is assessed failure to file, failure to pay, and the 25% large tax deficiency penalty for the same period and the taxpayer has a good compliance record, all three of these penalties would be waived and the waiver of the three would count as one waiver.

The filing period for a tax is the period covered by a return or payment, whichever is shorter, except for audits. For an accelerated withholding taxpayer, for example, a filing period is the period covered by a payment rather than the period covered by the quarterly return.

The period of an audit is treated as one filing period, regardless of the number of separate filing periods that occurred during the period of the audit and regardless of whether there are delinquent filing periods in the audit period. Thus, if a sales tax audit that covers a three-year period includes three monthly filing periods for which the taxpayer did not file a return, the three delinquent monthly periods are considered to be part of the one audit period.

If an audit covers more than one tax type, each tax type is a different filing period, with two exceptions. The first exception is for corporate income and franchise taxes. In an audit, corporate income and franchise taxes are treated as one tax type. The second exception is for State sales and use tax, local sales and use tax, and the Mecklenburg public transportation sales and use tax. These three taxes are treated as one tax type for purposes of penalty waivers.

Period grouping is also applicable to taxpayers who voluntarily file original or amended returns for more than one period at the same time. If the taxpayer has been contacted by the Department of Revenue about the tax type, then period grouping does not apply.

VII. Request to Waive Penalties

A taxpayer may request a waiver of penalties in any of the following three ways:

- Submitting Form NC-5500, Request to Waive Penalties
- Writing a letter
- Calling the Department, in limited circumstances

[Form NC-5500](#): This form, *Request to Waive Penalties*, has been developed for use in administering penalty waiver requests. The form is available by calling our toll-free taxpayer assistance line at 1-877-252-3052 and selecting the menu option for Forms, from any Department of Revenue field office or by accessing the Department's website at <http://www.dornrc.com/downloads/NC5500.pdf>. A taxpayer who completes Form NC-5500 must sign the form before it can be processed.

Letter: A taxpayer may write a letter instead of completing Form NC-5500; however, the letter must contain the same information that is requested on Form NC-5500. The Department can process a request submitted on Form NC-5500 faster than it can process the same request submitted in a letter.

Phone Call: When the request is based on the reason of good compliance record, a request to waive a penalty can be made by telephone.

A request to waive a penalty is not a request for an administrative review. It therefore does not extend or otherwise affect the requirement that a taxpayer who wants to contest an assessment must make a written request for review or for additional information within 45 days after the date of the assessment.

VIII. Grant or Denial of Request to Waive Penalties

If the Department grants a request for waiver of a penalty, the Department informs the taxpayer of this action either through an amended assessment notice, refund with explanation, or a letter. If the Department denies a request for waiver of a penalty, the Department sends the taxpayer a letter of denial.

A taxpayer may request a review of the denial of a request to waive a penalty. A request for review must be in writing and must explain why the taxpayer's request to waive the penalty should have been granted. A request for review should be sent to the address on the letter of denial.

IX. Penalty Statutes

The text of the penalty statute G.S. 105-236, which sets out the failure to pay, failure to file, negligence, large tax deficiency, and several other penalties, is set out below.

G.S.105-236: Penalties.

Penalties assessed by the Secretary under this Subchapter are assessed as an additional tax. The clear proceeds of any civil penalties levied pursuant to subdivisions (3), (4), (5)a, and (6) of this section shall be remitted to the Civil Penalty and Forfeiture Fund in accordance with G.S. 115C-457.2. Except as otherwise provided by law, and subject to the provisions of G.S. 105-237, the following penalties shall be applicable:

(1) Penalty for Bad Checks. – When the bank upon which any uncertified check tendered to the Department of Revenue in payment of any obligation due to the Department returns the check because of insufficient funds or the nonexistence of an account of the drawer, the Secretary shall assess a penalty equal to ten percent (10%) of the check, subject to a minimum of one dollar (\$1.00) and a maximum of one thousand dollars (\$1,000). This penalty does not apply if the Secretary finds that, when the check was presented for payment, the drawer of the check had sufficient funds in an account at a financial institution in this State to pay the check and, by inadvertence, the drawer of the check failed to draw the check on the account that had sufficient funds.

(1a) Penalty for Bad Electronic Funds Transfer. – When an electronic funds transfer cannot be completed due to insufficient funds or the nonexistence of an account of the transferor, the Secretary shall assess a penalty equal to ten percent (10%) of the amount of the transfer, subject to a minimum of one dollar (\$1.00) and a maximum of one thousand dollars (\$1,000). This penalty may be waived by the Secretary in accordance with G.S. 105-237.

