OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	)	OTA Case No. 18032484
	)	
SPYGLASS REALTY PARTNERS, INC.	)	Date Issued: February 25, 2019
	)	
	)	
	)	

OPINION

Representing the Parties:

For Appellant: John A. Roskos, CPA

For Respondent: David Muradyan, Tax Counsel III

J. ANGEJA, Administrative Law Judge: Pursuant to Revenue and Taxation Code section 19324,[1] Spyglass Realty Partners, Inc. (appellant) appeals an action by the Franchise Tax Board (FTB or respondent) in denying appellant's claim for refund in the amount of $1,248.51 for the 2014 tax year, requesting refund of an S corporation late-filing penalty imposed under section 19172.5, and a late-filing penalty imposed under section 19131. This matter is being decided based on the written record because appellant waived its right to an oral hearing.

ISSUES

Whether appellant established a basis for abatement of the: (1) section 19172.5 S corporation late-filing penalty; or (2) section 19131 late-filing penalty.

FACTUAL FINDINGS

1. Appellant is a California corporation registered with the California Secretary of State. It is taxed as an S corporation for federal and California income tax purposes.
2. Appellant hired a professional tax preparer, Mr. John A. Roskos, CPA, to prepare and file its 2014 federal and state tax returns.

[1] Unless otherwise indicated, all section references are to the Revenue and Taxation Code for the tax year at issue.

3. On March 31, 2015, appellant submitted signed forms to Mr. Roskos authorizing him to electronically file its federal and state tax returns with the IRS and FTB, respectively. Mr. Roskos did not file appellant's state tax return with FTB at this time.[2]
4. On April 12, 2015, appellant made a payment of $868 towards its 2014 tax year liability.[3]
5. Subsequently, FTB sent appellant a Request for Past Due Corporation Tax Return, dated September 13, 2017, notifying appellant that it had not filed a 2014 tax return and requesting an explanation within 30 days. In response, Mr. Roskos electronically filed appellant's 2014 tax return with FTB on October 5, 2017, approximately 31 months after the due date. The return reported $800 in minimum annual tax, plus self-assessed "penalties and interest" of $68,[4] for a total liability of $868 for the 2014 tax year (which appellant had untimely paid on April 12, 2015).
6. After processing the return, FTB sent appellant a Notice of Balance Due, dated November 21, 2017, notifying appellant that FTB had assessed penalties and interest for the late filing. Appellant's total liability consisted of $800 for the minimum franchise tax, $21.96 for the estimated tax penalty, $200 for the section 19131 late-filing penalty,[5] $1,080 for the section 19172.5 S corporation late-filing penalty,[6] plus $14.55 in accrued interest if paid by December 6, 2017. After applying appellant's $868 payment, the remaining unpaid balance due by December 6, 2017, was $1,248.51.

[2] The filing status of appellant's federal return is not specified in the record.

[3] Of this amount, $800 was due the prior year, on April 15, 2014, because the amount of appellant's estimated tax did not exceed the $800 minimum franchise tax imposed under section 23153. (See §§ 19025(a), 23802(c).)

[4] The self-assessed penalty was for underpayment of estimated tax. Even if the return had been timely filed on March 31, 2015, within the extension period, the estimated tax penalty would have been assessed because appellant was required to pay the estimated tax by April 15, 2014 (see footnote 3, *supra*). This self-assessed amount for interest and the estimated tax penalty is not at issue in appeal.

[5] This amount represents 25 percent of the $800 minimum franchise tax.

[6] This amount represents $18, multiplied by the number of shareholders (5), multiplied by the number of months late the return was filed, not to exceed 12 months (here, 12 months, covering the period March 15, 2015, through October 5, 2017).

