OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	)	OTA Case No. 18011093
	)	
YDB LLC	)	Date Issued: September 10, 2018
	)	
	)	
	)	

OPINION

Representing the Parties:

For Appellant: Larry S. Blair

For Respondent: Maria Brosterhous, Tax Counsel IV

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

D. CHO, Administrative Law Judge: Pursuant to California Revenue and Taxation Code section 19324,[1] YDB LLC (appellant) appeals an action by the Franchise Tax Board (FTB or respondent) in denying appellant's claim for refund of $2,296.62 for the 2014 tax year and $1,419.18 for the 2015 tax year.

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

ISSUES

1. Whether appellant had a California limited liability company (LLC) filing obligation and was subject to the LLC annual tax for the 2014 and 2015 tax years.[2]
2. Whether appellant has established reasonable cause for a refund of a Section 19131 late-filing penalty for the 2014 tax year.

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

[2] We note that appellant has not claimed a refund of the LLC annual tax. However, appellant disputes that it had a filing requirement, and the penalties imposed would not apply if appellant did not have a filing requirement. For these reasons, we will discuss the LLC annual tax and whether appellant had a filing obligation.

3. Whether appellant has established reasonable cause for a refund of a Section 19172 partnership late-filing penalty for the 2014 tax year.
4. Whether appellant has shown reasonable cause for failing to timely pay tax for the 2014 and 2015 tax years.
5. Whether appellant has demonstrated that a 10-percent estimated LLC fee penalty can be abated for the 2015 tax year.

FACTUAL FINDINGS

1. Appellant is an LLC dealing in financial investments that was organized in Delaware on December 16, 2003. Appellant was not registered with the California Secretary of State during the 2014 and 2015 tax years. Appellant had two members, Mr. Yves de Balmann and the de Balmann Family Irrevocable Trust (de Balmann Trust), during the 2014 and 2015 tax years. Mr. de Balmann was a managing member and had a 65 percent interest in appellant's profits and losses. The de Balmann Trust had a 35 percent interest in appellant's profits and losses.
2. On October 9, 2015, Mr. de Balmann and his wife filed a joint California Nonresident or Part-Year Resident Income Tax Return for the 2014 tax year, which reported that he and his wife moved to Sonoma, California on April 26, 2014.
3. Appellant did not file a California LLC Return of Income for the 2014 tax year. However, respondent received information from a federal Form 1099 that appellant derived income that may have come from a California source for the 2014 tax year, and on May 27, 2016, respondent issued a Demand for Tax Return (Demand), which required that appellant respond by June 29, 2016, either by filing a 2014 return or by explaining why a 2014 return was not required.
4. Appellant filed a California LLC Return of Income for the 2014 tax year on July 14, 2016, and paid a tax liability of $6,800. According to the 2014 California LLC return, appellant listed a Sonoma, California address as its address, which was the same address as its managing member, Mr. de Balmann. In addition, the check used to pay for this tax liability listed Mr. de Balmann's Sonoma, California address.
5. On April 5, 2015, and September 8, 2016, appellant filed a federal U.S. Return of Partnership Income return for the 2014 and 2015 tax years, respectively, listing the Sonoma, California address as its address.

6. Appellant filed a California LLC Return of Income for the 2015 tax year on September 31, 2016, and again listed the Sonoma, California address as its address.
7. By check dated December 11, 2016, appellant made a total payment of $10,515.80. This amount consisted of $6,800 for appellant's 2015 tax liability, $1,419.18 for penalties related to the 2015 tax year, and $2,296.62 for penalties related to the 2014 tax year.
8. On December 19, 2016, appellant filed a claim for refund for the late-filing penalty for the 2014 tax year, the partnership late-filing penalty for the 2014 tax year, the late-payment penalties for the 2014 and 2015 tax years, and the 10-percent estimated LLC penalty for the 2015 tax year, asserting reasonable cause.
9. Respondent denied the claim for refund for the 2014 and 2015 tax years by letters dated March 28, 2017, and March 9, 2017, respectively.
10. This timely appeal followed.

DISCUSSION

Issue 1 – Whether appellant had a California LLC filing obligation and was subject to the LLC annual tax for the 2014 and 2015 tax years.

Section 17941(a) imposes an annual tax in the amount of $800 on all LLC's that are "doing business" in California. Section 23101(a) defines "doing business" as "actively engaging in any transaction for the purpose of financial or pecuniary gain or profit." Managerial functions performed by a taxpayer in California are sufficient to constitute "doing business" in the state. (*Appeal of Reno Liquor Company, Inc*., 59-SBE-004, Feb. 17, 1959.)[3]

Also, for taxable years beginning on or after January 1, 2011, a taxpayer is "doing business" in California if the taxpayer is organized or commercially domiciled in this state. (§ 23101(b)(1).) "Commercial domicile" has been defined as "the place where the corporate management functions, the place where the real control exists with respect to the business activities of the corporation." (*Appeal of Norton-Simon, Inc.*, 72-SBE-008, Mar. 28, 1972.)

