

**OFFICE OF TAX APPEALS
STATE OF CALIFORNIA**

In the Matter of the Appeal of:) OTA Case No. 18010671
)
TAG MARKETING, INC.) Date Issued: July 18, 2018
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)
_____)

OPINION

Representing the Parties:

For Appellant: Bottaini, Gallucci & O’Hanlon, P.C.¹

For Respondent: Eric A. Yadao, Tax Counsel III

For Office of Tax Appeals: Neha Garner, Tax Counsel III

HOSEY, Administrative Law Judge: Pursuant to California Revenue and Taxation Code section (Section) 19324,² Tag Marketing, Inc. (appellant) appeals an action by the Franchise Tax Board (FTB or respondent) in denying appellant’s claim for refund for the 2014 tax year.³

Appellant waived its right to an oral hearing and therefore the matter is being decided based on the written record.

ISSUES

1. Is appellant liable for the Section 19131 late-filing penalty?
2. Is appellant liable for the Section 19172.5 S corporation late-filing penalty?

¹ The signature of the individual signing for the firm is not legible.

² Unless otherwise indicated, all “Section” references are to sections of the California Revenue and Taxation Code.

³ Appellant’s refund claim requested a refund of “delinquent penalties” but does not state the specific refund amount claimed or the specific penalties for which a refund was claimed. The penalties imposed were a Section 19131 late-filing penalty of \$200.00, a Section 19172.5 S corporation late-filing penalty of \$216.00, a Section 19133 demand penalty of \$200.00, and a Section 19142 underpayment of estimated tax penalty of \$21.96. In addition, a filing enforcement cost recovery fee of \$100.00 was imposed. It appears appellant only seeks abatement of the late-filing penalties, however, to ensure we address all the issues, we address all of the penalties imposed, as well as the filing enforcement cost recovery fee.

3. Is appellant liable for the Section 19133 demand penalty?
4. Is appellant liable for the Section 19142 underpayment of estimated tax penalty?
5. Is appellant liable for the filing enforcement cost recovery fee?

FACTUAL FINDINGS

1. Appellant failed to file its 2014 California income tax return by the due date of March 15, 2015. On June 3, 2016, respondent mailed a Demand for Tax Return (Demand) to appellant advising appellant to respond no later than July 6, 2016, by either filing a 2014 return, providing a copy of a return already filed, or explaining why a 2014 return was not required. The Demand stated that respondent received information from Certified Collision Group, LLC (CCG) indicating that appellant was a member thereof, received California source income, and was required to file a return. The Demand further stated that a late-filed return would result in late-filing penalties and that the failure to timely respond to the Demand would result in a demand penalty.
2. CCG registered to do business in California in 2014. Appellant was one of four members holding equal 25 percent interests in CCG. All of CCG's members were able to manage the LLC. CCG filed a Certificate of Conversion with the California Secretary of State (SOS) to convert CCG to a Nevada LLC in August 2017. Appellant's officer, Thomas Adams, signed the form as a manager of CCG.
3. Appellant did not respond to respondent's Demand by the July 6, 2016 deadline for a response.
4. As respondent had not received a response to the Demand, respondent issued a Notice of Proposed Assessment (NPA) on July 29, 2016. The NPA proposed an assessment of the minimum tax of \$800, a late-filing penalty of \$200, a demand penalty of \$200, and a filing enforcement fee of \$100, plus interest.
5. On August 30, 2016, appellant filed its 2014 tax return, reporting the minimum tax due of \$800, plus an additional amount of \$22 (for either interest or a self-assessed estimated tax penalty), and paid the \$822 total amount shown as due on the return. Appellant listed one shareholder in the S corporation during the year, and Thomas Adams signed as appellant's president. Appellant indicated that it began doing business in California or receiving income from a California source on June 20, 2014.

6. Respondent processed the return and issued a Notice of Balance Due dated December 16, 2016, for the penalties set forth in the NPA. On December 22, 2016, appellant requested a waiver of the balance due, stating appellant was not aware it was required to file a return. Respondent advised appellant to pay the balance due no later than January 3, 2017, and stated that appellant could file a claim for refund requesting a waiver of the penalties upon a showing of reasonable cause. The balance was not paid, and, on January 27, 2017, respondent issued a Corporation Past Due Notice demanding appellant pay the balance owed in full immediately. The notice further stated that, if the balance owed was not fully paid by February 11, 2017, respondent might initiate collection action and charge additional interest and penalties.
7. Also on January 27, 2017, appellant's accounting firm sent a letter requesting "reasonable cause abatement of delinquent penalties." The letter stated that CCG, a limited liability company (LLC) only began operating in June of 2014, and that appellant was not aware that its investment in CCG required appellant to file a California return. Appellant also stated that it did not recall receiving a Schedule K-1 from CCG for 2014. The letter contends that there was reasonable cause for the late filing of appellant's return because, once appellant became aware of the filing requirement, it promptly filed.
8. On February 6, 2017, appellant's accounting firm remitted a check for \$770 to cover the balance due. In addition, the firm requested a refund of the delinquency penalties on the basis of reasonable cause.
9. On March 24, 2017, respondent denied appellant's claim for refund, stating that appellant had not shown reasonable cause for failing to timely file its return and pay tax.
10. On June 21, 2107, appellant timely appealed.

