

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 18010768
KIDZART TEXAS, LLC) Date Issued: March 13, 2019
_____)

OPINION

Representing the Parties:

For Appellant: Sue Bartman, Chief Executive Officer

For Respondent: Eric Yadao, Tax Counsel

M. GEARY, Administrative Law Judge: Pursuant to Revenue and Taxation Code section 19324,¹ Kidzart Texas, LLC (appellant) appeals an action by the Franchise Tax Board (FTB) denying appellant’s claim for refund of \$2,234.50 for the 2006, 2008, 2009, 2010, 2011, 2013, and 2015 taxable years.²

Appellant waived its right to an oral hearing. Therefore, we decide the matter based on the written record.

ISSUES

1. Is appellant entitled to abatement of the late-filing penalties imposed by FTB for the 2006, 2008, 2009, and 2010 taxable years and the late-payment penalties imposed by FTB for the 2006, 2008, 2010, and 2011 taxable years?
2. Is appellant entitled to abatement of the estimated tax penalties imposed by FTB for the 2009, 2010, 2011, 2013, and 2015 taxable years?
3. Is appellant entitled to interest abatement?

¹ Unless otherwise indicated, all statutory (“section” or “§”) references are to the Revenue and Taxation Code.

² FTB indicates the amount of the claim is \$2,235.50, but appellant’s claim requests a refund of \$2,234.50. According to FTB, the penalties imposed on appellant total \$2,059.23, and interest totals \$1,150.15. Appellant requests abatement of the penalties and also requests interest abatement. Since we are limited by the amount of the claim, we infer that appellant requests abatement of \$175.27 (\$2,234.50 - \$2,059.23 = \$175.27) in interest.

FACTUAL FINDINGS

1. Appellant, a franchisor, is a limited liability company (LLC) domiciled in Mississippi. It elected S corporation tax treatment effective January 1, 2009.³
2. Appellant received California-source income for the 2011 taxable year. It timely filed its 2011 California tax return on or about April 15, 2012, paying with the return the minimum tax (\$800), a late-payment penalty of \$44, an estimated tax penalty of \$26, and interest of \$3. Appellant, who had not previously filed a California income tax return, stated in its 2011 return that it started to receive California-source income in May 2005.
3. On October 31, 2012, FTB sent to appellant a “Request for Past Due Corporation Tax Return” for the taxable years 2005 through 2010.
4. Appellant filed its 2006, 2008, 2009, and 2010 returns late and paid its taxes late for the 2006, 2008, 2010, and 2011 taxable years.
5. For the 2006, 2008, 2009, and 2010 taxable years, FTB imposed late-filing penalties on appellant pursuant to section 19131.
6. For the 2006, 2008, and 2011 taxable years, FTB imposed late-payment penalties on appellant pursuant to section 19132.
7. For the 2006 and 2008 taxable years, FTB also imposed late-filing penalties on appellant pursuant to section 19172.⁴
8. For the 2010 tax year, FTB imposed a late-filing penalty pursuant to section 19172.5.
9. For the 2009, 2010, 2011, 2013, and 2015 taxable years, FTB imposed estimated tax penalties pursuant to section 19142.
10. Appellant paid all tax, interest and penalties, and thereafter filed a timely claim for refund, which FTB denied. This timely appeal followed.

³ Because of the election, some of the filing requirements (and applicable penalties) changed effective the 2009 taxable year.

⁴ Although section 19172 refers to a partnership, it also applies to an LLC taxed as a partnership.

DISCUSSION

Issue 1 – Is appellant entitled to abatement of the late-filing penalties imposed by FTB for the 2006, 2008, 2009, and 2010 taxable years and the late-payment penalties imposed by FTB for the 2006, 2008, and 2011 taxable years?

For the taxable years at issue, a limited liability company (LLC) that was classified as a partnership for California tax purposes, and that was doing business or organized in the state, or was registered with the Secretary of State, was required to file its return and pay the taxes due on or before the 15th day of the fourth month first following close of its taxable year.

(R&TC, §§ 18633.5(a), 19001.) For the same period, and as relevant here, an S corporation was required to file its return and pay the taxes due on or before the 15th day of the third month first following close of its taxable year. (See former R&TC, §§ 18601, 19001.) Although there are provisions that allow both types of filers extensions of time within which to file their returns (See R&TC, §§ 18567 and 18604), there were no extensions in effect for the taxable years for which FTB imposed late-filing penalties.⁵

Appellant was an LLC classified as a partnership for California income tax purposes during the 2006 and 2008 taxable years. It elected S corporation tax treatment for the 2009 taxable year and thereafter. Appellant's returns for 2006, 2008, 2009, and 2010 were late and its tax payments for the 2006, 2008, and 2011 taxable years were late. Consequently, FTB imposed the various penalties at issue.

