

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:)
) OTA Case No. 18032389
)
) Date Issued: February 15, 2019
GRID SUBJECT MATTER EXPERTS, LLC)
)
)
)

OPINION

Representing the Parties:

For Appellant: Sean T. Boyd, CPA

For Respondent: Eric A. Yadao, Tax Counsel III

S. HOSEY, Administrative Law Judge: Pursuant to California Revenue and Taxation Code section 19324,¹ Grid Subject Matter Experts, LLC (appellant) appeals an action by the respondent Franchise Tax Board (FTB) denying appellant’s claim for refund of \$1,818.39² for the 2016 tax year.

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

ISSUES

1. Has appellant established that it is entitled to abatement of the late-filing penalty imposed under section 19131?
2. Has appellant established that it is entitled to abatement of the per-shareholder late-filing penalty imposed under section 19172.5?
3. Has appellant established that it is entitled to a waiver of the underpayment of estimated tax penalty imposed under section 19142?

¹ Unless otherwise indicated, all statutory “section” or “§” references are to sections of the California Revenue and Taxation Code for the tax year at issue.

² This is comprised of a late-filing penalty of \$1,429.69 under section 19131, a per-shareholder late-filing penalty of \$72 under section 19172.5, and an underpayment of estimated tax penalty of \$316.70 under section 19142.

FACTUAL FINDINGS

1. Appellant is a Delaware limited liability company (LLC) that registered with the California Secretary of State (SOS) in August 2011.
2. Appellant elected to be treated as a subchapter S Corporation for federal and state tax purposes for 2016. During that year, appellant had two members.³
3. Appellant's 2016 tax return was due on March 15, 2017, and was filed on April 18, 2017. On its return, appellant reported a total tax liability of \$17,978, total estimated tax payments of \$5,291, a self-assessed amount for unspecified penalties and interest of \$741, and a total amount due of \$13,428. Appellant paid the balance due with its return.
4. FTB issued a Return Information Notice (RIN) dated July 27, 2017, stating that appellant's estimated tax payments for 2016 totaled only \$3,681, which was less than the \$5,291 reported on the return. The RIN also assessed an estimated tax penalty of \$316.70, a late-filing penalty under section 19131 of \$1,429.69, and a late-filing penalty under section 19172.5 of \$72. Taking into account these adjustments, and applying what FTB determined was the correct amount of appellant's tax payments for 2016, the RIN advised appellant to pay a balance due of \$2,767.60.
5. FTB's records indicated the following payments were received from appellant during 2016 and applied to appellant's account for the 2016 tax year:
 - a) \$1,587 on May 24, 2016;
 - b) \$250 on May 31, 2016 (to satisfy a SOS fee/penalty);
 - c) \$2,117 on June 15, 2016;
 - d) \$507.01 on June 28, 2016; and
 - e) \$1,587 on December 1, 2016.
6. Appellant contends that the \$2,117 payment listed above was intended as an estimated tax payment for the 2016 tax year, and the subsequent payment of \$507.01 was intended as a payment for the 2015 tax year. However, those payments were not accompanied by payment vouchers, or otherwise accompanied by instructions from appellant designating how the payments should be applied.
7. FTB, following its process for applying undesignated payments to the oldest outstanding

³ Consistent with appellant's election to be treated as a subchapter S corporation, appellant's members are treated as subchapter S shareholders for tax purposes.

liability first, applied the \$2,117 payment to a liability appellant had outstanding for its 2015 tax year, and refunded the balance to appellant. FTB applied the \$507.01 payment as an estimated tax payment for appellant's 2016 tax year.

8. Appellant contends that it is entitled to an abatement of the penalties as they were incorrectly imposed. Appellant argues that FTB misapplied appellant's payments, thereby increasing the amount of penalties owed by appellant.
9. Appellant was forfeited by the SOS from February 7, 2017 to July 13, 2017.
10. Appellant paid the balance due for 2016 and claimed a refund, which FTB denied.
11. Appellant filed this timely appeal.

DISCUSSION

Issues 1 & 2 - Has appellant established that it is entitled to abatement of the late-filing penalty imposed under section 19131 and the per-shareholder late-filing penalty imposed under section 19172.5?

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 tax underpayment shown on the return. The penalty is five percent of the amount of tax required to be shown on the return for every month or portion of a 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).) FTB imposed penalties against appellant under section 19131 for 2016 of \$1,429 (appellant's \$14,296.99 unpaid tax liability balance times five percent times two, since the return was filed two months late).

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 for a maximum of 12 months. Here, appellant's 2016 return was filed two months late, so the penalty imposed under section 19172.5 was \$72.00 (\$18 times two members/shareholders times two months late).