(lb) Making Payment in Wrong Form. – For making a payment of tax in a form other than the form required by the Secretary pursuant to G.S. 105-241(a), the Secretary shall assess a penalty equal to five percent (5%) of the amount of the tax, subject to a minimum of one dollar (\$1.00) and a maximum of one thousand dollars (\$1,000). This penalty may be waived by the Secretary in accordance with G.S. 105-237.

(2) Failure to Obtain a License. – For failure to obtain a license before engaging in a business, trade or profession for which a license is required, the Secretary shall assess a penalty equal to five percent (5%) of the amount prescribed for the license per month or fraction thereof until paid, not to exceed twenty-five percent (25%) of the amount so prescribed, but in any event shall not be less than five dollars (\$5.00). In cases in which the taxpayer fails to obtain a license as required under G.S. 105-449.65 or G.S. 105-449.131, the Secretary may assess a penalty of one thousand dollars (\$1,000).

(3) Failure to File Return. – In case of failure to file any return on the date it is due, determined with regard to any extension of time for filing, the Secretary shall assess a penalty equal to five percent (5%) of the amount of the tax if the failure is for not more than one month, with an additional five percent (5%) for each additional month, or fraction thereof, during which the failure continues, not exceeding twenty-five percent (25%) in the aggregate, or five dollars (\$5.00), whichever is the greater.

(4) Failure to Pay Tax When Due. – In the case of failure to pay any tax when due, without intent to evade the tax, the Secretary shall assess a penalty equal to ten percent (10%) of the tax, except that the penalty shall in no event be less than five dollars (\$5.00). This penalty does not apply in any of the following circumstances:

- a. When the amount of tax shown as due on an amended return is paid when the return is filed.
- b. When a tax due but not shown on a return is assessed by the Secretary and is paid within 45 days after the date of the proposed notice of assessment of the tax.

(5) Negligence and large tax deficiency. -

- a. Finding of negligence. – For negligent failure to comply with any of the provisions to which this Article applies, or rules issued pursuant thereto, without intent to defraud, the Secretary shall assess a penalty equal to ten percent (10%) of the deficiency due to the negligence.
- b. Large individual income tax deficiency. – In the case of individual income tax, if a taxpayer understates taxable income, by any means, by an amount equal to twenty-five percent (25%) or more of gross income, the Secretary shall assess a penalty equal to twenty-five percent (25%) of the deficiency. For purposes of this subdivision, "gross income" means gross income as defined in section 61 of the Code.
- c. Other large tax deficiency. – In the case of a tax other than individual income tax, if a taxpayer understates tax liability by twenty-five percent (25%) or more, the Secretary shall assess a penalty equal to twenty-five percent (25%) of the deficiency.
- d. No double penalty. – If a penalty is assessed under subdivision (6) of this section, no additional penalty for negligence or large tax deficiency shall be assessed with respect to the same deficiency.
- e. Inheritance and gift tax deficiencies. – This subdivision does not apply to inheritance, estate, and gift tax deficiencies that are the result of valuation understatements.

(5a) Misuse of Exemptions Certificate. – For misuse of a certificate by a purchaser, the Secretary shall assess a penalty equal to two hundred fifty dollars (\$250.00). An exemption certificate is a certificate issued by the Secretary that authorizes a retailer to sell tangible personal property to the holder of the certificate and either collect tax at a preferential rate or not collect tax on the sale. Examples of an exemption certificate include a certificate of resale, a direct pay certificate, and a farmer's certificate.

(5b) Road Tax Understatement. – If a motor carrier understates its liability for the road tax imposed by Article 36B of this Chapter by twenty-five percent (25%) or more, the Secretary shall assess the motor carrier a penalty in an amount equal to two times the amount of the deficiency.

(6) Fraud. – If there is a deficiency or delinquency in payment of any tax because of fraud with intent to evade the tax, the Secretary shall assess a penalty equal to fifty percent (50%) of the total deficiency.

(7) Attempt to Evade or Defeat Tax. – Any person who willfully attempts, or any person who aids or abets any person to attempt in any manner to evade or defeat a tax or its payment, shall, in addition to other penalties provided by law, be guilty of a Class H felony.

(8) Willful Failure to Collect, Withhold, or Pay Over Tax. – Any person required to collect, withhold, account for, and pay over any tax who willfully fails to collect or truthfully account for and pay over the tax shall, in addition to other penalties provided by law, be guilty of a Class I misdemeanor. Notwithstanding any other provision of law, no prosecution for a violation brought under this subdivision shall be barred before the expiration of six years after the date of the violation.