7. On December 6, 2017, appellant's tax preparer, Mr. Roskos, personally paid the $1,248.51 balance due on behalf of appellant.[7] Later that same day, Mr. Roskos filed a claim for refund in the amount that he paid, $1,248.51, contending that appellant had reasonable cause for the late filing because appellant relied on him to timely file the return, which was reasonable because he timely filed all prior tax returns for appellant. Mr. Roskos alternatively contends that the penalty should be abated because he generally meets deadlines; however, "because of the volume of returns and extensions" he had to prepare, he forgot to file appellant's return. In support, Mr. Roskos stated that he is a sole proprietor and had to file over 275 federal and state tax returns for 2014.
8. By letter dated January 8, 2018, FTB denied the appellant's claim for refund on the basis that appellant failed to show reasonable cause for the late filing.
9. By letter dated January 16, 2018, Mr. Roskos timely appealed the refund denial on behalf of appellant, contending that appellant exercised ordinary business care in relying on Mr. Roskos to file the return, and the breakdown was entirely Mr. Roskos' fault. Mr. Roskos further contended that he overlooked the filing deadline due to the busy filing season for him, and his oversight was unintentional, but he is only human. In support, Mr. Roskos stated that he personally paid appellant's late-filing penalties because the late filing was his fault, and that appellant will only reimburse him for the $1,248.51 that he personally paid if we grant appellant's refund claim and refund the $1,248.51 to appellant. Mr. Roskos also submitted a transaction history from his checking account to prove that he personally paid the claimed refund amount, $1,248.51.
10. In a subsequent letter dated June 5, 2018, Mr. Roskos further explained that, since he paid the penalties, he is the one being penalized, not appellant, which he contends is not the intent of a late-filing penalty because he is only the return preparer.

[7] Mr. Roskos paid $1,248.51, which is the claimed refund amount. The total amount of the late-filing penalties assessed for 2014 ($1,280) exceeds the claimed refund amount because appellant overreported the estimated tax penalty (the only penalty which would have applied if the return was filed as intended on March 31, 2015), and the balance was applied towards appellant's remaining 2014 tax liabilities.

DISCUSSION

The S corporation late-filing penalty

California imposes a late-filing penalty on an S corporation for the failure to file a return on or before the due date, unless it is shown that the late filing is due to reasonable cause. (§ 19172.5(a).) The amount of the S corporation late-filing penalty is the product of two multiplication factors. (§ 19172.5(b)(1).) The two factors are: (1) $18 dollars; and (2) the number of persons who are shareholders in the S corporation during any part of the taxable year. (§ 19172.5(b)(2).) The late-filing penalty amount is increased monthly for each month, or fraction of a month, not to exceed 12 months, during which the S corporation's failure to file a required return continues. (§ 19172.5(a).) This penalty is assessed against the S corporation. (§ 19172.5(c).)

In the case of an S corporation, a return is due on or before the 15th day of the third month following the close of the tax year. (§ 18601(d)(1).) Pursuant to section 18604(a), FTB automatically allows corporations, including S corporations, a seven-month extension of time to file a return. (§ 18604(a); FTB Notice 92-11, Oct. 23, 1992.)[8] An extension is not allowed if a return is not filed within the automatic extension period. (FTB Notice 92-11, *supra*.) Here, the late-filing penalty imposed under section 19172.5 applies because appellant did not file a 2014 tax return until October 5, 2017, which is approximately 31 months after the March 15, 2015 due date. Appellant does not dispute the calculation of the S corporation late-filing penalty or contend that the return was timely filed; instead, appellant requests abatement.

In order to abate a late-filing penalty imposed pursuant to section 19172.5, an S corporation must establish that its failure to timely file was due to "reasonable cause." (§ 19172.5(a).) Existing precedential decisions of the Board of Equalization (BOE) discussing penalty abatement only interpret statutory language which requires a taxpayer to establish that two standards are met: (1) that the failure was due to "reasonable cause;" and (2) that the failure was not the result of willful neglect. (See, e.g., *Appeal of Michael E. Myers*, 2001-SBE-001, May 31, 2001 [section 19131 late-filing penalty]; *Appeal of M.B. and G.M. Scott*, 82-SBE-249, Oct. 14, 1982 [late payment penalty]; *Appeal of Stephen C. Bieneman*, 82-SBE-148, July 26,

[8] FTB Notice 92-11 discusses application of section 25402, which was subsequently renumbered as section 18604 by Senate Bill 3 (Stats. 1993, ch. 31). FTB Notice 2016-04 (Nov. 4, 2016) supersedes FTB Notice 92-11 for taxable years beginning on or after January 1, 2016, and shortens the automatic extension period to six months for S corporations.

