OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18011801
WOWYOW INC.	) Date Issued: April 18, 2019

OPINION

Representing the Parties:

For Appellant: Adam Boskovich, CEO

For Respondent: Maria Huseinbhai, Tax Counsel

For Office of Tax Appeals: Neha Garner, Tax Counsel III

P. KUSIAK, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, appellant appeals an action by respondent Franchise Tax Board (FTB) affirming a proposed assessment of tax of $5,831.13, a late-filing penalty of $1,457.78, a notice and demand penalty (demand penalty) of $1,457.78, and a filing enforcement cost recovery fee of $100, plus applicable interest for the 2014 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 filing obligation and owed tax in the amount of $5,831.13 for the 2014 tax year.
2. Whether appellant has established reasonable cause for failing to timely file its tax return.
3. Whether appellant has demonstrated reasonable cause for failing to respond to the demand for its tax return.
4. Whether the filing enforcement fee may be abated.
5. Whether interest may be abated.

FACTUAL FINDINGS

1. Appellant is a Delaware corporation.
2. Appellant did not file a timely California tax return for the 2014 tax year.
3. FTB received information from the California Employment Development Department (EDD) that appellant paid a California employee $10,000.00 in wages and paid $481.30 in employer withholding taxes. FTB's records indicate that appellant's employee was a California resident during the tax year at issue, and that the employee reported this income on his California income tax return. According to a printout of appellant's website that FTB provided on appeal, appellant identifies its California resident employee as appellant's "Co-Founder." Furthermore, the printout indicates that appellant's contact address is in San Diego, California.
4. On May 27, 2016, FTB issued a Demand for Tax Return (Demand) for the 2014 tax year requesting that appellant respond by June 29, 2016, by filling out the enclosed form and stating whether appellant had previously filed a 2014 California tax return or if not, to either file a return or explain why it did not have a filing requirement. The Demand also stated that if a return was required, FTB must impose a late-filing penalty and applicable interest on any late-paid tax. FTB also stated that if appellant failed to respond by June 29, 2016, it would assess a minimum tax or a tax based on the best available information, as well as a demand penalty and a cost recovery fee.
5. Appellant replied on June 14, 2016, by completing the section of the form FTB enclosed to determine if appellant had a filing requirement for the 2014 tax year. In response to the questions on FTB's form, appellant stated that it was an internet company and that its annual payroll within and outside of California was $3,900; however, it did not state what its annual payroll total was within California. Appellant also stated that it had a satellite office in San Diego and that it leased or rented personal or real property in California from or to others but did not provide any further information. Appellant's CEO signed the form and provided a contact phone number with a San Diego area code.
6. FTB replied by letter on September 15, 2016, stating that it disagreed with appellant's position that it was not required to file a California tax return for the 2014 tax year. FTB explained that the entity leased or rented real property within California and that activity was not protected under Public Law 86-272. FTB's notice advised appellant that it must

file its return by October 18, 2016. FTB's notice also advised appellant that if it did not file a return, FTB would estimate appellant's income and propose a tax assessment based on that estimate, and impose applicable interest, a late-filing penalty, a demand penalty, and a cost recovery fee.

7. Appellant did not file a return or otherwise respond to FTB's notice. As a result, FTB issued a Notice of Proposed Assessment (NPA) on December 16, 2016, that estimated appellant's taxable income as $65,963, proposed tax of $5,831.13, and imposed a demand penalty of $1,457.78, a late-filing penalty of $1,457.78, and a filing enforcement fee of $100, plus applicable interest.
8. Appellant timely protested the NPA, arguing that it was a Delaware corporation that did not have a permanent office in California. Appellant stated that it would occasionally open a satellite office or rent meeting areas for contractors and employees to visit on a temporary basis, but that it was only for the convenience of the employees. Appellant also stated that it did not have any income in 2014 and that it was in the product development stage and surviving on investment capital.
9. FTB issued a Notice of Action, affirming the NPA, on September 20, 2017. This timely appeal followed.

