

**OFFICE OF TAX APPEALS
STATE OF CALIFORNIA**

In the Matter of the Appeal of:) OTA Case No. 18011005
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J. CHU-HSIANG CHI, M.D. INC.) Date Issued: July 30, 2018
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OPINION

Representing the Parties:

For Appellant: Michael S. Sy, Tax Preparer

For Respondent: Samantha Q. Nguyen, Tax Counsel

KWEE, Administrative Law Judge: Pursuant to Revenue and Taxation Code (RTC) section 19324,¹ J. Chu-Hsiang Chi, M.D. Inc. (appellant) appeals an action by the Franchise Tax Board (FTB or respondent) in denying appellant’s claim for refund in the amount of \$881.53 for the 2012 tax year. This matter is being decided based on the written record because appellant waived its right to an oral hearing.

ISSUES

Did appellant establish a basis for abatement of the: (1) S corporation late-filing penalty; (2) demand penalty; (3) collection cost recovery fee; (4) filing enforcement cost recovery fee; or (5) accrued interest?

FACTUAL FINDINGS

1. On or about April 15, 2012, appellant timely mailed a check payable to FTB in the amount of \$800, as an estimated tax payment for the 2012 tax year. FTB accepted and applied the payment towards appellant’s 2012 tax liability with an effective date of April 15, 2012.

¹ Unless otherwise indicated, all statutory references are to sections of the Revenue and Taxation Code.

2. The following year, appellant hired a paid tax preparer, Mr. Michael Sy, to prepare and electronically file its 2012 California S Corporation Franchise or Income Tax Return, Form 100S.
3. On or about April 5, 2013, appellant's tax preparer attempted to electronically file appellant's 2012 tax return using return preparation and filing software developed by TaxWorks, Inc. and Redgear Technologies, Inc. Due to issues with the software, appellant's tax return was not filed with FTB at this time.
4. In 2014, a group of tax professionals filed a class action lawsuit against the software developer, alleging that the "professional tax return preparation software for the 2012 tax year was not fit for its intended use." The lawsuit resulted in a class action settlement. Appellant's tax preparer was a member of the settlement class covered by the settlement, and he filed a claim for damages against the software developer on December 23, 2015.
5. FTB first contacted appellant regarding the non-filing via a Demand for Tax Return (Demand) dated November 13, 2015. The Demand notified appellant that FTB had no record of having received a 2012 tax return from appellant, and asked appellant to either file a tax return or provide a copy of its tax return if one already had been filed. The Demand also notified appellant that failing to respond by December 16, 2015, would result in imposition of a 25-percent penalty (demand penalty). Appellant failed to timely respond to the Demand.
6. Two months later, on January 15, 2016, FTB issued a Notice of Proposed Assessment (NPA) for \$6,520.53 in additional tax, plus a late-filing penalty under section 19131, a demand penalty under section 19133, an S corporation late-filing penalty under section 19172.5, and a filing enforcement cost recovery fee under section 19254(a)(2).² In response to the NPA, appellant's president, J. Chu-Hsiang Chi, submitted a copy of her personal income tax return for 2012.
7. Subsequently, on February 8, 2016, appellant's president submitted a signed statement that appellant had previously filed the required tax return for 2012, and further stating that she was attaching a copy of that return. Appellant's president signed the attached tax return by hand, and there is no date next to her signature. Appellant's tax preparer, Mr. Michael Sy, also signed the return by hand and dated his signature April 5, 2013. The tax

²The additional proposed tax and the section 19131 late-filing penalty are not at issue in this appeal.

return does not include an electronic file date stamp on the top left corner.³ The tax return reports that appellant was subject to the \$800 minimum franchise tax, and that appellant had made an estimated tax payment of \$800. In connection with the appeal, appellant also provided a copy of a check it had paid to FTB in the amount of \$800, dated April 15, 2012, with the memo “Corp Est. Tax 2012.” This estimated tax payment for 2012 was paid with appellant’s 2011 tax return.