1982 [demand penalty]; *Appeal of Howard G. and Mary Tons*, 79-SBE-027, Jan. 9, 1979 [late-filing penalty].)[9] Nevertheless, the definition of "reasonable cause" is a standard one that is applicable to section 19172.5 as well.[10]

In order for a taxpayer to establish that a failure to act was due to reasonable cause, the taxpayer must show that the failure occurred despite the exercise of ordinary business care and prudence, or that cause existed as would prompt an ordinarily intelligent and prudent businessman to have so acted under similar circumstances. (*Appeal of Howard G. and Mary Tons, supra*.)[11]

In *United States v. Boyle* (1985) 469 U.S. 241, 249 (*Boyle*), the U.S. Supreme Court established a bright-line rule (*id.* at p. 248) and expressly held that "[t]he failure to make a timely filing of a tax return is not excused by the taxpayer's reliance on an agent, and such reliance is not 'reasonable cause' for a late filing . . . ." (*Id.* at p. 252.) While the Court noted that reasonable cause may exist if a taxpayer relies on the advice of an accountant or attorney with respect to substantive matters of tax law or whether a return needs to be filed in the first place (*id.* at pp. 250-251), it nonetheless concluded that "one does not have to be a tax expert to know that tax returns have fixed filing dates and that taxes must be paid when they are due. In short, tax returns imply deadlines. Reliance by a lay person on a lawyer [or an accountant] is of course common; but that reliance cannot function as a substitute for compliance with an unambiguous statute." (*Id*. at p. 251.)

The courts have consistently applied the rule set forth in *Boyle*, even in circumstances where a taxpayer acted prudently in dealing with its agent or employee. (See, e.g., *Kimdun Inc. v. United States* (C.D. Cal. 2016) 202 F.Supp.3d 1136 [finding that reliance on payroll service to make payments was not sufficient to establish reasonable cause under *Boyle*, despite a third-party outside payroll service's embezzlement of money that was intended to pay the employment tax

[9] Precedential BOE opinions 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: <www.boe.ca.gov/legal/legalopcont.htm>.

[10] We do not address willful neglect in this section because it is not required by section 19172.5.

[11] As relevant, BOE has historically looked to federal law for guidance on the standard of what constitutes reasonable cause, and has generally found the standard of "reasonable cause" the same for federal and state purposes, and we continue to do so. (See *Appeal of Yvonne M. Goodwin*, 97-SBE-003, Mar. 19, 1997; *Appeal of Thomas K. and Gail G. Boehme*, 85-SBE-134, Nov. 6. 1985; *Andrews v. Franchise Tax Bd.* (1969) 275 Cal.App.2d 653, 658; *Rihn v. Franchise Tax Bd.* (1955) 131 Cal.App.2d 356, 360.)

obligations]; *Conklin Bros. of Santa Rosa Inc. v. United States* (9th Cir. 1993) 986 F.2d 315 [finding that reliance on taxpayer's controller to make payments was not sufficient to establish reasonable cause, despite the controller's alleged intentional concealment of her failure to make payroll tax payments].) Precedential decisions that bind this agency have also consistently applied the *Boyle* rule. (See, e.g., *Appeal of Goodwin* 97-SBE-003, Mar. 19, 1997 ["As a general rule, the responsibility for the mere filing of a tax return is a nondelegable personal duty which cannot be avoided by placing the responsibility with an agent"]); *Appeal of Orr,* 68-SBE-010, Feb. 5, 1968 ["It is the duty of the taxpayer to see that a timely return is filed, and the delegation of this responsibility will not serve to excuse late filing."].)[12]

Appellant contends that the late filing was due to reasonable cause because it delegated the filing to a professional tax preparer and, through no fault of appellant, the tax preparer failed to timely file the return. Appellant also contends that it should be excused for the late filing due to circumstances which caused its tax preparer to miss the filing deadline. Specifically, Mr. Roskos, appellant's preparer, explains that he overlooked the filing deadline "because of the volume of returns and extensions" he had to prepare, and that he did not discover the oversight until FTB notified appellant about the non-filing.

