Penalty Waiver Policy

(Effective March 1, 2018)

North Carolina Department of Revenue

I. Introduction

The North Carolina General Statutes require the North Carolina Department of Revenue to impose certain civil penalties on taxpayers who do not comply with the tax statutes and give the Secretary of Revenue the authority to waive or reduce all of these penalties. This document describes the penalty waiver policy of the Department of Revenue. It applies to requests for waiver of civil penalties considered by the Department on or after March 1, 2018 and supersedes all prior documents. It does not apply to any Department of Revenue compliance program or initiative which includes terms for the full or partial waiver of penalties for participants, except to the extent described in the program or initiative.

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.

NOTE: *A request to waive a penalty is not a request for review. Therefore, it does not extend or otherwise affect the requirement that a taxpayer who wants to contest a proposed assessment must make a written request for review within 45 days after the date of the proposed assessment.*

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(a)(3)
Failure to Pay	105-236(a)(4)
10% Negligence	105-236(a)(5)a
25% Individual Income Tax Deficiency	105-236(a)(5)b
25% Other Large Tax Deficiency	105-236(a)(5)c

III. Waiver Criteria

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

- General Waiver Criteria
    - Automatic Reasons
    - Good Compliance
- Special Circumstances

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

Exceptions to General Waiver Criteria

- The failure to pay penalty on trust taxes withheld or collected and not remitted, such as sales and withholding taxes.

- Penalties assessed for taxes that are not reported at regularly recurring intervals. Examples of taxes that are not reported at regularly recurring intervals include inheritance, estate, gift, and the unauthorized substances taxes.[1] The good compliance 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 reason.

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 reason. Waiver of a penalty based on the category of special circumstances is the exception rather than the rule.

IV. General Waiver Criteria

A. Automatic Reasons under General Waiver Criteria

The 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.

Automatic Reasons	Periods Subject to Waiver
Death of the taxpayer, the taxpayer's immediate family member, or the taxpayer's tax preparer	Returns and payments due within 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	Returns and payments due within 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, returns and payments due within three months from the date of the disaster or accident

[1] North Carolina's inheritance tax, gift tax, and estate tax have all been repealed. However, this policy still applies to any of those taxes due prior to their repeal.

An immediate family member is any of the following:

- A parent, a child, or a spouse. This applies whether or not the individual lives in the same household as the taxpayer. A parent includes a stepparent and a child includes a stepchild, a foster child, or an adopted child.

- Any other individual who lives in the same household as the taxpayer, whether or not he or she is related to the taxpayer.

For some penalties, automatic reasons are unlikely to be the cause of the action by the taxpayer that resulted in the assessment of the penalty (for example, bad check or funds transfer penalty, civil fraud penalty and misuse of an exemption certificate).

B. Good Compliance Reason under General Waiver Criteria

The good compliance reason allows every taxpayer one penalty waiver for most tax types every three years. Its purpose is to recognize that everyone makes mistakes and sometimes has difficulty complying with the tax statutes.

The good compliance reason applies to many, but not all, of the penalties assessed by the Department. Whether or not this reason applies to a penalty depends on two factors. The first factor is the type of tax for which the penalty is imposed and the second factor is the type of penalty.

The good compliance reason does not apply to any penalties imposed for taxes that are not reported at regularly recurring intervals. The taxes that are not reported at regularly recurring intervals consist of inheritance, gift, estate, and unauthorized substances taxes[2]. The good compliance reason does not apply to penalties imposed for these taxes because these taxes by their nature lack the compliance history on which the good compliance reason is based.

The good compliance reason does not apply to some penalties because of the nature of the penalty. The penalties that are not subject to the good compliance reason include

[2] North Carolina's inheritance tax, gift tax, and estate tax have all been repealed. However, this policy still applies to any of those taxes due prior to their repeal.

the bad check penalty, the penalty for a bad electronic funds transfer, the civil fraud penalty, the frivolous return penalty, the penalty for providing an unreasonable withholding certificate, and the penalty for misuse of an exemption certificate. **The failure to pay penalty is not subject to good compliance reason if the taxpayer collected but failed to remit trust taxes such as sales or withholding taxes.** The following chart lists the penalties that are subject to the good compliance reason. If a penalty is not listed in this chart, it cannot be waived on the basis of the taxpayer's good compliance.

