OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	)	OTA Case No. 18011768
	)	
CLGT SOLUTIONS, LLC	)	Date Issued: July 30, 2018
	)	
	)	
	)	

OPINION

Representing the Parties:

For Appellants: Ann E. Graff, Vice President

For Respondent: Eric A. Yadao, Tax Counsel III

For Office of Tax Appeals: William J. Stafford, Tax Counsel III

J. MARGOLIS, Administrative Law Judge: Pursuant to California Revenue and Taxation Code section 19324,[1] CLGT Solutions, LLC (appellant) appeals the action of the Franchise Tax Board (FTB or respondent) in denying appellant's claims for refunds for tax years 2013, 2014 and 2015.

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

ISSUES

1. Is appellant liable for the late-filing penalties assessed against it under sections 19131 and 19172.5 for 2013 and 2014?
2. Is appellant liable for the late payment penalty assessed against it under section 19132 for 2015?

[1] Unless otherwise indicated, all section references are to sections of the California Revenue and Taxation Code.

3. Is appellant liable for the estimated tax penalties assessed against it under section 19142 for 2013, 2014 and 2015?
4. Is appellant entitled to interest abatement?

FACTUAL FINDINGS

1. Appellant is an Ohio-based limited liability company (LLC) that was formed in 2011.
2. Appellant elected to be taxed as a subchapter S corporation for federal and state tax purposes.
3. During the years at issue, appellant had four members.
4. Consistent with appellant's election to be treated as a subchapter S corporation for tax purposes, appellant's members are treated as subchapter S shareholders for tax purposes.
5. On December 29, 2011, appellant filed a Form LLC-5, "Application to Register a Foreign Limited Liability Company" with the California Secretary of State's Office (SOS). That form contained the following warning:

> ***Important!*** LLCs in California may have to pay a minimum $800 yearly tax to the Franchise Tax Board.

6. Appellant filed its 2013 California tax return (Form 100S) on April 19, 2016, after its due date of March 15, 2014.[2] Appellant paid the $800 minimum tax due on April 15, 2016.
7. Appellant filed its 2014 Form 100S on April 19, 2016, after its due date of March 15, 2015. Appellant paid the $800 minimum tax due on April 15, 2016.
8. Appellant timely filed its 2015 Form 100S on April 4, 2016, before the extended due date of October 17, 2016. Appellant paid the $800 minimum tax due on April 15, 2016.
9. For all the tax years at issue, appellant failed to make any payments of estimated taxes.
10. For both the 2013 and 2014 tax years, the FTB imposed late-filing penalties of $864 under section 19172.5, late-filing penalties of $200 under section 19131, and underpayment of estimated tax penalties of $21.96 under section 19142.
11. For the 2015 tax year, the FTB imposed a late payment penalty of $44 under section 19132 and an underpayment of estimated tax penalty of $22.01 under section 19142.
12. In November 2016, appellant timely filed FTB Forms 2914, "Reasonable Cause - Business Entity Claim for Refund," for all three years.

[2] The S corporation filing deadline is set forth in section 18601.

13. In March and May of 2017, FTB issued notices denying appellant's claims for refund.

14. Appellant timely filed this appeal by letter dated May 22, 2017.

DISCUSSION

The Revenue and Taxation Code contains two penalties that are applicable to late-filed subchapter S corporation returns. The first penalty, under section 19131, is computed with reference to the amount of the corporation's tax shown on the return. The penalty is five (5) percent of the amount of tax required to be shown on the return for every month that the return is late, up to a maximum of 25 percent. (§ 19131(a).) For purposes of calculating this penalty, the amount of tax required to be shown on the return is reduced by any timely paid tax amounts, and any credits against the tax which may be claimed on the return. (§ 19131(c).) The FTB imposed penalties against appellant under section 19131 for 2013 and 2014 of $200 (appellant's $800 minimum tax liability times 25 percent).

The second penalty, under section 19172.5, takes into account the fact that a subchapter S corporation is a pass-through entity. It imposes a penalty against a subchapter S corporation based upon the number of its pass-through shareholders and the lateness of the return. The penalty is computed as follows: $18 per month per subchapter S shareholder (or, in the case of an LLC taxed as a subchapter S corporation, per LLC member), for a maximum of 12 months. Here, appellant's 2013 and 2014 returns were filed twelve or more months late, so the penalty imposed under section 19172.5 was $864.00 ($18 times 4 members/shareholders times 12 months) per year.