(9) Willful Failure to File Return, Supply Information, or Pay Tax. – Any person required to pay any tax, to make a return, to keep any records, or to supply any information, who willfully fails to pay the tax, make the return, keep the records, or supply the information, at the time or times required by law, or rules issued pursuant thereto, shall, in addition to other penalties provided by law, be guilty of a Class 1 misdemeanor. Notwithstanding any other provision of law, no prosecution for a violation brought under this subdivision shall be barred before the expiration of six years after the date of the violation.

(9a) Aid or Assistance. – Any person, pursuant to or in connection with the revenue laws, who willfully aids, assists in, procures, counsels, or advises the preparation, presentation, or filing of a return, affidavit, claim, or any other document that the person knows is fraudulent or false as to any material matter, whether or not the falsity or fraud is with the knowledge or consent of the person authorized or required to present or file the return, affidavit, claim, or other document, is guilty of a felony as follows:

- a. If the person who commits an offense under this subdivision is an income tax return preparer and the amount of all taxes fraudulently evaded on returns

filed in one taxable year is one hundred thousand dollars (\$100,000) or more, the person is guilty of a Class C felony.

- b. If the person who commits an offense under this subdivision is an income tax return preparer and the amount of all taxes fraudulently evaded on returns filed in one taxable year is less than one hundred thousand dollars (\$100,000), the person is guilty of a Class F felony.
- c. If the person who commits an offense under this subdivision is not covered under sub-subdivision a. or b. of this subdivision, the person is guilty of a Class H felony.

(10) Failure to File Informational Returns. –

- a. Repealed by Session Laws 1998-212, s. 29A.14(m), effective January 1, 1999.
- b. The Secretary may request a person who fails to file timely statements of payment to another person with respect to wages, dividends, rents, or interest paid to that person to file the statements by a certain date. If the payer fails to file the statements by that date, the amounts claimed on the payer's income tax return as deductions for salaries and wages, or rents or interest shall be disallowed to the extent that the payer failed to comply with the Secretary's request with respect to the statements.
- c. For failure to file an informational return required by Article 36C or 36D of this Chapter by the date the return is due, there shall be assessed a penalty of fifty dollars (\$50.00).

(10a) Filing a Frivolous Return. – If a taxpayer files a frivolous return under Part 2 of Article 4 of this Chapter, the Secretary shall assess a penalty in the amount of up to five hundred dollars (\$500.00). A frivolous return is a return that meets both of the following requirements:

- a. It fails to provide sufficient information to permit a determination that the return is correct or contains information which positively indicates the return is incorrect, and
- b. It evidences an intention to delay, impede or negate the revenue laws of this State or purports to adopt a position that is lacking in seriousness.

(10b) Misrepresentation Concerning Payment. – A person who receives money from a taxpayer with the understanding that the money is to be remitted to the Secretary for application to the taxpayer's tax liability and who willfully fails to remit the money to the Secretary is guilty of a Class F felony.

(11) Any violation of Subchapter I, V, or VIII of this Chapter or of Article 3 of Chapter 119 of the General Statutes is considered an act committed in part at the office of the Secretary in Raleigh. The certificate of the Secretary that a tax has not been paid, a return has not been filed, or information has not been supplied, as required by law, is prima facie evidence that the tax has not been paid, the return has not been filed, or the information has not been supplied.

(12) Repealed by Session Laws 1991, c. 45, s. 27. (1939, c. 158, s. 907; 1953, c. 1302, s. 7; 1959, c. 1259, s. 8; 1963, c. 1169, s. 6; 1967, c. 1110, s. 9; 1973, c. 476, s. 193; c. 1287, s. 13; 1979, c. 156, s. 2; 1985, c. 114, s. 11; 1985 (Reg. Sess., 1986), c. 983; 1987 (Reg. Sess., 1988), c. 1076; 1989, c. 557, ss. 7 to 10; 1989 (Reg. Sess., 1990), c. 1005, s. 9; 1991, c. 45, s. 27; 1991 (Reg. Sess., 1992), c. 914, s. 2; c. 1007, s. 10; 1993, c. 354, s. 22; c. 450, s. 10; c. 539, ss. 709, 710, 1292, 1293; 1994, Ex. Sess., c. 24, s. 14(c); 1995, c. 390, s. 36; 1995 (Reg. Sess., 1996), c. 646, s. 10; c. 647, s. 51; c. 696, s. 1; 1997-6, s. 8; 1997-109, s. 3; 1998-178, ss. 1, 2; 1998-212, s. 29A.14(m); 1999-415, ss. 2, 3; 1999-438, ss. 15, 16; 2000-119, s. 2; 2000-120, s. 7; 2000-140, s. 70; 2002-106, ss. 2, 4; 2005-276, s. 6.37(n); 2005-435, s. 1.)