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OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	)	OTA Case No. 18010891
	)	
KEIM FAMILY PARTNERSHIP	)	Date Issued: October 31, 2018
	)	
	)	
	)	

OPINION

Representing the Parties:

For Appellant: Richard Keim

For Respondent: Kenneth A. Davis, Tax Counsel IV

J. ANGEJA, Administrative Law Judge: Pursuant to California Revenue and Taxation Code section 19324,[1] the Keim Family Partnership (appellant) appeals an action by the Franchise Tax Board (FTB or respondent) in denying appellant's claim for refund of $1,804 for the 2010 tax year, $1,944 for the 2011 tax year, $1,944 for the 2012 tax year, and $2,592 for the 2013 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 tax return filing obligation during the appeal years.
2. Whether appellant has established reasonable cause to abate the late-filing penalties.
3. Whether appellant has established reasonable cause to abate the filing enforcement fee imposed for the 2010 tax year.
4. Whether appellant has established that interest should be abated.

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

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FACTUAL FINDINGS

1. FTB received information that appellant had received California source income in 2010, but FTB had no record that appellant had filed a tax return for that year. Accordingly, on April 3, 2015, FTB issued a Demand for Tax Return to appellant, requesting appellant, by May 6, 2015, to file a 2010 tax return or explain why no return was due. The notice further provided that if appellant had a requirement to file a 2010 return but failed to file it by May 6, 2015, FTB would impose a filing enforcement cost recovery fee.
2. Appellant filed a 2010 Limited Liability Company (LLC) tax return (Form 568) on July 27, 2015; 2011 and 2012 LLC tax returns on August 10, 2015, and a 2013 LLC tax return on August 5, 2015. Appellant then filed amended returns as a partnership (Form 565), for 2010, 2011, and 2013 on November 15, 2015; and for 2012 on December 8, 2015.
3. On each of its partnership tax returns appellant reported that it was not an investment partnership. In addition, on each partnership return appellant reported rental income from California sources.
4. Each of the LLC tax returns reported the $800 minimum tax applicable to an LLC, and applicable penalties and interest. Each of the partnership returns reported zero tax due.
5. FTB accepted the partnership returns and reversed the $800 minimum tax assessments for each year. FTB imposed partnership late-filing penalties under Section 19172 for each of the years at issue as well as a cost recovery fee for 2010, plus interest.
6. Beginning on November 6, 2015, FTB sent several past-due billing notices to appellant. In response, appellant paid the liabilities, and on December 15, 2016, appellant filed a claim for refund for the 2010 through 2013 tax years.[2] In its claim for refund, appellant asserts that it is a qualified investment partnership that is not doing business in California and is only a "flow-through" entity. Appellant asserts in its claim that it was a general partnership, it did not have a minimum tax requirement, and as such, no penalties or interest should be assessed.
7. On March 22, 2017, FTB denied the claims for refund, and this timely appeal followed.

[2] Appellant's claim for refund included a claim for $900 for the 2014 tax year; however, appellant's appeal before the Board of Equalization shows that appellant only included the 2010 – 2013 tax years. Therefore the 2014 tax year is not at issue on appeal.

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DISCUSSION

Issue 1 – Whether appellant had a California tax return filing obligation during the appeal years.

In its appeal letter, appellant claims that it is not a partnership; however, this assertion is inconsistent with the fact that appellant filed partnership returns for the appeal years. Appellant's claim for refund asserted that appellant was a general partnership that did not conduct business in California and "merely had an investment in a California flow through entity." Since all of the available evidence indicates that appellant was a partnership, we understand that appellant contends that it is a qualified investment partnership with only passive, non-reportable income in California, and therefore appellant believes it had no California tax return filing obligation.

Generally, partnership income (including non-resident partnership income) has a source where the partnership property is located and where the operations are carried on. (*Appeal of Lore Pick*, 85-SBE-066, June 25, 1985; *Appeal of H. F. Ahmanson & Co.*, 65-SBE-013, Apr. 5, 1965; see also §§ 17041, 17951.)[3] Here, it is undisputed that appellant received rental income from properties in California, and therefore that income has its source in California. However, section 17955 provides that partnership income of a nonresident that constitutes income from qualifying investment securities is not income from California sources even if the partnership has a usual place of business in this state. (§ 17955(a)(2); see also *Appeal of Robert M. and Ann T. Bass*, 89-SBE-004, Jan. 25, 1989.) To qualify under this section, the partnership must be an investment partnership, meaning that at least 90 percent of its total assets consist of qualifying investment securities and that at least 90 percent of its gross income consists of interest, dividends, and gains from the sale of qualifying investment securities. (§ 17955(c)(1)(A)-(B).) Section 17955 does *not* apply to income derived from investment activity that is interrelated with any trade or business activity in this state separate and distinct from the acts of acquiring, managing, and disposing of qualified investment securities. (§ 17955(b).)