Appellant argues that *Swart Enterprises, Inc. v. Franchise Tax Board* (2017) 7 Cal.App.5th 497 (*Swart*) supports its position. In *Swart*, the taxpayer was a small, family-owned

[3] Pursuant California Code of Regulations, title 18, section 30501(d)(3), precedential opinions of the State Board of Equalization (BOE) that were adopted prior to January 1, 2018, may be cited as precedential authority to the Office of Tax Appeals 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: http://www.boe.ca.gov/legal/legalopcont.htm.

corporation with its place of business and headquarters in Iowa. (*Id*. at p. 502.) The taxpayer did not have any physical presence in California; it did not sell or market products or services to California; and it did not register with the California Secretary of State. (*Ibid*.) The taxpayer's only connection with California was its passive ownership of a 0.2 percent interest in a California LLC, Cypress Equipment Fund XII, LLC, that was conducting business in California. (*Ibid*.)

Based on these facts, the court examined whether the actions of a California LLC doing business in California could be attributed to one of its members that resided outside of California. As part of its examination, the court applied the holding in *Golden State Theatre & Realty Corp. v. Johnson* (1943) 21 Cal.2d 493 (*Golden State Theatre & Realty Corp*.) when it concluded that "active" is the opposite of "passive" (*Swart, supra,* 7 Cal.App.5th at p. 504) and ultimately found that passively holding an ownership interest with no right of control over the business affairs of an LLC does not constitute "doing business" in California within the meaning of Section 23101 for the tax year at issue, which was prior to January 1, 2011. Subdivision (b) of Section 23101 was not effective for the tax year at issue in *Swart* and, therefore, was not examined by the court.

In *Golden State Theatre & Realty Corp*., *supra*, the taxpayer contended that it was not "actively" engaged in any transaction for financial gain (and thus not "doing business") because it merely acquired property and derived income therefrom, and none of the transactions occurred regularly. The California Supreme Court disagreed, stating:

> The doing of business, however, does not necessarily mean a regular course of business under the [predecessor to Section 23101], for by its plain terms a corporation is doing business if it actively engages in any transaction for pecuniary gain or profit. [The taxpayer] would identify "doing business" with "carrying on a trade or business." A series of transactions regularly engaged in may be necessary to establish the "carrying on of a trade or business" but the Legislature made it clear that it had no such concept in mind when it referred to transaction in the singular as "any transaction." The word "actively" must therefore be interpreted as the opposite of passively or inactively, and as used in [the predecessor to Section 23101] it means active participation in any transaction for pecuniary gain or profit. Within this meaning [the taxpayer] was doing business in 1936.

(*Id*. at p. 496.)

In *Carson Estate Co. v. McColgan* (1943) 21 Cal.2d 516 (*Carson Estate Co.*), the California Supreme Court held that a corporation was doing business in California when it made

a purchase of bonds in one year, a sale of bonds in the following year, 12 purchases and sales of stock in the year thereafter, and two such transactions in the last year that was considered. Thus, a single purchase of bonds in one year constituted "doing business." Also, a transaction does not need to result in actual profit for purposes of Section 23101, and the relevant inquiry is whether the activity or transaction was motivated by financial or pecuniary gain. (*Hise v. McColgan* (1944) 24 Cal.2d 147, 150-151.)

Here, there is no dispute that appellant's member, Mr. de Balmann, moved to Sonoma, California on or about April 26, 2014. Further, there is no dispute that appellant listed Mr. de Balmann's Sonoma, California address as appellant's address on its federal partnership returns for the 2014 and 2015 tax years as well as its California LLC returns for the 2014 and 2015 tax years. There is also no dispute that Mr. de Balmann was a managing member of appellant, held a controlling interest in appellant, and signed tax returns and checks for appellant.[4] There is no indication in the record that appellant's other member, the de Balmann Trust, exercised any management or control over appellant, and there is no indication that appellant had any other members or managers. Based on the record, Mr. de Balmann made management decisions for appellant from California after he moved to California on April 26, 2014.

Appellant contends that it is a holding company for marketable securities that are professionally managed by investment advisors located in New York state. However, appellant has presented no evidence to support this contention or show the relevant facts and circumstances, nor does appellant dispute that managerial actions were performed in California.