Penalties Subject to Good Compliance	General Statute
Tax paid in wrong form, such as paid by check when required to be paid by EFT	105-236(a)(1b)
License not obtained before engaging in business	105-236(a)(2)
Failure to File (FTF) for all taxes, except those not reported at regularly recurring intervals	105-236(a)(3)
Failure to Pay (FTP) for all taxes, except trust taxes collected but not remitted and those not reported at regularly recurring intervals	105-236(a)(4)
10% Negligence for all taxes, except those not reported at regularly recurring intervals	105-236(a)(5)a
25% Large Tax Deficiency for individual income tax	105-236(a)(5)b
25% Large Tax Deficiency for taxes other than individual income, except those taxes not reported at regularly recurring intervals	105-236(a)(5)c
200% Understatement of Road Tax Liability	105-236(a)(5b)
Failure to file informational return required by Article 36C (Gasoline, Diesel, and Blends) or Article 36D (Alternative Fuel)	105-236(a)(10)c.
Motor carrier does not file road tax return when due	105-449.45(d)
Motor Fuel taxpayer fails to obtain a license	105-236(a)(2)
Failure to file informational return required by Article 4A (Withholding)	105-236(a)(10)c.
Motor Carrier fails to carry registration card or fails to display a decal	105-449.52(a)(1)
Motor Carrier unable to account for a decal	105-449.52(a)(2)
Motor Carrier decal unlawfully obtained	105-449.52(a)(3)
Failure to file informational return required by G.S. 105-251.2(c) (Payment Settlement Entities)	105-251.2(d)

Good compliance is the one conditional reason within the category of general waiver criteria. It is a conditional reason because the taxpayer must meet five conditions to qualify for a waiver under this reason.

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

(1) No Prior Waivers: The taxpayer has not received a penalty waiver for that tax type based on good compliance during the "look-back" period. The "look-back" period is a three-year period that consists of the taxpayer's most recent waiver history. It ends on the date a request for penalty waiver is being considered by the Department. A waiver during the “look-back” period based on an automatic reason or on special circumstances are inconsequential when reviewing the “look-back” period. An abatement of a penalty during the “look-back” period is also inconsequential. A penalty is abated when it was imposed in error.

(2) No Tax Returns Due: The taxpayer must have filed all tax returns due. This condition is not limited to the three year “look-back” period or the tax type.

(3) 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 final bill 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 request for review or litigation are inconsequential as it relates to the lookback period. These liabilities are in dispute and should not be part of the consideration. However, to receive a penalty waiver for a liability that is the subject of a review, the taxpayer must first pay the tax, interest, and any penalty that is not waivable. This condition is not limited to the “look-back” period or the tax type.

(4) Not Same Mistake: The error or practice that resulted in the assessment of 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) Provided All Requested Documentation: The taxpayer must have provided all available information requested by Department personnel with respect to the assessment of the liability for which the penalty was assessed.

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 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 if the taxpayer has an outstanding income tax liability arising from a joint return filed with the taxpayer's spouse.

V. Action When Taxpayer Qualifies for Good Compliance

If a taxpayer meets all of the good compliance conditions, the taxpayer is eligible for waiver of the penalty in its entirety except as otherwise noted in this policy.

VI. Penalties Grouped for Waiver under Good Compliance

All penalties that are subject to good compliance and are assessed for the same filing period and tax type are treated as one for purposes of applying the good compliance reason. For example, if an individual income 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, 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 a semiweekly withholding taxpayer, for example, a filing period is the period covered by a payment rather than the period covered by the quarterly return.

An audit period is treated as one filing period, regardless of the number of separate 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 considered separately, 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, local, and the Public Transportation Sales and Use taxes. These three taxes are treated as one tax type for purposes of penalty waivers.

Original or amended returns voluntarily filed for multiple periods at the same time are considered as one filing period.

VII. Request to Waive Penalties

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

- Submit Form NC-5500, Request to Waive Penalties
- Write a letter
- Call the Department, in limited circumstances

Form NC-5500: This form, *Request to Waive Penalties*, should be used to request a penalty waiver. The form is available on the Department's website, www.ncdor.gov, by calling our toll-free taxpayer assistance line at 1-877-252-3052, or from any Department of Revenue service center. A taxpayer who completes Form NC-5500 must sign the form before it can be processed.

Letter: A taxpayer may submit a letter instead of Form NC-5500; however, the letter must contain the same information that is requested on Form NC-5500. The Department prefers a request be submitted on Form NC-5500 to ensure faster processing.

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

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 request for waiver of a penalty by telephone may be denied during the call; however, a letter of explanation will not be issued as the request was not received in writing.

A taxpayer may request a reconsideration of the denial of a request to waive a penalty. A request for reconsideration of a denial of penalty waiver must be filed within 30 days of the date of denial, must be in writing, and must explain why the taxpayer's request to waive the penalty should have been granted. A request for reconsideration should be sent to the North Carolina Department of Revenue, Customer Service, P.O. Box 1168, Raleigh, NC 27602-1168.

IX. Statute of Limitations for Refunds of Previously Paid Penalties That Are Waived

An overpayment created by the waiver of a previously paid penalty may only be refunded if the penalty waiver request was made within the statute of limitations for refunds in G.S. 105-241.6. Generally, the request for penalty waiver must have been made within the later of (1) three years after the due date of the return with respect to which the penalty was assessed, or (2) two years after payment of the penalty.