8. Appellant’s 2012 tax return was late-filed on February 8, 2016. This was the first time FTB received appellant’s 2012 tax return.
9. FTB accepted appellant’s 2012 tax return, as filed, on February 8, 2016. Thereafter, on July 15, 2016, FTB issued a Past Due Notice to appellant reflecting a revised balance due of \$511.75, representing a demand penalty of \$200, a late-filing penalty of \$216, a filing enforcement cost recovery fee of \$92, and \$3.75 in accrued interest. The notice informed appellant that failure to pay the balance due may result in imposition of collection fees and collection actions, including a bank levy.
10. On August 31, 2016, FTB issued a “Formal Demand for Payment,” informing appellant, in pertinent part, that failure to pay the liability may result in collection actions, including bank levy, and imposition of collection fees.
11. On October 7, 2016, FTB issued a “Corporation Final Notice before Levy,” notifying appellant that FTB will impose a \$365 collection cost recovery fee if appellant failed to pay the liability. After appellant failed to respond to FTB’s final notice before levy, FTB levied appellant’s bank account in the amount of \$881.53, representing the \$365 collection cost recovery fee, \$200 demand penalty, \$216 late-filing penalty,⁴ \$92 filing enforcement cost recovery fee, and \$8.53 in accrued interest. These are the items and amounts at issue in this appeal.
12. On December 29, 2016, appellant’s tax preparer filed a “Reasonable Cause – Individual and Fiduciary Claim for Refund” in the amount of \$881.53, requesting refund of the items described above, on behalf of appellant. Appellant’s tax preparer contends that he

³ Appellant’s tax preparer later explained that, due to issues with the tax software he used, appellant’s return was not successfully filed with FTB on April 5, 2013.

⁴ This amount represents \$18, multiplied by the number of shareholders (1), multiplied by the number of months late the return was filed as calculated from the original due date, not to exceed 12 months (here, 12 months, covering the period March 15, 2013, through February 8, 2016).

timely filed appellant's 2012 tax return electronically; however, due to a deficiency with his software, the return was not electronically transmitted to FTB. Appellant's tax preparer provided evidence showing that there were issues with the software he had purchased to prepare tax returns for 2012, including a claim form that he submitted in connection with the class action lawsuit against the software developer, and an undated notice that was issued to members of the class regarding the class action settlement.

13. On May 4, 2017, FTB issued a Notice of Action denying appellant's claim for refund on the basis that appellant failed to establish reasonable cause for relief from the penalties and fees.
14. On July 3, 2017, appellant's tax preparer timely filed the instant appeal, contending that appellant timely paid its 2012 tax liability and filed a tax return using the e-filing software; however, delays were caused due to a defect with the software he used to file 2012 tax returns.
15. On December 31, 2017, FTB filed an opening brief, contending that appellant is confusing the \$800 minimum franchise tax with the \$881.53 in penalties and fees imposed by FTB, and conceding that appellant timely paid the \$800 minimum franchise tax for 2012. FTB also contended that appellant was not entitled to abatement of the penalties and fees imposed.

DISCUSSION

The S Corporation late-filing penalty

California imposes a late-filing penalty on an S corporation for the failure to file a return on or before the due date, unless it is shown that the late filing is due to reasonable cause. (§ 19172.5(a).) The amount of the S Corporation late-filing penalty is the product of two multiplication factors. (§ 19172.5(b).) The two factors are: (1) eighteen dollars; and (2) the number of persons who are shareholders in the S corporation during any part of the taxable year. (§ 19172.5(b).) Next, the late-filing penalty amount is increased monthly for each month, or fraction of a month, not to exceed 12 months, during which the S corporation's failure to file a required return continues. (§ 19172.5(b).)