The Revenue and Taxation Code also imposes a late payment penalty for a taxpayer's failure to pay the amount of tax shown on a return before the due date. (§ 19132(a)(1).) The late payment penalty is the sum of two figures that may not exceed 25 percent of the unpaid tax. (§ 19132(a)(2).) The first addend is five percent of the tax that remained unpaid as of the due date. (§ 19132(a)(2)(A).) The second addend is .5 percent of the unpaid tax balance per month for each month, or portion of a month, that the tax remains unpaid after the due date, not to exceed 40 months. (§ 19132(a)(2)(B).) For these purposes, the due date for payment of the tax is determined without regard to any extension of time to file the return. (§ 19001.)

Both the late-filing penalty under section 19131 and the late payment penalty under section 19132 will be abated if it is established that the late filing and late payment were attributable to reasonable cause and not willful neglect. (§§ 19131(a), 19132(a).) The late-filing

penalty under section 19172.5(a) will be abated if the taxpayer establishes that the late filing was attributable to reasonable cause.[3] (§ 19172.5(a).)

Appellant makes a reasonable cause-type argument in contending that its tax filing and payment obligations were "overlooked due to an administrative error and not willful negligence." Appellant explains that although it registered to do business in California with the SOS, it never actually conducted any business in this state. Appellant further notes that when it was contacted by the FTB in February of 2014 in relation to its unfiled 2012 tax return, it promptly filed a 2012 California return and paid the amount due. Appellant claims it did not realize that it also needed to file subsequent years' returns until it received a notice from FTB inquiring about appellant's 2013 tax year. In response to that notice, appellant promptly filed its past-due returns and paid the full amount of all taxes, penalties and interest due.

While appellant's prompt responses to the FTB's notices are laudable, they do not establish reasonable cause for appellant having failed to timely file its returns and timely pay its taxes in the first place. Although appellant may have had a sincere belief that it was not required to file California tax returns, that belief alone does not constitute reasonable cause for failing to timely file. (*Appeal of Byron C. Beam*, 78-SBE-042, June 29, 1978.[4]) California law provides that every LLC that has qualified to do business within this state is subject to an annual minimum franchise tax regardless of whether the LLC actually conducts business in this state, until a certificate of cancellation or registration or articles of organization is filed on behalf of the LLC with the SOS. (§ 17941(b)(1).)

Moreover, ignorance of one's tax filing and payment requirements does not constitute reasonable cause for failing to comply with those requirements. (*Appeal of Diebold, Inc.*, 83-SBE-002, Jan. 3, 1983.) To establish reasonable cause, a taxpayer "must show that the failure to file timely returns 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.) As applied to the facts here, we conclude that a reasonably prudent businessperson that

[3] Showing a lack of willful neglect is not required to abate the section 19172.5 per-partner, late-filing penalty. In most cases, however, a showing of reasonable cause also would suffice to establish that the taxpayer did not act with willful neglect.

[4] Published decisions of the Board of Equalization, designated by "SBE" in the citation, are available on that Board's website at: http://www.boe.ca.gov/legal/legalopcont.htm.

registered to do business in California would have read the warning on the Form LLC-5 and investigated and complied with California's tax requirements.

With respect to the estimated tax penalties assessed against appellant, we note that there is no reasonable cause exception to those penalties, and appellant has not shown any grounds for abating those penalties. Accordingly, we find that appellant is liable for the estimated tax penalties assessed by FTB.

Appellant's claim for refund seeks to recover the entire amount it paid for the years at issue, which includes interest. However, appellant has not specifically addressed the FTB's imposition of interest in its appeal. Interest is required to be assessed from the date when payment of tax is due through the date that it is paid. (§ 19101.) Interest is not a penalty, but is compensation for appellant's use of money after it should have been paid to the state. (*Appeal of Amy M. Yamachi*, 77-SBE-095, June 28, 1977.) There is no reasonable cause exception to the imposition of interest. (*Appeal of John M. Shubert*, 79-SBE-161, Sept. 25, 1979.)

