OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	)	OTA Case No. 18010947
	)	
DAVID STONE AND	)	Date Issued: December 11, 2018
	)	
CHRISTINE GERMAINE STONE	)	
	)	

OPINION

Representing the Parties:

For Appellants: Nicole Stewart, CPA

For Respondent: David Kowalczyk, Tax Counsel

K. GAST, Administrative Law Judge: Pursuant to California Revenue and Taxation Code section 19324,[1] David Stone and Christine Germaine Stone (appellants) appeal an action by the Franchise Tax Board (FTB or respondent) in denying appellants' claim for refund in the amount of $9,365 for the 2012 tax year.

Appellants waived their right to an oral hearing, and therefore this matter is being decided based on the written record.

ISSUE

Have appellants established the late-filing penalty imposed under section 19131 should be abated due to reasonable cause?

FACTUAL FINDINGS

1. During the 2012 tax year, appellants were California nonresidents. Mr. David Stone (appellant-husband) was a shareholder who owned 100 percent of the stock of an S corporation that was doing business in California and registered with the California Secretary of State.

[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. The 2012 tax year was the first year the S corporation derived income from California sources. Thus, appellants' previous accountant prepared and timely filed a 2012 California S corporation return. The S corporation issued to appellant-husband a Schedule K-1, reporting California source income. The accountant did not prepare or file a 2012 California nonresident income tax return for appellants.
3. On October 20, 2015, respondent issued to appellants a Request for Tax Return because it did not receive their 2012 return by the April 15, 2013 due date.
4. On January 15, 2016—two years and nine months past the due date—appellants untimely filed their 2012 return, reporting a tax liability of $37,460, but not did remit payment.
5. On June 21, 2016, respondent issued a Notice of State Income Tax Due, imposing a late-filing penalty of $9,365, plus interest.
6. By October 18, 2016, appellants had paid the tax, late-filing penalty, and interest due.
7. On June 9, 2017, appellants filed a claim for refund, contending the late-filing penalty should be abated due to reasonable cause.[2]
8. On August 29, 2017, respondent denied appellants' claim for refund due to lack of reasonable cause. This timely appeal followed.
9. On appeal, appellants submitted a letter, dated August 29, 2018, from their prior accountant who prepared their nonresident individual and S corporation returns for the 2012 tax year. In the letter, the accountant states that his firm "erroneously" did not prepare a 2012 joint California nonresident tax return for appellants, despite the fact that appellant-husband received a California Schedule K-1 from the S corporation indicating that he had California-source pass-through income. He further states that when preparing appellants' 2012 nonresident returns for filing in various states, his firm "overlooked" preparing a 2012 joint California nonresident return, which was the first year appellants were required to file in California.

DISCUSSION

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 due to willful neglect.

[2] Appellants filed an earlier claim for refund for the late-filing penalty on February 19, 2016. Because this claim was filed prior to the payment of the liability due, it only operated to toll the statute of limitations until it was perfected when the liability was paid in 2016. (§ 19322.1.)

(§ 19131(a).) The late-filing penalty is computed at five percent of the amount of tax required to be shown on the return for every month that the return is late, up to a maximum of 25 percent. (*Ibid.*) Here, it is undisputed that respondent properly computed the late-filing penalty. In addition, respondent does not assert willful neglect is present in this case, and therefore the only issue is whether appellants have demonstrated reasonable cause for the late filing.

To establish reasonable cause to abate the late-filing penalty, "the 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 prompt an [ordinarily] intelligent and prudent businessman to have so acted under similar circumstances." (*Appeal of Howard G. and Mary Tons*, 79-SBE-027, Jan. 9, 1979.)[3] The burden of proof is on the taxpayer to establish reasonable cause exists to support an abatement of the penalty. (*Ibid*.)