In the case of an S corporation, a return is due on or before the fifteenth day of the third month following the close of the tax year. (§ 18601(d)(1).) Pursuant to section 18604(a), FTB

automatically allows corporations, including S corporations, a seven-month extension of time to file a return. (§ 18604(a); FTB Notice 92-11, Oct. 23, 1992.⁵) An extension is not allowed if a return is not filed within the automatic extension period. (*Ibid.*)

In order to abate a late-filing penalty imposed pursuant to section 19172.5, an S Corporation must establish that its failure to timely file was due to “reasonable cause.” (§ 19172.5(a).) Existing precedential decisions of the Board of Equalization (BOE) discussing penalty abatement only interpret statutory language which requires a taxpayer to establish that two standards are met: (1) that the failure was due to “reasonable cause;” and (2) that the failure was not the result of willful neglect. (See, e.g., *Appeal of Michael E. Myers*, 2001-SBE-001, May 31, 2001[section 19131 late-filing penalty];⁶ *Appeal of M.B. and G.M. Scott*, 82-SBE-249, Oct. 14, 1982 [late payment penalty]; *Appeal of Stephen C. Bieneman*, 82-SBE-148, July 26, 1982 [demand penalty]; *Appeal of Howard G. and Mary Tons*, 1979-SBE-027, Jan. 9, 1979 [late-filing penalty].)⁷ Nevertheless, the definition of “reasonable cause” is a standard one that is applicable to section 19172.5 as well.⁸

In order for a taxpayer to establish that a failure to act was due to reasonable cause, the taxpayer must show that the failure occurred despite the exercise of ordinary business care and prudence, or that cause existed as would prompt an ordinarily intelligent and prudent businessman to have so acted under similar circumstances. (*United States v. Boyle* (1985) 469 U.S. 241, 245-246 (*Boyle*); *Appeal of Stephen C. Bieneman, supra*; *Appeal of Howard G. and Mary Tons, supra*.) Furthermore, an allegation that a taxpayer was unable to timely file a return, in absence of evidence establishing why the taxpayer was unable to timely file, and of the continuity of the taxpayer’s efforts to file the return from the due date until the date the return

⁵ FTB Notice 92-11 discusses application of section 25402, which was subsequently renumbered as section 18604 by Senate Bill 3 (Stats. 1993, ch. 31). FTB Notice 2016-04 (Nov. 4, 2016) supersedes FTB Notice 92-11 for taxable years beginning on or after January 1, 2016, and shortens the automatic extension period to 6 months, for S corporations.

⁶ Here, appellant was not subject to a late-filing penalty under section 19131, because no additional tax was required to be paid on the date prescribed for payment. On the other hand, the section 19172.5 S corporation late-filing penalty applies regardless of whether any tax was required to be paid on the date prescribed for payment.

⁷ Pursuant to California Code of Regulations, title 18, section 30501(d)(3), precedential BOE opinions that were adopted prior to January 1, 2018, may be cited as precedential authority to the Office of Tax Appeals (OTA) unless a panel removes, in whole or in part, the precedential status of the opinion. BOE’s precedential opinions are viewable on BOE’s website: www.boe.ca.gov/legal/legalopcont.htm.

⁸ We do not address willful neglect in this decision because it is not required by section 19172.5.

was late-filed, does not constitute reasonable cause. (*Raymond J. Beran, et. al. v. Commissioner* (1980) T.C. Memo. 1980-119.)

Here, the late-filing penalty imposed under section 19172.5 applies because appellant did not file a 2012 tax return until February 8, 2016, which is almost three years after the March 15, 2013, due date. While appellant established that a software error prevented its tax preparer from timely filing a return on or around April 5, 2013,⁹ appellant provides no supporting documentation to explain how appellant was continually prevented from filing a return from the date of the software error until the time appellant finally filed its 2012 return 35 months later. It is the taxpayer's responsibility to ensure that a return is timely filed. (*Boyle, supra*, 469 U.S. at p. 249.) In this case, it should have been readily apparent at, or within days after, the attempted filing that appellant's tax return had not been electronically transmitted to FTB. Appellant does not provide evidence, such as an electronic transmission log, to indicate why it was reasonable to believe otherwise. Thus, under the facts of this case, we find that it was not reasonable for appellant (or, by delegation, its tax preparer) to fail to verify that a tax return was electronically submitted to FTB, such as by reviewing the electronic transmission log, by reviewing appellant's account history on FTB's website, or otherwise, which could have been done within days after the April 5, 2013 attempted tax filing. The duty to ensure a tax return was timely filed is the responsibility of the taxpayer, and even if appellant had delegated such responsibility to its tax preparer, any such reliance on the tax preparer does not constitute reasonable cause. (*Boyle, supra*, 469 U.S. at p. 250.)