Appellant does not deny that it filed its returns and paid its taxes late, as alleged, or that FTB correctly calculated and imposed the penalties at issue. It relies on the same alleged circumstances to argue that it had reasonable cause for its failure to timely file its returns and pay the estimated taxes and taxes due for the taxable years at issue. It states it did business in many states during the years in question and was not aware it had a filing requirement or owed taxes in California until 2012, when the accountant it hired to handle its 2011 tax filings so informed it. Generally, it argues that it exercised ordinary business care and prudence at all relevant times by consulting five different certified public accounting firms, fully disclosing all relevant facts to these tax professionals, and reasonably relying on their advice that appellant had no filing

⁵ There are no extensions of time for paying taxes (RT&C, §§ 18567(a), 18604(b)) and there were no automatic extensions of time for filing returns in effect because appellant filed the returns after October 15 of the years following the taxable years 2006, 2008, 2009, and 2010.

requirement in California. But the facts described by appellant do not include the allegation that the tax professionals specifically advised appellant it had no California filing requirement. Rather, appellant states it relied on the tax professionals to file all required returns, and none of its advisors advised appellant to file a California return for any of the years in question. Appellant further alleges that there was confusion among accountants regarding California's filing requirements during the time in question, and it refers to unspecified "amendments" to California law and a notice sent to accountants regarding the change. Finally, appellant notes that FTB did not notify it regarding the past due returns and payments until after it filed its 2011 return, and it states that if its request for abatement of the penalties is denied, it will not be able to continue to do business in California.

FTB must impose a late-filing penalty when a taxpayer fails to file a tax return by the due date, and a late-payment penalty when a taxpayer fails to pay the amount of tax due by the due date, unless the evidence establishes that the failures were due to reasonable cause and not to willful neglect.⁶ (R&TC, §§ 19131, 19132.) Similarly, and as relevant here, sections 19172 and 19172.5 provide that under similar circumstances, a partnership (or an LLC treated as a partnership) and an S corporation, respectively, are liable for late-filing penalties, calculated based on the number of partners (members) or shareholders, respectively, during any part of the taxable year, unless the evidence shows that the failure is due to reasonable cause.

To establish reasonable cause for relief on a penalty, a taxpayer must provide credible and competent evidence supporting a claim of reasonable cause; otherwise the penalty cannot be abated. (*Appeal of Tao Xie*, 2018-OTA-076P, July 23, 2018.)^{7, 8} To establish reasonable cause, the taxpayer must show the failure to timely file returns or make tax payments occurred despite the exercise of "ordinary business care and prudence." (*Appeal of Sidney G. Friedman and Ellen Friedman*, 2018-OTA-077P, August 23, 2018.) Unsupported assertions are not sufficient to

⁶ There is nothing in the evidence suggestive of willful neglect, so we will make no further mention of that element.

⁷ Because the "reasonable cause" standard set forth in the various penalty statutes at issue is identical, we can rely on authorities discussing that standard as it applies to any one of the penalties.

⁸ Precedential opinions issued by the Office of Tax Appeals can be seen on its website at <<https://ota.ca.gov/opinions/>>.

satisfy a taxpayer's burden of proof. (*Appeal of Aaron and Eloise Magidow*, 82-SBE-274, Nov. 17, 1982.)⁹

Taxpayers have a personal, non-delegable obligation to file a tax return and pay the taxes due by the due date, and reliance on tax professionals to fulfill those obligations is not reasonable cause. (*United States v. Boyle* (1985) 469 U.S. 241, 247-248.) Ignorance of the law is not an excuse for failing to file a timely return. (*Appeal of J. Morris and Leila G. Forbes*, 67-SBE-042, Aug. 7, 1967.) Nevertheless, if the evidence establishes that (1) the taxpayer consulted with a tax professional on a substantive question of law and provided the tax professional with all of the information needed to correctly answer the question, (2) the tax professional provided the taxpayer with legal advice on the question of law, and (3) taxpayer reasonably relied on that advice and otherwise exercised ordinary and reasonable care with regard to the action taken in reliance on the advice, such evidence may establish reasonable cause. (*United States v. Boyle*, *supra*, 469 U.S. at pp. 250-251.)