The penalties were properly imposed because appellant filed its return on April 18, 2017,

more than one month late. Section 18601 requires every corporation doing business in California to file a tax return on or before the 15th day of the third month following the close of the taxpayer's taxable year. Section 18604 allows FTB to grant a reasonable extension of time for the filing of a corporate return. For subchapter S corporations, for the year at issue FTB automatically grants a six-month extension of time to file a return provided the entity is in good standing in California on the original return due date.⁴ However, FTB did not grant an extension for appellant, and appellant did not qualify for the automatic extension, as it was not in good standing on March 15, 2016. Appellant's privilege to conduct business in California had been forfeited by the SOS from February 7, 2017 to July 13, 2017, during the time the original filing was due.⁵ Therefore, appellant's 2016 tax year return was due no later than March 15, 2017 and appellant did not qualify for the automatic extension.

Nevertheless, the late-filing penalty under section 19131 will be abated if it is established that the late filing was attributable to reasonable cause and not willful neglect. (§ 19131(a).) Furthermore, 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.⁶ (§ 19172.5(a).)

Appellant does not provide arguments as to why the *late-filing* penalties should be abated. Rather, appellant contends that its *payment* obligations were due to FTB's misapplication of appellant's otherwise timely payments. Appellant made two payments around the same time: \$2,117 on June 15, 2016, and \$507.01 on June 28, 2016. Appellant may have intended for the first payment to be applied to its 2016 tax year, but because it did not designate how the payment should be applied, FTB applied it in accordance with its procedures. The payment was applied to the earliest year for which there was a balance due, appellant's 2015 tax year, and the excess was refunded to appellant. In support of its position, appellant has provided a copy of the estimated tax payment filing instructions it received from its tax return preparer,

⁴ See FTB Notice 92-11 (Oct. 23, 1992), superseded by FTB Notice 2016-04 (Nov. 04, 2016). Additionally, we note that the 2016 instructions relating to Form FTB 3539 (Payment for Automatic Extension for Corporations and Exempt Organizations) reflects this requirement, stating as follows: "To qualify for the automatic extension, the corporation . . . must file its CA tax return by the extended due date and its powers, rights, and privileges must not be suspended or forfeited by FTB or the CA SOS as of the original due date."

⁵ Section 18604 allows FTB to grant a reasonable extension of time for filing a return for taxpayers subject to the Corporation Tax Law, in a manner and form as FTB may determine.

⁶ Showing a lack of willful neglect is not required to abate the section 19172.5 per-shareholder, late-filing penalty.

setting forth the amount of the estimated tax payments to be paid (totaling only \$5,291, far less than appellant's ultimately reported tax liability of \$17,987). Appellant was instructed that each payment should be accompanied by a completed voucher, which would identify the California corporation number, EIN number, SOS number and the tax year to which the payment should be applied. However, this evidence only shows that appellant was aware of the obligation to designate the payment for a specific tax year, not that it actually made such a designation. Furthermore, once FTB processed the first payment and applied it to the 2015 balance due and sent appellant a refund of the excess amount, appellant should have realized that the application of payments was not done the way it had intended. A reasonably prudent businessperson would have contacted FTB after the unexpected refund was issued and determined that the payment had not been applied to the proper tax year. Additionally, regardless of whether the \$2,117 payment had been applied to the 2016 taxable year as appellant intended, late-filing penalties still would have been imposed. Appellant's return was filed late with a balance due. However, the amount of the penalty imposed under section 19131 would have been reduced slightly (by approximately \$218) as the amount due with the return would have been less (\$12,152.99 instead of \$14,269.99).⁷

Appellant has not provided evidence or argument that the late-filing of the 2016 tax return was due to reasonable cause and therefore appellant is not entitled to abate the late-filing penalty imposed under section 19131 or the per-shareholder late-filing penalty imposed under section 19172.5.

Issue 3 – Has appellant established that it is entitled to a waiver of the underpayment of estimated tax penalty imposed under section 19142?

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, or part of a year, that it is qualified to do business in this state. (§§ 19023, 19025.) A corporation that underpays its estimated tax is penalized by an addition to tax equal to a specified rate of interest applied to the amount of the underpayment. (§§ 19142, 19144.) A penalty for the underpayment of estimated tax is properly imposed where the taxpayer's installment payments

⁷ The amount of the late-filing penalty imposed under section 19172.5 would not be affected since that penalty is not computed by reference to the amount of tax due.

are less than the amounts due at the end of the installment periods. (*Appeal of Bechtel, Inc.*, 78-SBE-052, July 26, 1978.)⁸ There is no general reasonable cause exception to the estimated tax penalty. (*Appeal of Weaver Equipment Co.*, 80-SBE-048, May 21, 1980.)

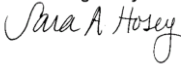
With respect to the estimated tax penalty assessed against appellant, we note that there is no reasonable cause exception to that penalty, and appellant has not shown any grounds for abating it. Accordingly, we find that appellant is liable for the estimated tax penalty assessed by FTB.

HOLDINGS

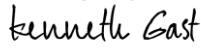
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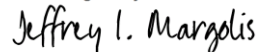
DISPOSITION

FTB’s denial of 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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 Kenneth Gast
 Administrative Law Judge

DocuSigned by:

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 Jeffrey I. Margolis
 Administrative Law Judge

⁸ Precedential decisions of the State 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#boeopinion>>.