In *United States v. Boyle* (1985) 469 U.S. 241, 251-252 (*Boyle*), the U.S. Supreme Court 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 . . . ." To be sure, the court noted 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, even when such advice turned out to have been mistaken. (*Id*. at pp. 250-251.) The reason the court drew this distinction between substantive versus non-substantive tax advice is, with respect to the former, "[m]ost taxpayers are not competent to discern error in the substantive advice of an accountant or attorney," and "[t]o require the taxpayer to challenge the attorney, to seek a 'second opinion,' or to try to monitor counsel on the provisions of [the tax law] himself would nullify the very purpose of seeking the advice of a presumed expert in the first place." (*Id.* at p. 251, citation omitted.) " 'Ordinary business care and prudence' do not demand such actions." (*Ibid.*)

However, the court then concluded "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." (*Boyle, supra,* at p. 251.) In sum, "[r]eliance on another to perform the ministerial task of filing or paying cannot be reasonable cause for failure to file or pay by the deadline." (*Estate of Thouron v. United States* (3d Cir. 2014) 752 F.3d 311.)

[3] Board of Equalization (BOE) opinions are generally available for viewing on its website: <http://www.boe.ca.gov/legal/legalopcont.htm#boeopinion>.

Here, appellants contend they have reasonable cause to abate the late-filing penalty because they relied on the tax expertise of their prior accountant to help them timely file nonresident individual returns in multiple states where their S corporation was doing business and filing returns. As support, appellants submitted a letter from that accountant. In the letter, the accountant states that his firm "erroneously" did not prepare a 2012 joint California nonresident tax return. He further states that when preparing appellants' 2012 nonresident multistate returns, his firm "overlooked" preparing a 2012 California nonresident return, which was the first year appellants were required to file in California.

Appellants, however, have not provided any support for their contention they relied on the substantive tax law advice of their prior accountant to not file a 2012 California nonresident income tax return. To establish such reliance, appellants must have shown that (1) the accountant is a tax professional with competency in the subject tax law, and (2) the accountant's advice is based on appellants' full disclosure of the relevant facts and documents. (*Rohrabaugh v. United States* (7th Cir. 1979) 611 F.2d 211, as cited in *Boyle, supra,* at p. 244.) But, here, the evidence shows that the failure to file was not based on substantive tax advice from the prior accountant informing appellants that they did not have an obligation to file a California nonresident return. In other words, the accountant does not claim that he rendered substantive tax advice, or that such advice was even necessary for him to provide, for purposes of determining whether appellants had a California filing requirement. Rather, he admits he simply made a mistake, and "overlooked" filing appellants' 2012 California nonresident return. Reasonable cause cannot be established when appellants relied on their accountant to perform a non-delegable duty of filing their return on time.

In addition, while the 2012 tax year was the first year the S corporation derived income from California sources, appellants have not shown that they inquired with their tax preparer about whether a California nonresident income tax return was being prepared and filed after receiving a Schedule K-1 with California source income. As a shareholder who owned 100 percent of the stock of the S corporation, appellant-husband should have been aware that with an S corporation comes the benefit of pass-through taxation; that is, any business income or loss is passed through to the shareholders who report it on their personal income tax returns. The S corporation issued appellant-husband a Schedule K-1, reporting California source income, which would have prompted an ordinary and prudent businessperson to inquire as to his California

personal income tax filing obligation. The exercise of ordinary business care and prudence would have required appellants to follow up with their tax preparer to ensure that they timely met their California tax filing obligation. Finally, California does not permit penalty abatement due to good filing history; instead, reasonable cause, which is lacking here, must be shown.[4]

HOLDING

Appellants have not established the late-filing penalty should be abated due to reasonable cause.

DISPOSITION

Respondent's action is sustained.

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Kenneth Gast
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Kenneth Gast
Administrative Law Judge

We concur:

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John O Johnson
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John O. Johnson
Administrative Law Judge

DocuSigned by:
Amanda Vassigh
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Amanda Vassigh
Administrative Law Judge

[4] While the Internal Revenue Service has an administrative program called "First Time Abate," under which it will abate timeliness penalties if a taxpayer has timely filed returns and paid tax for the past three years, neither the California Legislature nor FTB has adopted a comparable penalty abatement program. The California Legislature has considered and declined to adopt bills that would change California law to allow a first-time abatement of timeliness-related penalties for taxpayers based solely on their history of timely filing and payment. (See Assem. Bill No. 1777 (2013-2014 Reg. Sess.).)