We have only appellant's unsupported statements that it made full disclosure to the tax professionals and reasonably relied on them to file all required returns. We have no independent evidence regarding what appellant told its tax advisors, what the tax advisors did to determine whether appellant was required to file a California return, or what specific advice the tax advisor gave to appellant. Based on the evidence, it is just as likely that the tax advisors were unaware of the minimum LLC tax and simply assumed that there was no filing requirement. That would not support appellant's reasonable cause argument. While we understand appellant has been unable to obtain evidence from its former tax advisors, appellant has the burden of proof. It has failed to carry that burden. On the basis of the evidence, we find that appellant has not established that it reasonably relied on advice from tax professionals on a substantive question of law.

Furthermore, appellant has provided no evidence of any ambiguity in the law regarding its filing requirement, and we are not aware of any. We are also not aware of a change in the filing requirement during the time at issue that could have caused appellant or its tax advisors to

⁹ Pursuant to the Office of Tax Appeals Rules for Tax Appeals, California Code of Regulations, tit. 18, § 30501(d)(3), precedential opinions of the State Board of Equalization (BOE) which 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 as part of a written opinion that the panel issues pursuant to this section. BOE opinions are generally available for viewing on the BOE's website: <<http://www.boe.ca.gov/legal/legalopcont.htm#boeopinion>>.

be confused about whether appellant was required to file a California return for any of the years in question. On the basis of the evidence, we find that appellant has not shown that its late returns and payments were due to reasonable cause. We conclude that appellant is not entitled to abatement of the late-filing and late-payment penalties imposed by FTB.

Issue 2 – Is appellant entitled to abatement of the estimated tax penalties imposed by FTB for the 2009, 2010, 2011, 2013, and 2015 taxable years?

In addition to the obligation to timely file returns and pay taxes, 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. (R&TC, §§ 19023, 19025.) If the amount of estimated tax does not exceed the \$800 minimum franchise tax (R&TC, § 23153(d)(1)), the entire amount of the estimated tax shall be due and payable on or before the fifteenth day of the fourth month of the taxable year. (R&TC, § 19025(a).) 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. (R&TC, §§ 19142, 19144.) There is nothing in the law that allows an entity relief from the penalty on a showing of reasonable cause or extenuating circumstances. (*Appeal of Weaver Equipment Company*, 80-SBE-048, May 21, 1980.)

Appellant has been earning California-source income since at least 2005. Consequently, it was required to pay estimated tax for each of the taxable years at issue. The evidence shows, and appellant does not deny, that appellant did not pay its estimated tax for the years at issue, which caused FTB to impose estimated tax penalties for the 2009, 2010, 2011, 2013, and 2015 taxable years. Appellant does not argue that FTB incorrectly calculated or imposed the estimated tax penalties. Rather, it argues that it did not pay its estimated taxes for those years due to reasonable cause, that being because it did not know that it owed estimated taxes and because it relied on its accountants to handle all required tax filings and payments. However, as explained above, there is no reasonable cause exception for failing to pay estimated taxes. Based on the evidence, we find that appellant is not entitled to abatement of the estimated tax penalties imposed by FTB for the 2009, 2010, 2011, 2013, and 2015 taxable years.

Issue 3 – Is appellant entitled to interest abatement?

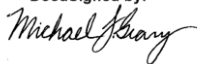
Interest is not a penalty. It is compensation to the state for a taxpayer's use of the funds, and the law requires FTB to collect interest on past-due taxes. There is no reasonable cause exception to the imposition of interest. (R&TC, § 19101(a); *Appeal of Amy M. Yamachi*, 77-SBE-095, June 28, 1977; *Appeal of Audrey C. Jaegle*, 76-SBE-070, June 22, 1976.) FTB can abate interest when the interest is attributable to unreasonable error or delay by an FTB officer or employee while performing a ministerial or managerial act in his or her official capacity. (R&TC, § 19104(a).) However, appellant does not allege or prove unreasonable error or delay by an FTB officer or employee. It argues that there is reasonable cause to abate interest, but that is not a basis for abatement. Consequently, we conclude that appellant is not entitled to interest abatement.

HOLDINGS


1. Appellant is not entitled to abatement of the late-filing penalties imposed by FTB for the 2006, 2008, 2009, and 2010 taxable years or late-payment penalties imposed by FTB for the 2006, 2008, and 2011 taxable years.
2. Appellant is not entitled to abatement of the estimated tax penalties imposed by FTB for the 2009, 2010, 2011, 2013, and 2015 taxable years.
3. Appellant is not entitled to interest abatement.

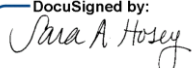
DISPOSITION

We sustain FTB's denial of the claim for refund.

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Michael F. Geary
Administrative Law Judge

We concur:

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Neil Robinson
Administrative Law Judge

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Sara A. Hosey
Administrative Law Judge