Appellant also argues that it was "organized and domiciled in Delaware." However, a company's state of organization does not constitute its commercial domicile if the company is not controlled from that state and does not engage in activities in that state. (*Southern Pac. Co. v. McColgan* (1945) 68 Cal.App.2d 48, 80.) We see no evidence that appellant is controlled from Delaware or engages in activities in Delaware such that Delaware should be considered its commercial domicile. Furthermore, as noted above, appellant's managing member exercised management functions for appellant in California, which supports FTB's determination that appellant was doing business in California.

[4] While the checks and tax returns are dated in 2015 and 2016, it seems reasonable to infer that Mr. de Balmann managed and controlled appellant from California once he moved to California on April 26, 2014.

Appellant argues that the *Swart* decision supports its appeal. However, *Swart* involved very different facts and issues. *Swart* dealt with a situation where respondent was attempting to attribute the actions of a California LLC to an out-of-state member holding a small passive interest in the California LLC; while in this appeal, respondent is attributing the actions of a managing member of an LLC to the LLC itself, which is the opposite of what occurred in *Swart*.

For the foregoing reasons, we conclude that FTB correctly determined that appellant had a filing requirement and was subject to the LLC annual tax.

Issue 2 – Whether appellant has established reasonable cause for a refund of the Section 19131 late-filing penalty for the 2014 tax year.

For the taxable year at issue, Section 18633.5(a) provides that every LLC that is classified as a partnership for California tax purposes shall file its return on or before the 15th day of the fourth month following the close of its taxable year. Section 19131 states that a penalty shall be imposed 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 specified as five percent of the tax due for each month that a valid 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, the total tax for the 2014 tax year was $6,800, of which $6,000 was the LLC fee under Section 17942. The LLC return was due on April 15, 2015, but appellant filed its 2014 return on July 14, 2016. FTB imposed the 25-percent late-filing penalty upon the $6,000 late-paid LLC fee amount, resulting in a penalty of $1,500. (FTB did not impose the late-filing penalty with respect to the $800 late-paid annual LLC tax.)

To establish reasonable cause for the late filing, a taxpayer must show that the failure to file timely occurred despite the exercise of ordinary business care and prudence, or that an ordinarily intelligent and prudent businessperson would have acted in the same manner under similar circumstances. (*Appeal of Howard G. and Mary Tons*, 79-SBE-027, Jan. 9, 1979.) In addition, ignorance of the law is not an excuse for failing to file a timely return. (*Appeal of Diebold, Inc.*, 83-SBE-002, Jan. 3, 1983.)

Although appellant argues that it reviewed the filing requirements and believed it did not have a filing requirement in California based on its understanding that it was not doing business in California, appellant has not provided evidence of any actions by it, prior to the due date of its

tax return, to determine whether it had a filing requirement. Appellant has not shown that it exercised ordinary business care and prudence to determine whether it had a California filing obligation after its managing member moved to California. Without any evidence showing any steps appellant took, prior to the due date of its tax return, to determine whether it had a filing obligation, we are unable to give appellant's conclusory statement much weight.

Furthermore, we note that appellant's belief, however sincere, that it did not have a filing requirement for the 2014 tax year, is insufficient to find reasonable cause. (*See Appeal of J. Morris and Leila G. Forbes*, 67-SBE-042, Aug. 7, 1967.) Absent evidence that appellant made a reasonable attempt to acquaint itself as to California's LLC tax filing requirements prior to the tax filing deadline, we do not see a basis for abating the penalty. (*Appeal of Diebold, Inc., supra*.) Accordingly, we find that appellant failed to meet its burden of proof in substantiating that reasonable cause exists for the abatement of the Section 19131 late-filing penalty for the 2014 tax year.

Issue 3 -Whether appellant has established reasonable cause for a refund of the Section 19172 partnership late-filing penalty for the 2014 tax year.

For the taxable year at issue, Section 18633.5(a) provides that every LLC doing business in California shall file its return on or before the 15th day of the fourth month following the close of its taxable year. Thus, appellant's 2014 LLC tax return was due on April 15, 2015. Section 19172 imposes a late-filing penalty when a partnership (or an LLC treated as a partnership) fails to file a return at the time prescribed unless it is shown that the failure was due to reasonable cause. The late-filing penalty under Section 19172 is computed at $18 per partner per month, or fraction thereof, that the return is late, up to a maximum of twelve months. Respondent correctly imposed the late-filing penalty of $432 (i.e., $18 x 2 partners x 12 months).

Appellant contends that its belief that it did not have a filing obligation in California is reasonable cause to abate the late-filing penalty; however, for the reasons stated above, we find that appellant's erroneous belief does not constitute reasonable cause. Therefore, we conclude that appellant failed to meet its burden of proof in substantiating that reasonable cause exists for the abatement of the Section 19172 partnership late-filing penalty for the 2014 tax year.

Issue 4 – Whether appellant has shown reasonable cause for the failure to timely pay tax for the 2014 and 2015 tax years.