DISCUSSION

Issue 1: Whether appellant had a California filing obligation and owed tax in the amount of $5,831.13 for the 2014 tax year.

R&TC section 23151, subdivision (a), provides that every corporation doing business within the limits of this state and not expressly exempted from taxation by the provisions of the Constitution of this state or by this part, shall annually pay to the state, for the privilege of exercising its corporate franchises within this state, a tax according to or measured by its net income or, if greater, the minimum tax specified in R&TC section 23153. For 2014, the tax is computed at the rate of 8.84 percent of net income for the taxable year. (R&TC, §§ 23151, subd. (f)(2); 23153, subd. (b)(3).) For 2014, the annual minimum franchise tax was $800. (R&TC, § 23153, subd. (d).)

Since 2011, R&TC section 23101 has contained two alternative bases for finding a taxpayer is doing business in this state. Doing business is defined in subdivision (a) of section

23101 as "actively engaging in any transaction for the purpose of financial or pecuniary gain or profit." (R&TC, § 23101, subd. (a).) The transaction does not need to result in an actual profit for purposes of R&TC section 23101, and the relevant inquiry is whether the activity or transaction was motivated by a financial or pecuniary gain. (*Hise v. McColgan* (1944) 24 Cal.2d 147, 150-151; *Appeal of Columbia Supply Co*., 60-SBE-012, June 9, 1960.)[1] A corporation engaging in even a single profit-motivated transaction during the taxable year is "doing business" in California. (*Carson Estate Co. v. McColgan* (1943) 21 Cal.2d 516; *Appeal of Cagan Homes, Inc.*, 65-SBE-044, Nov. 30, 1965.) Managerial functions performed by a taxpayer in California are sufficient to constitute "doing business" in the state. (*Appeal of Reno Liquor Company, Inc*., 59-SBE-004, Feb. 17, 1959.) Corporations not organized in California that have employees in the state engaged in providing personal services other than in interstate commerce are engaged in intrastate business in this State and are subject to the franchise tax even though those corporations have no office or regular place of business in this state. (*Appeal of Knoll Pharmaceutical Co., Inc.*, 77-SBE-084, June 28, 1977.)

Subdivision (b) of R&TC section 23101, effective for tax years beginning on or after January 1, 2011, provides an alternate basis for doing business. A taxpayer will be considered to be doing business in California if: (1) it is organized or commercially domiciled in this state; (2) it has sales in this state for the applicable tax year that exceed the lesser of five hundred thousand dollars ($500,000) or 25 percent of the taxpayer's total sales; (3) its real and tangible personal property in California exceed the lesser of fifty thousand dollars ($50,000) or 25 percent of the taxpayer's total real property and tangible personal property; or (4) the compensation it pays to employees in California exceeds the lesser of fifty thousand dollars ($50,000) or 25 percent of total compensation paid.[2] (R&TC, § 23101, subd. (b).)

We do not have enough information to determine whether any of the requirements under subdivision (b) of R&TC section 23101 have been satisfied. Therefore, our determination of whether appellant was doing business in this state relies on an analysis of whether appellant was

[1] Precedential opinions of the State Board of Equalization (BOE) may be found on BOE's website at: <http://www.boe.ca.gov/legal/legalopcont.htm>.

[2] The dollar threshold amounts are those set forth in the statute; they have been revised annually since 2011 to take into account the effects of inflation pursuant to R&TC section 17041, subd. (h).

actively engaging in any transaction for the purpose of financial or pecuniary gain or profit under subdivision (a) of R&TC section 23101.

