

**OFFICE OF TAX APPEALS**  
**STATE OF CALIFORNIA**

In the Matter of the Appeal of:  
**CONTUS CORPORATION**

) OTA Case No. 18010996  
)  
) Date Issued: March 18, 2019  
)  
)  
)  
)  
)  
)

**OPINION**

Representing the Parties:

For Appellant: Michael Hunter, CPA

For Franchise Tax Board (FTB): David Muradyan, Tax Counsel III

For Office of Tax Appeals: Josh Lambert, Tax Counsel

G. THOMPSON, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC) section 19324, Contus Corporation appeals an action by FTB denying its claim for a refund of the following amounts: for the 2011 tax year, a late-filing penalty of \$200, an S corporation late-filing penalty of \$7,128, and an underpayment of estimated tax penalty (estimated tax penalty) of \$25.32; and, for the 2012 tax year, a late-filing penalty of \$200, an S corporation late-filing penalty of \$6,534, and an estimated tax penalty of \$23.58.<sup>1</sup>

Appellant requested that this appeal be submitted for decision on the basis of the written record and without an oral hearing. Accordingly, the appeal is being decided based on the written record and without an oral hearing.

**ISSUE**

Whether appellant has shown grounds for abating the late-filing penalties imposed under R&TC section 19131, the S corporation late-filing penalties imposed under R&TC section 19172.5, or the estimated tax penalties imposed under R&TC section 19142.

---

<sup>1</sup> The above amounts total \$14,110.90, which is the amount stated in appellant’s refund claim. However, on appeal, appellant states that it is only seeking a refund of one half of this amount (i.e., \$7,055.45).

## FACTUAL FINDINGS

### Overview

1. During 2011 and 2012, appellant, an S corporation, owned a 37.99-percent membership interest in About Golf Limited (AGL), a limited liability company. AGL commenced business in California during 2010 and apportioned items of income and loss to California during 2011 and 2012.
2. Appellant had 33 shareholders during 2011 and 2012.
3. AGL filed timely California income tax returns for 2011 and 2012 by the extended due date for each year. Each of AGL's returns include a California Schedule K-1 for appellant that apportions items of California income and loss to appellant.
4. Appellant did not file timely California tax returns for 2011 and 2012.
5. After being contacted by FTB, appellant filed late California tax returns for 2011 and 2012. On the returns, appellant listed January 1, 2011 as the "Date business began in California or date income was first derived from California sources."<sup>2</sup> For 2011, appellant reported total pre-apportioned net income of \$1,162,082, but California apportioned net income of only one dollar. For 2012, appellant reported a total pre-apportioned net loss of \$401,704 and a California apportioned net loss of \$8,051. Based on these amounts, it paid the minimum California franchise tax of \$800 for both years.
6. FTB subsequently imposed the penalties that are at issue in this appeal. Appellant paid the amounts FTB showed as due and filed a claim for refund of the penalties. After FTB denied appellant's refund claim, appellant filed this timely appeal.

### 2011 Tax Year

7. Because appellant had not timely filed a 2011 return, FTB sent appellant a Demand for Tax Return (Demand) dated July 19, 2013, requiring appellant to respond by August 21, 2013, by either filing a 2011 return or explaining why a 2011 return was not required.

---

<sup>2</sup> On appeal, appellant contends it had no sales, office, property or employees in California. Based on these contentions, we infer that the January 1, 2011 date on appellant's 2011 and 2012 tax returns refers to the date appellant first derived income from California sources.

8. On February 10, 2014, FTB received appellant's 2011 California S corporation tax return (Form 100S). On its return, appellant reported a tax liability of \$800, plus \$26 of self-assessed penalties and interest.
9. On February 15, 2014, appellant submitted a payment of \$824.
10. FTB accepted the 2011 return as filed but imposed an S corporation late-filing penalty of \$7,128, a late-filing penalty of \$200, and an estimated tax penalty of \$25.32.
11. On May 2, 2014, FTB sent appellant a Corporation Past Due Notice for 2011 and 2012, requesting that appellant pay the full amount due by May 17, 2014.
12. On June 6, 2014, FTB sent appellant a Corporation Final Notice Before Levy, stating that the full amount due must be paid.
13. On July 28, 2014, FTB sent appellant's bank an Order to Withhold Corporation Tax.
14. FTB's records show payments of \$7,392.39 and \$90.93 on August 15, 2014 and October 29, 2014, respectively.

#### 2012 Tax Year

15. On February 10, 2014, FTB received appellant's 2012 S corporation tax return. On the return, appellant reported a tax liability of \$800, plus \$24 of self-assessed penalties and interest. Appellant paid \$824 on February 15, 2014.
16. FTB accepted the return as filed. However, FTB imposed an S corporation late-filing penalty of \$6,534, a late-filing penalty of \$200, and an estimated tax penalty of \$23.58.
17. As noted previously, on May 2, 2014, FTB sent appellant a Corporation Past Due Notice for 2011 and 2012, requesting that appellant pay the full amount due by May 17, 2014.
18. FTB's records show payments of \$4,841.30 and \$2,323.91 on August 15, 2014 and October 29, 2014, respectively.