As noted above, reliance on an agent, such as a tax preparer, to timely file a tax return does not constitute reasonable cause. (See *Boyle*, *supra*, 469 U.S. 241, 252.) Therefore, appellant's stated reliance on its accountant to timely file a California S corporation return does not constitute reasonable cause for a late filing.

The section 19131 late-filing penalty

Section 19131 imposes a penalty for the failure to file a return on or before the due date, unless it is shown that the late filing is due to reasonable cause and not willful neglect. (§ 19131(a).) The amount of the late-filing penalty imposed by section 19131 is five percent of the tax due, after allowing for timely payments, for every month or fraction of a month that the return is late, up to a maximum penalty of 25 percent. (§ 19131(a).) This is a separate and

[12] The concurrence below attempts to create an exception to the *Boyle* rule by opining that a taxpayer may establish reasonable cause for failing to timely file a return, so long as the taxpayer did not merely *assume* that its agent would timely file it, but instead took reasonable steps to ensure that its agent attempted to do so. The concurrence cites no authority in support of its proposed exception, and does not attempt to distinguish the authorities cited above. *Boyle* and its progeny articulate a clear, bright-line rule that the duty to file a return is *nondelegable* and *personal*. The plain meaning of these words precludes the possibility that "reasonable delegation" could establish reasonable cause.

distinct penalty from the S Corporation late-filing penalty discussed above. A person may be subject to both late-filing penalties for the same tax year.

FTB correctly asserts, and appellant does not dispute, that the late-filing penalty applies at the maximum rate of 25 percent (for returns filed five or more months late) because appellant filed its return on October 5, 2017, approximately 31 months late. For the reasons explained above, we find that appellant's late-filing was not due to reasonable cause.[13]

HOLDINGS

Appellant failed to establish a basis for relief of the (1) section 19172.5 S corporation late-filing penalty, or (2) the section 19131 late-filing penalty.

DISPOSITION

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

DocuSigned by:
Jeff Angeja
0D390BC3CCB14A9...
Jeffrey G. Angeja
Administrative Law Judge

I concur:

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

[13] Based on our finding that appellant failed to establish reasonable cause, it is not necessary for us to address willful neglect.

Concurring Opinion of Kwee, Administrative Law Judge:

I concur in the holding of the majority opinion under the facts of this case. Nevertheless, I believe the majority opinion may be interpreted as an absolute prohibition on penalty abatement when an agent is involved, regardless of whether reasonable cause exists for reasons unrelated to the hiring of an agent to file a return. While I agree that circumstances constituting reasonable cause are not met in the instant case, I write this concurrence to explain why I believe it is not appropriate to adopt a blanket prohibition against finding reasonable cause for a late-filing or late payment penalty based entirely on the fact that the taxpayer hired an agent to file the return.

United States v. Boyle (1985) 469 U.S. 241 (*Boyle*) and its progeny involve scenarios where the taxpayer failed to exercise ordinary business care to ensure a return was timely filed and instead *assumed* that an agent timely filed the return. Due to this assumption, many months or years lapse before the non-filing is discovered. This is what is meant by "reliance" on an agent to timely file a return. There may, of course, be other reasons for a late filing. Therefore, the analysis for whether reasonable cause exists does not automatically end with a finding that the taxpayer hired a professional tax preparer or other agent. It is still necessary to examine the reason for a late filing to determine if reasonable cause exists. If the reason for the late filing is that the taxpayer assumed their agent would timely file the return, then this is not reasonable cause, because this constitutes reliance on an agent as provided in *Boyle*. If there is some other reason for the late filing, a finding of reasonable cause is not automatically foreclosed and it is necessary to determine whether the requisite standard of care was met.