DISCUSSION

Issues 1 & 2 – Is appellant liable for the Section 19131 late-filing penalty and the Section 19172.5 S corporation late-filing penalty?

An S corporation is required to file its tax return on or before the 15th day of the third month, or on or before the extended due date of the 15th day of the tenth month following the close of the tax year. (§ 18601.) Here, appellant's 2014 return was due no later than March 15, 2015 (without extension), or October 15, 2015 (under the extended due date). Appellant filed its

2014 return on August 30, 2016. As such, appellant's 2014 California return was filed late.

A late-filing penalty will be imposed under Section 19131 when a taxpayer fails to file a tax return on or before its due date, unless the taxpayer establishes that the late filing was due to reasonable cause and was not due to willful neglect. The late-filing penalty under Section 19131 is calculated as five percent of the tax due for each month that a tax return is not filed after it is due (determined without regard to any extension of time for filing the return), not to exceed 25 percent of the tax. (§ 19131(a).) Here, appellant filed its 2014 return on August 30, 2016, more than 17 months late. The penalty was properly calculated at the maximum rate of 25 percent of the total tax due of \$800, totaling \$200.

With regard to the S corporation late-filing penalty imposed under Section 19172.5, if any S corporation fails to timely file a return, then the S corporation will be liable for a per shareholder penalty unless that failure is due to reasonable cause. The amount of the penalty under Section 19172.5 is calculated as \$18 multiplied by the number of S corporation shareholders multiplied by the number of months the return is late, up to 12 months. (§ 19172.5(b).) Here, appellant's return was filed over 17 months late and there was one shareholder in the S corporation. Based on the foregoing, the late-filing penalty under Section 19172.5 was properly calculated and imposed in the amount of \$216 (i.e., \$18 x 12 months x 1 shareholder = \$216).

To establish reasonable cause for failing to file a timely return, a taxpayer must show that the failure occurred "despite the exercise of ordinary business care and prudence, or that cause existed as would prompt an ordinary intelligent and prudent businessman to have so acted under similar circumstances." (*Appeal of Howard G. and Mary Tons*, 79-SBE-027, Jan. 9, 1979.)⁴ The burden is on the taxpayer to prove that the difficulties experienced prevented the taxpayer from filing a timely return. (*Appeal of David and Marilee Duff*, 2001-SBE-007, Dec. 20, 2001.) Ignorance of the law does not excuse a taxpayer's failure to comply with statutory requirements. (*Appeal of Diebold, Inc.*, 83-SBE-002, Jan. 3, 1983.)

⁴The Office of Tax Appeals (OTA) is the successor-in-interest to the California State Board of Equalization (BOE) with regard to income tax appeals. Therefore, precedential BOE opinions that were adopted prior to January 1, 2018, may be cited as precedential authority to OTA. (Cal. Code Regs., tit. 18, § 30501(d)(3).) BOE's precedential decisions, designated by "SBE," may be found on the BOE's website: www.boe.ca.gov/legal/legalopcont.htm.

Here, appellant contends that it was only an investor in CCG and that it had been in contact with CCG and was told that the business was not active in 2014. Appellant also contends that its belief that CCG was inactive in 2014 was confirmed by the fact that it did not receive a Schedule K-1 from CCG for that year.

However, appellant has not offered any documentary evidence to back up its allegations. Moreover, the evidence in this case contradicts appellant's position by indicating that appellant was a managing member of CCG and should have known, or been able to ascertain, that CCG had commenced operations in California in 2014. When CCG originally formed as a California LLC in June of 2014, appellant was one of four members holding equal 25 percent interests in CCG. The Articles of Organization CCG filed with the SOS indicated that all of CCG's members would manage the LLC.⁵ This evidence supports the conclusion that appellant was involved in the management and affairs of CCG and knew or should have known that CCG was conducting business in California during 2014. If appellant did not receive a Schedule K-1, as it claims on appeal, appellant should have made inquiries to CCG prior to the filing deadline to determine its filing obligations, and there is no evidence that it took any such action. Therefore, appellant has failed to establish reasonable cause for late filing.