#### Claim for Refund for the 2011 and 2012 Tax Years

19. On October 30, 2014, appellant submitted a claim for refund requesting abatement of all the penalties for the 2011 and 2012 tax years.
20. FTB denied the claim for refund, stating that appellant failed to demonstrate reasonable cause for the late-filing penalties, and that there was no provision in the law for abatement of the estimated tax penalty.

21. Appellant then filed this timely appeal. On appeal, appellant only requests a refund of one half of the penalties (i.e., \$7,055.45).<sup>3</sup>

## DISCUSSION

### R&TC Section 19131 Late-Filing Penalties

For the 2011 and 2012 tax years, an S corporation was required to file its tax return on or before the 15th day of the third month following the close of its taxable year. (R&TC, § 18601.) R&TC section 18604(a) provides for a reasonable extension of time to file a return, not to exceed seven months after the due date for filing a return. R&TC section 18604 further provides that an extension to file may be granted in the “manner and form as the Franchise Tax Board may determine.” Pursuant to FTB Notice No. 92-11, the extension of the time to file is conditioned upon filing the return within the automatic extension period. If the return is not filed by the extended due date, then no extension exists.<sup>4</sup>

Appellant’s tax returns for 2011 and 2012 were filed after both the regular due date and the extended due date. Appellant’s 2011 return was filed on February 10, 2014, more than 22 months after the March 15, 2012 due date. Appellant’s 2012 return was filed on February 10, 2014, more than ten months after the March 15, 2013 due date.

R&TC section 19131 imposes a late-filing penalty of 5 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. FTB properly calculated appellant’s late-filing penalties of \$200 for 2011 and \$200 for 2012 (i.e., the maximum of 25 percent of the \$800 of tax due for each year).

R&TC section 19131 provides that the late-filing penalty will be abated if the taxpayer establishes that the late filing was due to reasonable cause and was not due to willful neglect. 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 such cause existed as would

---

<sup>3</sup> Appellant does not expressly state why it is now seeking a refund of only one half of the penalties. To the extent appellant is seeking to compromise or settle its liability, we note that we have no such authority. R&TC sections 19442 and 19443 give FTB exclusive authority to settle or compromise franchise and income tax disputes.

<sup>4</sup> For tax years beginning on and after 2016, FTB Notice No. 92-11 has been superseded by FTB Notice No. 2016-04, which also conditions the extension on filing a return within the extension period.

prompt an ordinar[ily] intelligent and prudent businessman to have so acted under similar circumstances.” (*Appeal of Tons*, 79-SBE-027, Jan. 9, 1979.)<sup>5</sup>

Here, appellant owned a substantial ownership interest in AGL, which conducted business in California. Appellant has now filed tax returns acknowledging that it received California source income from AGL. Based on AGL’s tax returns, it appears that appellant received California Schedule K-1s from AGL showing items of California income and loss. In these circumstances, we believe a company exercising ordinary business care and prudence would at least consult with a professional to determine if it had a California filing obligation. However, appellant has provided no evidence or argument that, prior to the applicable due dates for 2011 and 2012, it undertook any efforts to determine whether it had a California filing obligation.

Appellant argues that, since being informed of the filing requirement, it has responded to all information and tax return requests. We note that FTB determined it needed to issue an Order to Withhold Corporation Tax to appellant’s bank, which calls into question appellant’s claim of prompt compliance. More important, even if appellant promptly complied with FTB notices alerting it to the filing requirement, its later compliance, after the due date had passed, cannot constitute a cause for its prior failure to file a timely tax return. In order to demonstrate reasonable cause for failing to timely file, appellant would need to show something that occurred prior to the due date that caused it to miss the filing deadline, and further show that this cause was reasonable.

Appellant states that it only owed the minimum tax for each year because it did not have a profit in California. However, there is no exemption from the filing requirement where only the minimum tax is due. Moreover, ignorance of the law does not excuse compliance with statutory requirements. (*Appeal of Diebold, Inc.*, 83-SBE-002, Jan. 3, 1983.)

Appellant also appears to contend that it is unfair for late penalties to accrue during the period when correspondence with FTB was occurring regarding its tax filing obligations. However, the fact FTB had to notify appellant to file tax returns does not demonstrate that appellant exercised ordinary business care and prudence in determining whether it had a California filing obligation. We note that appellant did not timely respond to FTB’s Demand,

---

<sup>5</sup> State Board of Equalization cases, designated “SBE,” may generally be found at: <http://www.boe.ca.gov/legal/legalopcont.htm>.

and it did not file its California tax returns until approximately six months after the Demand. We find appellant did not act with ordinary business care and prudence during the period following FTB's Demand and see no basis to abate any portion of the late-filing penalties on this ground.<sup>6</sup>

Appellant also briefly argues that its case is similar to *Swart Enterprises, Inc. v. Franchise Tax Bd.* (2017) 7 Cal.App.5th 497 (*Swart*).<sup>7</sup> Appellant contends that, like the taxpayer in *Swart*, it is a passive investor and has no direct activities in California.<sup>8</sup> However, unlike the taxpayer in *Swart*, appellant appears to concede that it has a filing requirement and owes the minimum tax, as appellant has filed tax returns indicating it conducted business in California and has not claimed a refund of the tax. Although it is not entirely clear, it appears appellant may be raising *Swart* to illustrate that the issues involved can be complex and, on this ground, argue that it had reasonable cause for not filing its tax return. However, as noted above, there is no evidence or argument that appellant exercised ordinary business care by considering these issues prior to the deadlines for filing its 2011 and 2012 tax returns.