For interest to be abated, a taxpayer must qualify under the abatement provisions of sections 21012, 19112, or 19104. The abatement of interest under section 21012 is not relevant here, since FTB did not provide appellant with any written advice. For interest to be abated under section 19112, a taxpayer must make a showing of extreme financial hardship caused by a significant disability or other catastrophic circumstance. Appellant makes no such showing. Moreover, interest abatement under section 19112 only applies to unpaid interest. Here, the interest already has been paid, hence it cannot be abated under section 19112. Under section 19104, subdivisions (a)(1) and (a)(2), FTB is authorized to abate interest only if there has been an unreasonable error or delay in the performance of a ministerial or managerial act by an FTB employee. Appellant has not alleged any such errors or delays. Thus, appellant has not established any grounds for abatement of interest.

Finally, we address appellant's argument that the amount assessed against it in penalties and interest for the three years at issue, $2,236, is excessive in relation to its total tax liability for that same period, $2,400. While we are sympathetic to appellant's position, we are constrained by the law to impose the penalties and interest that have been lawfully assessed by FTB pursuant to the Revenue and Taxation Code. In this regard, we specifically reject the argument raised in the dissent that the Legislature intended to supersede or repeal, in part, the late-filing penalty of section 19131 when it enacted the per-shareholder late-filing penalty of section 19172.5. No

legislative history – California or federal – is presented in support of that position, and the law is clear that implied repeal is strongly disfavored. (*Pacific Palisades Bowl Mobile Estates, LLC v. City of Los Angeles* (2012) 55 Cal.4th 783, 805.) "Absent an express declaration of legislative intent, we will find an implied repeal only when there is no rational basis for harmonizing two potentially conflicting statutes, and the statutes are irreconcilable, clearly repugnant, and so inconsistent that the two cannot have concurrent operation." (*Ibid.*, internal citations and quotations omitted.) Here, there is no need to harmonize inconsistent provisions or interpret ambiguous statutes. Both penalty statutes are clear on their face; both state that they "shall" apply unless reasonable cause is established (and in the case of the section 19131 penalty, an absence of willful neglect is shown). Both penalties apply to the situation before us and neither penalty precludes application of the other. Because there is no ambiguity in the plain meaning or application of these statutes, our analysis should begin and end there.[5] In sum, where, as here, both penalties clearly apply, we are obligated to sustain their imposition unless and until instructed otherwise by a published decision of an appellate court. (Cal. Const. Art. III Section 3.5).

HOLDINGS

1. The late-filing penalties imposed for 2013 and 2014 under sections 19131 and 19172.5 are sustained.
2. The late payment penalty imposed under section 19132 for 2015 is sustained.
3. The estimated tax penalties imposed under section 19142 for 2013, 2014, and 2015 are sustained.
4. Appellant is not entitled to abatement of interest.

[5] The dissent contends that the Legislature's statement in section 19172.5, that the per-partner, late-filing penalty applies "[i]n addition to the [criminal failure to file] penalty imposed by Section 19706," implies that other penalties not expressly mentioned in section 19172.5 may not be imposed under the canon of statutory interpretation *expressio unius est exclusio alterius* (the expression of one thing is the exclusion of the other). It is clear, however, that the Legislature knows how to draft a penalty statute that will negate, in specified circumstances, application of another penalty. For example, the Legislature expressly provided that the late payment penalty of section 19132(a) "shall not be assessed if, for the same taxable year, the sum of any penalties imposed under Section 19131 relating to failure to file return and Section 19133 relating to failure to file return after demand is equal to or greater than the [section 19132] subdivision (a) penalty." (§ 19132(b).) The fact that the Legislature did not include comparable, express language in section 19172.5 indicates that it did not intend to eliminate application of the 19131 penalty in situations where the section 19172.5 penalty also applied.

DISPOSITION

The FTB's denials of appellant's claims for refund are sustained in full.

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Jeffrey I. Margolis
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Jeffrey I. Margolis
Administrative Law Judge

Concurring:

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Sara A Hosey
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Sara A. Hosey
Administrative Law Judge

CONCURRING IN PART/DISSENTING IN PART:

I concur with the majority and join in rejecting interest abatement and in sustaining the late-filing penalties imposed under section 19172.5 for tax years 2013 and 2014, the late payment penalty imposed under section 19132 for tax year 2015, and the estimated tax penalties imposed under section 19142 for tax years 2013, 2014, and 2015.