In *Golden State Theatre & Realty Corp.* (1943) 21 Cal.2d 493, the taxpayer contended that it was not "actively" engaged in any transaction for financial gain (and thus not "doing business") because it merely acquired property and derived income therefrom, and none of the transactions occurred regularly. The California Supreme Court disagreed, stating:

> The doing of business, however, does not necessarily mean a regular course of business under the [predecessor to Section 23101], for by its plain terms a corporation is doing business if it actively engages in any transaction for pecuniary gain or profit. [The taxpayer] would identify "doing business" with "carrying on a trade or business." A series of transactions regularly engaged in may be necessary to establish the "carrying on of a trade or business" but the Legislature made it clear that it had no such concept in mind when it referred to transaction in the singular as "any transaction." The word "actively" must therefore be interpreted as the opposite of passively or inactively, and as used in [the predecessor to Section 23101] it means active participation in any transaction for pecuniary gain or profit.

(*Id*., at p. 496.)

Here, appellant's website lists a California address for public contact, and there are no other offices listed on its webpage. Wage information provided to the Employment Development Department (EDD) by appellant and appellant's California employee's 2014 W-2 both list a California address for appellant. The California employee's title on appellant's website lists him as the co-founder. Appellant also conceded it occasionally would open a satellite office in San Diego and that it leased or rented personal or real property in California, including meeting areas for contractors and employees to visit on a temporary basis.

There is ample evidence in the record to support our conclusion that in 2014 appellant was "actively engaging in any transaction for the purpose of financial or pecuniary gain or profit" in California (R&TC, § 23101.) Consequently, appellant is subject to the California franchise tax for the 2014 tax year. Furthermore, appellant is mistaken in its belief that it was not doing business in California because it did not generate any income for the 2014 tax year. Appellant's mailing address, co-founder's presence and office space in California establishes

substantial nexus so as to impose tax under R&TC section 23151 and to require the filing of a California franchise tax return for the 2014 tax year.

In the case of a failure to file a return, FTB is authorized to issue a proposed tax assessment based on an income estimate and may make such estimate using any available information. (R&TC, § 19087 subd. (a).) FTB's proposed assessment is presumed correct once FTB shows a reasonable and rational basis for the estimation. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Myers*, 2001-SBE-001, May 31, 2001.)

The tax agency has wide latitude in estimating income when the taxpayer fails to file a return or provide the information necessary to ascertain their tax liability. (*Palmer v. Internal Revenue Service* (9th Cir. 1997) 116 F.3d 1309, 1312; *Andrews v. Commissioner*, T.C. Memo. 1998-316 [use of data from the Bureau of Labor Statistics is an acceptable and reasonable method to estimate income]; *Appeal of Bailey*, 92-SBE-001, Feb. 20, 1992.)

However, there must be credible evidence in the record which, if accepted as true, would induce a reasonable belief that the amount of tax assessed against the taxpayer is due and owing. (*United States v. Bonaguro* (E.D.N.Y. 1968) 294 F.Supp. 750, 753, affd. sub nom., *United States v. Dono* (2d Cir. 1970) 428 F.2d 204.)

The taxing agency must offer a minimal foundation of substantive evidence supporting an inference that the taxpayer received income from the charged activity. (*United States v. Janis*, 428 U.S. 433, 441-442, *Weimerskirch v. Commissioner* (9th Cir. 1979) 596 F.2d 358.) Without that evidentiary foundation, minimal though it may be, an assessment will be found to be excessive and arbitrary even where the taxpayer is silent. (*Gerardo v. Commissioner* (3d Cir. 1977) 552 F.2d 549; *Jackson v. Commissioner* (1979) 73 T.C. 394; *Appeal of Jackson*, 86-SBE-093, May 6, 1986.)

In response to correspondence from FTB, appellant submitted information under penalty of perjury that it was an internet company, had zero income, had total payroll of $3,900 and was supported by investment capital. Based on information from EDD reporting the payment by appellant of wages to an employee in the amount of $10,000, FTB estimated appellant's income for 2014 at $65,963 and issued an NPA for additional tax in the amount of $5,831.13. FTB

indicates the estimate of income was based on "average income reported by businesses in your type of industry." No industry type is identified.