Issue 3 - Is appellant liable for the demand penalty?

California imposes a penalty against a taxpayer for failing to file a return or provide information after an FTB demand to do so, unless the failure to do so was attributable to reasonable cause and not to willful neglect. (§ 19133.) To establish reasonable cause, a taxpayer must show that the failure to respond occurred despite the exercise of ordinary business care. (*Appeal of Stephen C. Bieneman*, 82-SBE-148, Jul. 26, 1982.) A taxpayer's reason for failing to respond must be such that an ordinarily intelligent and prudent businessperson would have acted similarly under the circumstances. (*Appeal of Elmer R. and Barbara Malakoff*, 83-SBE-140, Jun. 21, 1983.) The demand penalty is 25 percent of the total tax, determined without regard to payments and withholding credits.

Here, the demand penalty was properly imposed as appellant failed to timely respond to the Demand, and it was properly calculated as \$200 (i.e., 25 percent of the \$800 tax liability).

⁵ We also note that when CCG converted from a California LLC to a Nevada LLC in 2017, appellant's officer, Thomas Adams, signed the Certificate of Conversion filed with the SOS on behalf of CCG, as CCG's manager.

Therefore, the only issue is whether appellant has demonstrated that its failure to timely respond to the Demand was attributable to reasonable cause and not willful neglect. The Demand asked appellant file a return, provide a copy of an already filed return, *or explain why no return for 2014 was required*. As discussed above, appellant states on appeal that it did not receive a Schedule K-1 and believed it did not have a filing requirement for 2014. Even if appellant was under the impression that it did not have a filing requirement, an ordinarily intelligent and prudent businessperson would have responded to the Demand by providing the requested explanation of the basis for appellant's belief that no return was required. Yet appellant failed to do that. Therefore, appellant has not established that its failure to respond to the Demand was due to reasonable cause and not willful neglect. Accordingly, we have no basis for abating the penalty.

Issue 4- Is appellant liable for the underpayment of estimated tax penalty?

A corporation subject to the franchise tax imposed by Part 11 of the Revenue and Taxation Code must file a declaration of estimated tax and pay the estimated tax for each year. (§§ 19023 & 19025.) If the amount of estimated tax does not exceed the minimum franchise tax, the entire amount of the estimated tax shall be due and payable on or before the fifteenth day of the fourth month of the taxable year. (§ 19025(a).) A corporation that underpays its estimated tax is liable for an addition to tax (i.e., a penalty) equal to a specified rate of interest applied to the amount of the underpayment. (§§ 19142, 19144.) The underpayment of estimated tax penalty is properly imposed where the taxpayer's installment payments are less than the amounts due at the end of the installment periods. (*Appeal of Bechtel, Inc.*, 78-SBE-052, Jul. 26, 1978.) There is no general reasonable cause exception to the penalty. (*Appeal of Weaver Equipment Co.*, 80-SBE-048, May 21, 1980.) There are a few limited statutory exceptions to the penalty, but there is no argument or evidence that any of these exceptions apply. (See § 19147.) Appellant did not make any timely estimated payments. Therefore, the estimated tax penalty was properly imposed.

Issue 5- Is appellant liable for the filing enforcement cost recovery fee?

Section 19254(a)(2) provides that the FTB shall impose a filing enforcement cost recovery fee if a person fails or refuses to make and file a tax return within 25 days after a formal legal demand to file a tax return has been mailed to that person by the FTB. Appellant does not

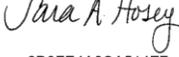
appear to dispute the amount of the fee, which is set by the Legislature. (§ 19254(b).) The FTB has no authority to waive or modify this fee and appellant has not shown that the fee was for any reason invalid or improper. Accordingly, we uphold the FTB’s imposition of the filing enforcement cost recovery fee.

HOLDINGS

1. Appellant is liable for the Section 19131 late-filing penalty.
2. Appellant is liable for the Section 19172.5 S corporation late-filing penalty.
3. Appellant is liable for the demand penalty.
4. Appellant is liable for the estimated tax penalty.
5. Appellant is liable for the filing enforcement cost recovery fee.

DISPOSITION

Respondent’s action in denying appellant’s claim for refund is sustained in full.

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 Sara A. Hosey
 Administrative Law Judge

We concur:

DocuSigned by:

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 Andrew J. Kwee
 Administrative Law Judge

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 Grant S. Thompson
 Administrative Law Judge