Here, appellant received income from rental real estate activities, which are trade or business activities in this state, and these activities disqualify appellant from the exception

[3] Published precedential opinions of the State Board of Equalization (BOE) may be found on its website at: http://www.boe.ca.gov/legal/legalopcont.htm. The Office of Tax Appeals is the successor to, and vested with, all of the duties, powers and responsibilities of the BOE necessary or appropriate to conduct appeals hearings. (Gov. Code, § 15672(a).) Therefore, precedential BOE opinions that were adopted prior to January 1, 2018, are precedential authority before OTA. (Cal. Code Regs., tit. 18, § 30501(d)(3).)

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provided by section 17955(b). Appellant's representations on its partnership returns that appellant is *not* an investment partnership are consistent with our conclusion that appellant does not qualify as an investment partnership. Appellant has provided no documentary evidence to support a contrary conclusion. For the foregoing reasons, we conclude that appellant was required to file partnership tax returns for the appeal years.

Issue 2 – Whether appellant has established reasonable cause to abate the late-filing penalties.

For the relevant tax years, section 18633 required every partnership with income from a California source to file a return on or before the 15th day of the fourth month following the close of its taxable year. Here, for each of the appeal years, appellant filed its partnership return more than 12 months after the statutory tax return due date. As relevant here, section 19172 imposes a late-filing penalty when 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. FTB correctly imposed late-filing penalties of: $1,728 for 2010 ($18 x 9 partners x 12 months); $1,944 for 2011 ($18 x 9 partners x 12 months); $1,944 for 2012 ($18 x 9 partners x 12 months); and $2,592 ($18 x 12 partners x 12 months).

To establish reasonable cause to abate the late-filing penalty, 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.)

Appellant argued initially that it did not have a filing requirement in California because it was a qualified investment partnership; however, for the reasons stated above we reject this contention. It appears that appellant may have believed that it did not have a filing requirement, but appellant has not provided any evidence of any action taken by appellant, 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. Without any evidence showing any steps appellant took, appellant has not met its burden of proving reasonable cause to abate the penalty. (*Appeal of Diebold, Inc.*, *supra*.) Furthermore, we note that appellant's belief, however sincere, that it did not have a filing

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requirement for the appeal years, is insufficient to find reasonable cause. (*See Appeal of J. Morris and Leila G. Forbes*, 67-SBE-042, Aug. 7, 1967.) Accordingly, we find that appellant failed to meet its burden of proof to substantiate that reasonable cause exists for the abatement of the Section 19172 late-filing penalty for the appeal years.

Issue 3 -Whether appellant has established reasonable cause to abate the filing enforcement fee imposed for the 2010 tax year.

Section 19254(a)(2) provides that a filing enforcement cost recovery fee shall be imposed if FTB mails a notice that continued failure to file a return may result in the imposition of such a fee. Once properly imposed, the statute provides no grounds upon which the fee may be abated. (See § 19254.)

Here, on April 3, 2015, FTB issued a Demand for Tax Return to appellant, requesting appellant to file a 2010 tax return by May 6, 2015, or explain why no return was due. The notice further advised appellant that if a 2010 return was due but not filed by May 6, 2015, FTB would impose a filing enforcement cost recovery fee. Appellant was obligated to file a return for 2010 but failed to file it within the time period set forth in the Demand for Tax Return. Therefore, FTB properly imposed the fee, and there is no basis for abating it.

Issue 4 – Whether appellant has established that interest should be abated.

Interest is required to be assessed from the date when payment of tax is due through the date that it is paid. (§ 19101.) Imposition of interest is mandatory; it 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 Yvonne M. Goodwin*, 97-SBE-003, Mar. 19, 1997.)

To obtain relief from the imposition of interest, a taxpayer must qualify under the waiver provisions of sections 21012, 19112, or 19104. The relief of interest under section 21012 is not relevant here, as FTB did not provide appellant with any written advice. Section 19112 requires a taxpayer to make a showing of extreme financial hardship caused by a significant disability or other catastrophic circumstance. However, appellant makes no such showing. Under section 19104, subdivisions (a)(1) and (2), FTB is authorized to abate or refund interest if there has been an unreasonable error or delay in the performance of a ministerial or managerial act by an

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employee of FTB. Here, appellant has not alleged any such errors or delays. Thus, appellant has not established any of the statutory grounds for interest abatement.

HOLDINGS

1. Appellant was a taxable as a partnership and had a California tax return filing obligation for the 2010, 2011, 2012, and 2013 tax years. In addition, appellant has not established that the income it reported on its returns for these years may be excluded from taxable income pursuant to Section 17955.
2. Appellant failed to establish reasonable cause to abate the late-filing penalties imposed for the 2010, 2011, 2012, and 2013 tax years.
3. Appellant failed to establish reasonable cause to abate the filing enforcement cost recovery fee imposed for the 2010 tax year.
4. Appellant has failed to establish that interest should be abated.

DISPOSITION

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

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Jeff Angeja
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Jeffrey G. Angeja
Administrative Law Judge

We concur:

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Teresa A. Stanley
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Teresa A. Stanley
Administrative Law Judge

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Sara A Hosey
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Administrative Law Judge