In sum, appellant held a substantial ownership interest in a pass-through entity that was conducting business in California and reported items of California income and loss to appellant on a Schedule K-1. Appellant now acknowledges that it is taxable by California but has not provided any evidence or argument that it took any timely steps, prior to the due date of its California tax returns for 2011 and 2012, to determine whether it had a California filing obligation. Therefore, we have no factual basis to conclude that appellant exercised ordinary business care and diligence.

### S Corporation Late-Filing Penalties

R&TC section 19172.5(a) provides that, for returns required to be filed after January 1, 2011, if any S corporation fails to file a return within the time prescribed (determined with regard to any extension of time for filing), then the S corporation shall be liable for a penalty

---

<sup>6</sup> By the time FTB contacted appellant with the Demand, the full amount of the R&TC section 19131 had already accrued, and the full amount of the R&TC section 19172.5 for 2011 had already accrued.

<sup>7</sup> Appellant references a tentative ruling by the trial court in the *Swart* litigation. The trial court later adopted the tentative ruling. The appellate court decision, which is cited above, sustained the trial court, but was not issued until after appellant filed its appeal letter.

<sup>8</sup> Appellant's appeal letter provides no evidence, and appellant did not reply to FTB's brief. The record does not include a copy of any governing documents of AGL, or any other documentation, to show that appellant's 37.99 percent interest was a passive interest. In contrast, the record in *Swart* clearly established that the *Swart* taxpayer's .2 percent interest was entirely passive.

unless that failure is due to reasonable cause. The amount of the penalty is calculated as \$18 multiplied by the number of persons who were shareholders in the S corporation during any part of the taxable year multiplied by each month (or fraction thereof) the return is late, up to 12 months. (R&TC, § 19172.5(b).)

Appellant argues that, as it has 33 shareholders, assessing the S corporation late-filing penalty based on the numbers of shareholders is burdensome. However, FTB properly followed R&TC section 19172.5, which requires that the penalty be calculated with reference to the number of shareholders.<sup>9</sup> The method of calculating the amount of the penalty is set by the Legislature. We have no power to change it. (See *Appeal of Walker*, 73-SBE-020, Mar. 27, 1973.)

Appellant's other arguments do not distinguish between the S corporation late-filing penalties and the R&TC section 19131 late-filing penalties. We addressed those arguments above in our discussion of the R&TC section 19131 late-filing penalties, and, for the same reasons, find that appellant has not shown grounds to abate the S corporation late-filing penalties.

#### Estimated Tax Penalties

A corporation subject to the franchise tax must pay estimated tax. (R&TC, § 19023.) If the amount of estimated tax does not exceed the minimum franchise tax, the entire amount of the estimated tax is due 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.) There is no general reasonable cause exception to the underpayment of estimated tax penalty.<sup>10</sup> (*Appeal of Johnson*, 2018-OTA-119P, Mar. 27, 2018.)<sup>11</sup>

Appellant does not dispute that it failed to make timely estimated tax payments or argue that FTB did not properly compute the underpayment of estimated tax penalties. Appellant did not remit any estimated payments during the tax years at issue. There is no reasonable cause

---

<sup>9</sup> FTB imposed the penalties in the amount of \$7,128 (i.e., \$18 × 33 shareholders x 12 months) for 2011 and \$6,534 (i.e., \$18 x 33 shareholders x 11 months) for 2012.

<sup>10</sup> For individuals, Internal Revenue Code section 6654(e)(3) provides narrow circumstances in which the estimated tax penalty for an individual taxpayer may be waived. The provision is not relevant here because appellant is a corporation.

<sup>11</sup> The Office of Tax Appeals publishes opinions on its website at: <https://ota.ca.gov/opinions/>.

exception or other ground upon which the estimated tax penalties might be abated. Thus, we have no basis to abate the estimated tax penalties.

HOLDING

Appellant has not shown grounds to abate the late-filing penalties under R&TC section 19131, the S corporation late-filing penalties under R&TC section 19172.5, or the estimated tax penalties imposed under R&TC section 19142.

DISPOSITION

FTB's action denying appellant's claim for refund is sustained.

DocuSigned by:  
*Grant S. Thompson*  
FC572D5881AE41B...  
Grant S. Thompson  
Administrative Law Judge

We concur:

DocuSigned by:  
*Kenneth Gast*  
FD75A3136CB34C2...  
Kenneth Gast  
Administrative Law Judge

DocuSigned by:  
*Sara A. Hosey*  
6D3FE4A0CA514E7...  
Sara A. Hosey  
Administrative Law Judge