In this appeal, FTB reaffirmed its view that a return was required and that appellant is liable for at least the minimum franchise tax of $800. But FTB did not provide any additional information to substantiate or explain its assessment of tax in excess of the minimum franchise tax or its computation of appellant's income in the amount of $65,963.

The payment of wages reported on a Form W-2 could be considered credible evidence of income received by the recipient of the wages reported. However, in this case, the payment of wages to a single individual, standing alone, does not provide a sufficient foundation to support an inference that appellant, as payor of those wages, received income.

In view of the absence of any information establishing the reasonableness of FTB's assessment of tax in excess of $800, we cannot find that respondent has established even a prima facie case that appellant received unreported income in that amount, and we cannot place the burden of establishing a negative on appellant in these circumstances. Accordingly, the assessment of additional tax in excess of the minimum franchise tax of $800 will not be sustained.

Issue 2: Whether appellant has established reasonable cause for failing to timely file its tax return.

R&TC section 19131 provides that a late-filing penalty shall be imposed when a taxpayer fails to file a tax return on or before its due date, unless the taxpayer establishes that the late filing was due to reasonable cause and was not due to willful neglect. To establish reasonable cause, the taxpayer "must show that the failure to file timely returns occurred despite theexercise of ordinary business care and prudence, or that cause existed as would prompt an ordinary [*sic*] intelligent and prudent businessman to have so acted under similar circumstances." (*Appeal of Tons*, 79-SBE-027, Jan. 9, 1979.) Even if the taxpayer is unaware of a filing requirement, ignorance of the law is not an excuse for failing to file a timely return. (*Appeal of Duff*, 2001-SBE-007, Dec. 20, 2001; *Appeal of Diebold, Inc.*, 83-SBE-002, Jan. 3, 1983; *Appeal of Oxford Liquor, Inc.*, 79-SBE-052, Mar. 7, 1979; *Appeal of Forbes*, 67-SBE-042, Aug. 7, 1967.)

Here, the due date for appellant's 2014 return was April 15, 2015. However, appellant has not filed a 2014 California tax return. Appellant argues that the late-filing penalty should be abated because it did not receive taxable income in 2014 and therefore believes it does not have a

filing requirement. However, as stated above, even if a taxpayer is unaware of a filing requirement, ignorance of the law does not excuse compliance with statutory requirements. (*Appeal of Diebold, supra*.) Therefore, the record does not show any facts and circumstances that would warrant a finding of reasonable cause.

Issue 3: Whether appellant has demonstrated reasonable cause for failing to file a return in response to the Demand for its 2014 return.

California imposes a penalty for the failure to file a return or to provide information upon the FTB's Demand to do so, unless reasonable cause prevented the taxpayer from responding to the Demand. (R&TC, § 19133.) The burden of proving "reasonable cause" for the failure to file upon Demand is on the taxpayer. (*Appeal of Beadling*, 77-SBE-021, Feb. 3, 1977.) To constitute reasonable cause, a taxpayer's reason for failing to respond to a Demand must be such that an ordinarily intelligent and prudent businessperson would have acted similarly under the circumstances. (*Appeal of Quality Tax & Financial Services, Inc.*, 2018-OTA-130P, Sept. 14, 2018;[3] *Appeal of Curry*, 86-SBE-048, Mar. 4, 1986.) Where no evidence has been offered to show that the failure to furnish information was due to reasonable cause and not willful neglect, there is no reason to disturb the imposition of the penalty. (*See Appeal of Quality Tax & Financial Services, Inc., supra.*)

Here, in a notice dated May 27, 2016, FTB advised the taxpayer to file a return, send a copy of a return that had been filed or explain why a return was not required. Appellant responded with information about the nature of the company, payroll expenditures and rental of real property in California. In correspondence dated September 15, 2016, FTB reiterated its Demand and advised appellant that, among other things, appellant might be subject to the demand penalty if appellant did not file a tax return within a prescribed period. FTB did not receive a return from appellant within the prescribed period in the Demand. On appeal, appellant argued that it did not file because it was not subject to a California filing requirement but has failed to provide any specific argument or evidence in reply to FTB's Determination of Filing Requirement and Demand. A review of the record does not show any facts and circumstances that would warrant a finding of reasonable cause.