I respectfully dissent from the conclusion and holding that the late-filing penalties under section 19131 were properly imposed in this case.

Respondent assessed two separate penalties for the same misdeed by the same entity. The two statutes (sections 19131 and 19172.5), standing alone, are not ambiguous. However, an ambiguity exists in how the two statutes are applied to the same taxpayer. It is open to interpretation as to whether only one statute should be applied, or whether both should be, as the majority concludes.

When one statute is followed later by another statute with respect to the exact same subject matter but applied to only a subset of the persons or entities covered under the original

statute, application of the statutes becomes ambiguous as to whether one or both statutes should be applied.

> "An indeterminacy in the application of language signals its vagueness or ambiguity. An ambiguity arises when language is reasonably susceptible of more than one application to material facts. There cannot be an ambiguity per se, i.e., an ambiguity unrelated to an application."

(*Dore v. Arnold Worldwide, Inc.* (2006) 39 Cal.4th 384, 391, quoting from *California State Auto. Assn. Inter–Ins. Bureau v. Superior Court* (1986) 177 Cal.App.3d 855, 859, fn. 1.) Ambiguity exists in the interplay between sections 19131 and 19172.5, and whether one section, the other, or both, may be applied to a particular taxpayer for the same misdeed. Respondent's inconsistent application of late-filing statutes, with respect to subchapter S corporations and entities treated as partnerships, reflects the ambiguity in the interplay of the late-filing statutes.[6]

The first step in resolving an ambiguity is to ascertain the legislative intent. The statutes at issue in this case (sections 19131(a) and 19172.5) were adopted in California using substantially the same language as their federal counterparts (Internal Revenue Code (IRC) sections 6651(a)(1) and 6699, respectively). California enacted section 19172.5 in 2010, mirroring the previously enacted IRC section 6699. It was added as an amendment to Senate Bill 401 three days prior to the bill's enrollment. (See Assem. Com. on Rev. and Tax., Rep. on Assem. Bill No. 401 (2009-2010) Reg. Sess., as amended April 5, 2010, Sec. 49.) The bill's analysis shows only an intent to "conform state tax laws to ever-changing federal tax laws." (*Id.*, at preamble.) The intent of the Legislature when adopting section 19172.5, therefore, clearly was to conform to the corresponding federal penalty found in IRC section 6699.

When material provisions of federal and state statutes are substantially identical, interpretation of the federal statute guides construction of the state statute. (*Douglas v. State of California* (1942) 48 Cal.App.2d 835, 838.) State statutes that are "in substance, exact counterparts of the federal rules," must have been intended to have the "same meaning, force and

[6] A review of prior cases shows that respondent has not consistently imposed both penalties on the same taxpayer. (See *Appeal of Maxim Greenbrook, LLC*, 2017 WL 6419233 (Cal.St.Bd.Eq.) Sept. 26, 2017 [imposing the per-partner, late-filing penalty under § 19172 and a late payment penalty under §19132, but not a general late-filing penalty under §19131]; compare *Appeal of Genicity Inc.*, 2017 WL 6419213 (Cal.St.Bd.Eq.) Aug. 29, 2017 [both § 19131 and § 19172.5 penalties imposed on the same taxpayer].) The late-filing penalty in section 19172, applicable to partnerships and limited liability companies taxed as partnerships, mirrors the language of the late-filing penalty in section 19172.5 that applies to subchapter S corporations. (§§ 19172, 19172.5.)

effect as have been given the federal rules by the federal courts." (*Kahn v. Kahn* (1977) 68 Cal.App.3d 372, 384.)

The Internal Revenue Service (IRS) practice has been to decline to aggregate the general and specific late-filing penalties. An IRS Program Manager Technical Advice Memorandum (Memorandum) states that IRC section 6699 "was added to the Code because Congress believed that there was previously no effective penalty regime for the failure to file an S corporation return." (See PMTA 2013-15 -- Section 6651 – Failure to File Tax Return or to Pay Tax, citing H.R. Rep. No. 110-426, at 35 (2007).) In that Memorandum, the IRS concluded there was nothing in the legislative history of IRC section 6699 to imply that Congress intended to penalize a particular entity twice for the same failure, and therefore it declined to assess the general late-filing penalty against an "S" corporation when the more specific per-partner, late-filing penalty applied. Although the Memorandum postdates adoption of section 19172.5, deference should be given to the IRS interpretation of legislative intent of the federal statute upon which the California statute was based.