Here, late-filing penalties were imposed under sections 19131 and 19172.5. Under both sections, the requisite standard of care for reasonable cause is the same. In order for a taxpayer to establish that a failure to timely file a return was due to reasonable cause, the taxpayer must show that the failure occurred despite the exercise of ordinary business care and prudence, or that cause existed as would prompt an ordinarily intelligent and prudent businessman to have so acted under similar circumstances. (*Boyle, supra,* at pp. 245-246; *Appeal of Stephen C. Bieneman,* 82-SBE-148, July 26, 1982; *Appeal of Howard G. and Mary Tons,* 79-SBE-027, Jan. 9, 1979.)

The decision in *Boyle* clarifies that assuming an agent will timely file a return is not reasonable cause because it does not meet the requisite standard of care (i.e., ordinary business care and prudence). (*Boyle, supra,* at p. 251.) The reason is that a taxpayer cannot delegate away their duty under the statute to exercise ordinary business care and prudence, and ordinary

business care includes ensuring a return is timely filed. That being said, *Boyle* does not mean that a taxpayer can never be relieved of a late-filing penalty simply by virtue of hiring a tax professional. *Boyle* does not abrogate a plain reading of California's statute—i.e., that the late-filing penalty applies "unless that failure is due to reasonable cause."[1] (§ 19172.5(a).)

Here, the return was filed approximately 31 months late and no unusual circumstances exist. This indicates that appellant failed to exercise ordinary business care and prudence and instead *assumed* that its agent, Mr. Roskos, timely filed the return, without verifying the filing status or taking any other action to personally meet the filing deadline. Therefore, in the absence of any special circumstances, or the exercise of ordinary business care by appellant, it can be concluded that the late filing was due to appellant's assumption that Mr. Roskos would timely file the return.

To say that it was "reasonable" for appellant to assume that Mr. Roskos would comply with the statutes may resolve the matter as between them, but not with respect to appellant's obligations under sections 19131 and 19172.5. (See *Boyle*, *supra*, at p. 250.) A "reasonable delegation" is not a basis for abatement because the Legislature has charged taxpayers with an unambiguous, precisely defined duty to file the return timely. (*Ibid*.) That Mr. Roskos, as appellant's agent, was expected to attend to the matter does not relieve appellant of his duty to comply with the statute. (*Ibid*.) Appellant does not contend that he personally took any actions to ensure that his tax return was timely filed. Instead, appellant contends that the late filing was due to Mr. Roskos' workload limitations. The standard of ordinary business care and prudence includes the responsibility to take adequate safeguards to ensure that known and unambiguous deadlines are timely met. (*Vaughn v. United States* (6th Cir. 2015) 635 Fed.Appx. 216, 220.) While a person is, of course, free to allocate his or her time and resources however they wish, here, the decision to prepare over 275 tax returns was entirely within Mr. Roskos' control. If the

[1] The Court in *Boyle* held that "The failure to make a timely filing of a tax return is not excused by the taxpayer's reliance on an agent, and such reliance is not 'reasonable cause' for a late filing under." (*Boyle*, *supra*, at p. 252.) In *Boyle*, the taxpayer exercised ordinary business care and prudence in hiring an attorney to assist with federal estate tax filing obligations. (*Id*. at 249.) Nevertheless, the Court found that it was not reasonable cause for the taxpayer "to *assume* that the attorney would comply with the statute" because, under the statute, the duty to timely file a return is imposed on the taxpayer. (*Id*. at 250.) In footnote 12, the majority disregards the fact that the holding in *Boyle* finds that "reliance on an agent" is not reasonable cause, and instead misapplies *Boyle* to express an interpretation that after an agent has been hired to prepare and file a return, it is irrelevant whether or not reasonable cause prevents the taxpayer from timely filing a return. Such an interpretation conflicts with the plain language of sections 19131 and 19172.5, and the majority opinion offers no authorities which apply such an expansive interpretation.

government had to bear the burden of late filings resulting from every tax preparer's individual workload limitations, then the state's tax filing "deadlines" would have little or no purpose or effect. Therefore, appellant failed to establish that its late filing was due to reasonable cause.

DocuSigned by:

3CADA62FB4864CB...

Andrew J. Kwee
Administrative Law Judge