Section 19132(a)(1)(A) imposes a late-payment penalty when a taxpayer fails to pay the amount shown as due on the return by the date prescribed for the payment of the tax. Generally, the date prescribed for the payment of the tax is the due date of the return (without regard to extensions of time for filing). (§ 19001.) The late-payment penalty has two parts. The first part is five percent of the unpaid tax. (§ 19132(a)(2)(A).) The second part is a penalty of one-half percent per month, or portion of a month, not to exceed 40 months, calculated on the outstanding balance. (§ 19132(a)(2)(B).)

The late-payment penalty, however, does not apply when the failure to pay is due to reasonable cause and not willful neglect. The taxpayer bears the burden of proving that both conditions existed. (*Appeal of Roger W. Sleight*, 83-SBE-244, Oct. 26, 1983.) To establish reasonable cause for the late payment of tax, a taxpayer must show that its failure to make a timely payment of the proper amount of tax occurred despite the exercise of ordinary business care and prudence. (*Appeal of Robert T. and M.R. Curry*, 86-SBE-048, Mar. 4, 1986.)

Here, appellant did not timely pay its tax for the 2014 and 2015 tax years. Once again, appellant relies on its argument that it reviewed California's filing requirements and concluded that it did not have a filing obligation, which included an obligation to pay California taxes. However, as noted above, ignorance of the law, or failure to ascertain California tax law requirements, amounts to a lack of ordinary business care and prudence. (*Appeal of Diebold, Inc., supra.*) In other words, appellant's conclusory statement that it did not have a filing requirement, without any explanation or supporting evidence to demonstrate the steps taken to ascertain whether appellant was required to file a California LLC return and pay California taxes, does not constitute reasonable cause. Accordingly, appellant has not established reasonable cause to warrant the abatement of this penalty.

Issue 5 – Whether appellant has shown that the 10-percent estimated LLC fee penalty can be abated.

California imposes an LLC fee on an LLC doing business in California. Section 17942, subdivisions (a)(2) & (a)(3), provide that every LLC subject to tax under Section 17941 shall pay annually to California a fee equal to: 1) $2,500 if the total income derived from or attributable to

California for the tax year is $500,000 or more, but less than $1,000,000; or 2) $6,000 if the total income derived from or attributable to California for the tax year is $1,000,000 or more, but less than $5,000,000. The LLC fee is due on the filing due date of the LLC return, which is on or before the 15th day of the fourth month following the close of the LLC's taxable year. (§§ 17942(c), 18633.5(a).)

For the years beginning on or after January 1, 2009, the LLC fee shall be estimated and paid on or before the fifteenth day of the sixth month of the current taxable year. (§ 17942(d)(1).) Section 17942(d)(2) provides, in part, that a penalty of 10 percent of the amount of any underpayment of estimated LLC fee shall be added to the LLC fee. The underpayment is equal to the difference between the total amount of the LLC fee for the taxable year less the timely estimated LLC fee payment. (*Ibid*.) The 10-percent penalty shall not be imposed if the timely estimated LLC payment is equal to or greater than the total amount of the LLC fee for the preceding taxable year. (*Ibid*.) There is no reasonable cause exception for abatement of the underpayment of estimated LLC fee penalty.

Here, respondent properly imposed the 10-percent estimated LLC fee penalty of $600 because appellant failed to timely pay its estimated LLC fee.[5] Appellant's fees were due on June 15, 2016, but appellant did not make a full payment until December 7, 2016. Therefore, respondent properly imposed the penalty based upon the amount of payment that remained due until December 7, 2016. Since the law does not provide a reasonable cause exception to this penalty, there is no basis to abate this penalty.

HOLDINGS

1. Appellant had a California filing obligation and was subject to the LLC annual tax for the 2014 and 2015 tax years.
2. Appellant failed to establish reasonable cause for a refund of the Section 19131 late-filing penalty for the 2014 tax year.
3. Appellant failed to establish reasonable cause for a refund of the Section 19172 partnership late-filing penalty for the 2014 tax year.
4. Appellant failed to establish reasonable cause for failure to timely pay tax for the 2014 and 2015 tax years.

[5] Respondent noted that the estimated LLC fee was not imposed for the 2014 tax year because it was appellant's first filing year, which qualified the entity for the prior year safe harbor.

5. Appellant failed to establish that the 10-percent LLC fee penalty can be abated for the 2015 tax year.

DISPOSITION

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

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Daniel Cho
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Daniel K. Cho
Administrative Law Judge

We concur:

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Grant S. Thompson
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Grant S. Thompson
Administrative Law Judge

DocuSigned by:
Nguyen Dang
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Nguyen Dang
Administrative Law Judge