Furthermore, when a penalty is both duplicative and ambiguous, the "rule of lenity" applies. The rule of lenity is an interpretive canon providing that " '[a]mbiguity in a statute defining a crime or imposing a penalty should be resolved in the defendant's favor.' " (*Mohamed v. Commissioner,* T.C. Memo. 2013-255, at p. 25 (*Mohamed*), quoting Scalia & Garner, Reading Law: The Interpretation of Legal Texts (2012) page 296.) *Mohamed* considered the application of a tax penalty statute and held that "[IRC] section 6651(f) imposes an addition to tax … [thus,] any ambiguity in its application is resolved by the rule of lenity." (*Mohamed, supra*, at p. 26.) "A tax provision which imposes a penalty is to be construed strictly; a penalty cannot be assessed unless the words of the provision plainly impose it." (*Bradley v. United States* (9th Cir. 1987) 817 F.2d 1400, 1402-1403, citing *Commissioner v. Acker* (1959) 361 U.S. 87, 91.) Applying the penalty statutes strictly, lenity applies, and respondent may not simultaneously apply both the subchapter S corporation late-filing penalty and the general section 19131 late-filing penalty against the same entity, for the same act.

The principle of *expressio unius est exclusio alterius* (the expression of one thing is the exclusion of the other) also applies here. The Legislature clearly articulated that the per-shareholder late-filing penalty may be aggregated with another penalty, the criminal penalty sanction imposed under section 19706. (§ 19172.5(a).) The absence of similar language with

respect to section 19131 implies the absence of such intent. In other words, the inclusion of the phrase "in addition to the penalty imposed by Section 19706" in section 19172.5(a) shows that the Legislature intentionally excluded other penalties that might be applicable to the same act, with respect to one subset of taxpayers.

A final principle of note when reconciling the application of the two statutes is codified in section 1859 of the Code of Civil Procedure: "[W]hen a general and particular provision are inconsistent the latter is paramount to the former. So, a particular intent will control a general one that is inconsistent with it." Further, it is a "fundamental principle of statutory construction that a new law supersedes an old law on the same subject." (*Appeal of West Valley Land Management Co.*, 93-SBE-014, Sept. 30, 1993, citing *Union League Club v. Johnson* (1941) 18 Cal.2d 275.) Every statute should be construed with reference to the whole system of law of which it is a part so that all may be harmonized and have effect." (*Stafford v. Realty Bond Service Corp.* (1952) 39 Cal.2d 797, 805.) Thus, the more specific late-filing penalty statute (section 19172.5(a), which applies only to subchapter S corporations "required to file a return under section 18601") is properly applied instead of the general late filing provision (section 19131) where, as here, the penalized act was by a subchapter S corporation.

Therefore, I conclude that the delinquent filing penalty under section 19172.5 is the only penalty that may be applied to appellant due to the late filing of its return.[7]

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Teresa A. Stanley
Administrative Law Judge

[7] I address the majority's reference to what they believe to be an implied repeal of section 19131 if both penalties are not applied to a subchapter S corporation. The specter of an implied repeal is not conjured by the interpretation that only one late-filing penalty may be applied to a subchapter S corporation. In order for an implied repeal to be at issue, one of two situations must exist; first, two statutes are in irreconcilable conflict; and second, where the "later statute covers the whole subject of the earlier one and is clearly intended as a substitute." (*Radzanower v. Touche Ross & Co.* (1976) 426 U.S. 148, 154.) Sections 19131 and 19172.5 are not in irreconcilable conflict when applied to different subsets of taxpayers. The two statutes are easily harmonized and can mutually coexist and apply to different taxpayers as provided by the Legislature. The later-enacted statute creates an exception to the application of the more general one and applies a different formula to calculate the penalty that is more useful when dealing with multi-member entities, such as subchapter S corporations.