[3] Precedential opinions of the Office of Tax Appeals may be found at: <https://ota.ca.gov/opinions>.

Issue 4: Whether the filing enforcement cost recovery fee may be abated.

R&TC section 19254, subd. (a)(2), provides that, if any person fails or refuses to make and file a return after the FTB mails to that person a formal Demand, the FTB is required to impose a filing enforcement cost recovery fee. Once properly imposed, there is no provision in the R&TC which would excuse the FTB from imposing the filing enforcement cost recovery fee for any circumstances. Here, FTB informed appellant in the Demand and in the Determination of Filing Requirement that appellant might be subject to the filing enforcement cost recovery fee if appellant did not file a tax return. FTB did not receive a return from appellant within the prescribed period in the Determination of Filing Requirement and subsequently in the Demand. Appellant still has not filed a return. Therefore, FTB properly imposed the filing enforcement fee, and we have no basis to abate this fee.

Issue 5: Whether interest may be abated.

Under California law, taxes are due and payable as of the original due date of the taxpayer's return without regard to the extension to file the return. (R&TC, §§ 18567, subd. (b); 19001.) If tax is not paid by the original due date, or if FTB assesses additional tax and that assessment becomes due and payable, R&TC section 19101 requires the charging of interest on the resulting balance due. Interest is not a penalty, but is simply compensation for a taxpayer's use of money after the due date of the tax. (*Appeal of Jaegle*, 76-SBE-070, June 22, 1976.) The imposition of interest is mandatory. (*Appeal of Yamachi*, 77-SBE-095, June 28, 1977; *Appeal of Jaegle, supra*.) There is no reasonable cause exception to the imposition of interest. (*Appeal of Jaegle, supra*.)

To obtain relief from the imposition of interest, under the facts presented, a taxpayer must establish eligibility for waiver or abatement of interest under provisions of R&TC sections 21012 or 19104. The relief of interest under R&TC section 21012 is not relevant here, as FTB did not provide appellant any written advice. Under R&TC section 19104, FTB is authorized to abate interest if there has been an unreasonable error or delay in the performance of a ministerial or managerial act by an employee of FTB. Such abatement can only occur if no significant aspect of the error or delay can be attributed to the taxpayer, and after FTB first contacts the taxpayer in writing with respect to the deficiency or payment. (R&TC, § 19104, subd. (b)(1).) However, appellant does not allege that FTB committed an error or delay in this matter or provide any

basis for which an abatement of interest may occur in this appeal. Therefore, appellant has not overcome its burden of showing error in FTB's determination not to abate interest.

HOLDING

1. Appellant was doing business in California in 2014 and owed California franchise tax in the amount of $800.
2. Appellant has failed to demonstrate reasonable cause to abate the late-filing penalty.
3. Appellant has failed to demonstrate reasonable cause to abate the demand penalty.
4. Appellant has failed to demonstrate that the filing enforcement fee should be abated.
5. Appellant has not demonstrated that interest should be abated.

DISPOSITION

The amount of tax due is reduced to $800, and the amount of the associated penalties under R&TC sections 19131 and 19133 are reduced accordingly, to $200 each. In all other respects, FTB's action is sustained.

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Patrick J. Kusiak
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Patrick J. Kusiak
Administrative Law Judge

We concur:

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Teresa A. Stanley
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Teresa A. Stanley
Administrative Law Judge

DocuSigned by:
John O. Johnson
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