Furthermore, it was not reasonable for appellant to continue to believe it timely filed a return during the 35 months that followed the attempted tax filing. In this regard, we note that the 2012 tax return that appellant provided to FTB on February 8, 2016, did not include an electronic file date stamp, and it was also hand-signed in pen by both appellant and appellant's tax preparer, which would not be the case if the return had been electronically filed. Finally, when FTB ultimately contacted appellant to notify appellant that it failed to file a 2012 tax return, appellant chose to ignore the notice, and appellant offers no explanation or evidence to explain why it was reasonable for appellant to continue to believe that its 2012 tax return had been filed after having received notice from FTB to the contrary. Therefore, we find that

⁹ Although this date is three weeks past the March 15, 2013, due date for an S corporation to file a 2012 tax return, it is still within the automatic seven-month extension of time to file.

appellant has not established reasonable cause as a basis for relief of the S corporation late-filing penalty.

The demand penalty

California imposes a penalty for the failure to file a return upon notice and demand by FTB, unless the failure is due to reasonable cause and not willful neglect. (§ 19133.) The purpose of the demand penalty is to encourage taxpayers to communicate with FTB by penalizing a failure to timely respond to a notice and demand. (See *Appeal of W. L. Bryant*, 83-SBE-180, Aug. 17, 1983; *Appeal of Frank E. and Lilia Z. Hublou*, 77-SBE-102, July 26, 1977.) The demand penalty is 25 percent of the total tax liability as determined or assessed. (§ 19133; Cal. Code Regs., tit. 18, § 19133(a).) With respect to a taxpayer subject to tax under the Corporation Tax Law, there is no requirement that the taxpayer have a prior history of failing to respond to notices from FTB.¹⁰

Here, FTB properly assessed a \$200 demand penalty, equal to 25 percent of the \$800 annual minimum franchise tax required to be reported on the return, because appellant failed to respond to the November 13, 2015 Demand. The Demand notified appellant that a return had not been filed, and that a 25-percent demand penalty would be imposed if appellant failed to respond to the Demand by December 16, 2015. Appellant's only explanation for this failure is that appellant's tax preparer was prevented from electronically filing the tax return on or about April 5, 2013, due to software issues. The software issue occurred almost three years before FTB issued the Demand. FTB assessed the demand penalty in response to appellant's failure to timely respond to the November 13, 2015 Demand; therefore, the tax preparer's failure to electronically file appellant's tax return in 2013 is not a relevant consideration. Instead, the pertinent inquiry is whether reasonable cause prevented appellant from timely responding to the Demand from the December 16, 2015, due date to respond to the Demand, until the date appellant ultimately filed the required tax return, February 8, 2016. Appellant offers no other explanation for failing to respond to the Demand during this timeframe. Therefore, we find that appellant did not establish reasonable cause for failing to timely respond to the Demand.

¹⁰ With respect to a failure to file a personal income tax return, FTB only will impose a demand penalty if both the following conditions are met: (1) the taxpayer fails to timely respond to a Demand for the tax year at issue, and; (2) during the four-taxable-year period preceding the taxable year at issue, FTB issued an NPA after the taxpayer failed to timely respond to a Demand or to a Request for Tax Return. (Cal. Code Regs., tit. 18, § 19133(b).)

The collection cost recovery fee

The RTC provides for imposition of a collection cost recovery fee under tax and fee programs administered by both FTB and the California Department of Tax and Fee Administration (CDTFA). With the exception of section 19254, all of the RTC provisions imposing collection cost recovery fees specifically authorize OTA to abate those fees on the basis of reasonable cause, provided that the taxpayer signs a statement under penalty of perjury setting forth the basis for relief. (§§ 6833, 9035, 11534, 19254, 32390, 38577, 40168, 43449, 45610, 46466, 55211 [which applies to all taxes and fees administered by CDTFA pursuant to the Fee Collections Procedures Law; part 30, of division 2, of the RTC], and 60495.) Section 19254, on the other hand, is unique in that it contains no language authorizing abatement of the fee upon a showing of reasonable cause.

Section 19254(a)(1) provides that FTB shall impose a collection cost recovery fee if a person fails to pay an amount of tax, interest, penalty, or other liability imposed under the Corporation Tax Law or Personal Income Tax Law after FTB has mailed a notice to the person advising the person that continued failure to pay the amount due may result in collection action, including imposition of a collection cost recovery fee. (§ 19254(a)(1).) As previously noted, there is no reasonable cause defense to imposition of the fee; thus, our inquiry is limited to determining whether FTB complied with the statutory notice requirements for imposing the collection cost recovery fee.

Here, FTB provided three separate notices, dated July 15, 2016, August 31, 2016, and October 7, 2016, all of which informed appellant that failure to pay the liability may result in collection action and imposition of a collection cost recovery fee. The collection cost recovery fee was required to be imposed by section 19254 because appellant failed to pay the liability after receiving notice that continued failure to pay the liability may result in imposition of the fee. Therefore, we find that appellant failed to establish a basis to abate the collection cost recovery fee.

The filing enforcement cost recovery fee

FTB is required to impose a filing enforcement cost recovery fee if a person fails to file a tax return required under the Corporation Tax Law or Personal Income Tax Law within 25 days after FTB mails to that person a formal legal demand to file a return. (§ 19254(a)(2).) There is

no exception for reasonable cause. Again, our inquiry is limited to determining whether FTB complied with the statutory notice requirements for imposing the fee. FTB mailed the formal demand to file a return on November 13, 2015, and appellant did not file a return until almost three months later on February 8, 2016. Therefore, FTB satisfied the requirements of section 19324(a)(2) by mailing the Demand, and imposition of a filing enforcement cost recovery fee is mandatory under these facts. We lack authority to grant appellant's request for relief from the filing enforcement cost recovery fee on the basis of a claim of reasonable cause.

Interest abatement

If any amount of tax is not paid by the due date, interest is required to be imposed from the due date until the date the taxes are paid. (§ 19101(a).) Interest also accrues as provided above on any unpaid penalty amount if the penalty is not paid within 15 days of any notice and demand for payment. (§ 19101(c)(2)(A).) Imposition of interest is mandatory and there is no reasonable cause exception to imposition of interest. (*Appeal of Amy M. Yamachi*, 77-SBE-095, June 28, 1977; *Appeal of Audrey C. Jaegle*, 76-SBE-070, June 22, 1976.) Here, \$8.53 in interest accrued because appellant failed to timely pay the disputed penalties in response to FTB's notices. Appellant's sole basis for requesting abatement of interest is that reasonable cause (the issue with appellant's tax preparer's software described above) prevented appellant from timely filing the return. As discussed, we concluded above that, under the facts of this case, the software issue does not constitute reasonable cause for failing to timely file the return. Furthermore, we lack authority to abate interest for reasonable cause. Therefore, appellant failed to establish a basis for interest abatement.

HOLDING

Appellant did not establish a basis for abatement of any of the penalties, interest, or fees assessed and collected by FTB.

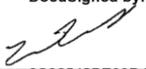
DISPOSITION

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

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Andrew J. Kwee
Administrative Law Judge

We concur:

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Tommy Leung
Administrative Law Judge

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Neil Robinson
Administrative Law Judge