

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 18042889
THOMAS M. PURBAUGH AND)
KAREN M. SPINA) Date Issued: June 12, 2019
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OPINION

Representing the Parties:

For Appellants: Christopher D. York, CPA
For Respondent: Bradley J. Coutinho, Tax Counsel

S. HOSEY, Administrative Law Judge: Pursuant to California Revenue and Taxation Code section 19324(a),¹ Thomas M. Purbaugh and Karen M. Spina (appellants) appeal an action by Franchise Tax Board (FTB) in denying their claim for refund in the amount of \$22,863.61 for the late-payment penalty for the 2015 tax year.

Administrative Law Judges Sara A. Hosey, Jeffrey I. Margolis, and Tommy Leung held an oral hearing for this matter in Sacramento, California, on March 26, 2019. At the conclusion of the hearing, the record was closed and this matter was submitted for a decision.

ISSUE

Have appellants established reasonable cause to abate the late-payment penalty imposed under section 19132?²

¹ Unless otherwise indicated, all statutory references are to sections of the California Revenue and Taxation Code for the tax year at issue.

² Appellants confirmed at the hearing that they are liable for the underpayment of estimated tax penalty imposed under section 19136 for the 2015 tax year. Therefore, this penalty is no longer at issue and will not be discussed further.

FACTUAL FINDINGS

1. Appellants timely filed their joint 2015 California resident income tax return by the extended due date. On that return, appellants reported total tax due of \$541,654. They offset that tax with income tax withholdings of \$21,766 and claimed estimated tax payments of \$553,406. Based on these total payments, appellants reported an overpayment for 2015 that they requested be applied to their 2016 tax year.
2. Subsequently, FTB adjusted appellants' return to reflect estimated tax payments of only \$104,186, rather than the claimed \$553,406. As a result, FTB determined that appellants had underpaid their taxes by \$415,702.³ FTB imposed a late payment penalty, and issued a notice reflecting the imposition of this penalty, among other adjustments not relevant here.
3. Appellants then notified FTB that its notice did not take into account a large, late extension payment they made on April 22, 2016—seven days after the payment due date of April 15, 2016. FTB agreed. This untimely extension payment reduced the originally-assessed late payment penalty to \$22,863.61.⁴ FTB applied the payment to fully offset the 2015 taxes due as well as the late payment penalty, plus interest.
4. Appellants timely filed a claim for refund, requesting abatement of the late-payment penalty on reasonable cause grounds.
5. FTB denied appellants' refund claim, asserting they had not established reasonable cause for abatement. This timely appeal followed.
6. In their reply brief, appellants assert that in 2015 they sold two business entities, which triggered a large tax liability for that year. Given the complex nature of the sale, they relied on their accountant, Mr. York and his firm, to compute the appropriate amount of tax liability to be paid at extension time for the 2015 tax year (i.e., by April 18, 2016). Importantly, appellants requested that their accountant allow them to make their extension payment electronically. However, the accountant did not submit the electronic

³ This is computed as follows: \$541,654 of tax due, less timely payments of \$21,766 of income tax withholdings and \$104,186 of estimated taxes, as determined and corrected by FTB.

⁴ This is computed as follows: \$415,702 underpayment x 5 percent, plus \$415,702 underpayment x 0.5 percent x 1 month late. The recomputed late payment penalty is lower than the originally assessed amount (\$37,413.18) because appellants' untimely payment of their remaining 2015 tax liability was not as late as FTB's records initially indicated (i.e., appellants paid the outstanding tax due of \$415,702 just seven days late, rather than several months later).

payment on time. Mr. York concedes this was his firm's "mistake," and was "an inadvertent error, beyond [a]ppellant's control," that "involved no bath faith nor willful neglect on anyone's part."

DISCUSSION

Section 19132 imposes a late-payment penalty when a taxpayer fails to pay the amount shown as due on the return on or before the date prescribed for payment of the tax. The late-payment penalty has two parts. The first part of the penalty is 5 percent of the unpaid tax. (R&TC, § 19132(a)(2)(A).) The second part is 0.5 percent per month, or a portion of a month, calculated on the outstanding balance. (R&TC, § 19132(a)(2)(B).) The aggregate amount of the penalty may not exceed 25 percent of the total unpaid tax. (R&TC, § 19132(a)(3).) Here, it is undisputed that FTB properly imposed and computed the late payment penalty. In addition, FTB does not assert willful neglect is present in this case, and therefore the only issue is whether appellant has demonstrated reasonable cause for the late payment.

The late-payment penalty, however, may be abated if the taxpayer shows that the failure to make a timely payment of tax was due to reasonable cause. (R&TC, § 19132(a).) To establish reasonable cause for the late payment of tax, the taxpayer must show that the failure to make a timely payment of the proper amount of tax occurred despite the exercise of ordinary business care and prudence. (*Appeal of Roger W. Sleight* (83-SBE-244) 1983 WL 15615.) The taxpayer bears the burden of proving reasonable cause exists. (*Ibid.*) The failure to timely remit the balance due on a tax liability caused by an oversight does not, by itself, constitute reasonable cause. (*Appeal of Friedman*, 2018-OTA-077P, Jul. 20, 2018.)

On appeal, appellants advance several contentions to show they have established reasonable cause to abate the late-payment penalty. Appellants first contend they exercised ordinary business care and prudence when faced with the complexity of computing the taxes due from the sale of their two businesses. Thus, they assert they engaged their longtime accountant, Mr. York and his firm, to assist in preparing, filing, and determining their taxes. They assert their accountant assured them their extension payment would be transmitted electronically by the due date and there was no reason to believe otherwise. They further assert their timely federal payment for the same tax year demonstrates they had a reasonable expectation their California extension payment would also be made timely. Finally, they contend they monitored their bank account and, as soon as they discovered funds had not been withdrawn by FTB, they notified

their accountant of the issue and promptly paid the outstanding tax liability just four days after the due date.

Relatedly, appellants contend they acted consistently with how an ordinarily intelligent and prudent businessperson would have acted under similar circumstances. They argue they are not accountants, did not have access to their accountant's software, and had an expectation that their accountant would properly advise them and ensure their payment obligations were carried out as instructed. They argue similarly-situated taxpayers would have hired a professional return preparer to ensure they were compliant with their tax obligations with respect to extraordinary business sale transactions. They further argue that tax return preparation has become increasingly complex in recent years with the introduction of electronic tax return filing procedures and is more than a "ministerial" act. Consequently, taxpayers cannot oversee the electronic process, which is exclusively controlled and used by the tax professional.

We, however, disagree with appellants' contentions. It is clear that an oversight or error, by itself, does not constitute reasonable cause on a late-payment penalty. (*Appeal of Friedman, supra.*) Appellant's representative made it clear that this was simply a mistake – a key punch error inside the tax software by his firm. Furthermore, it is well-settled law that taxpayers' reliance on a tax preparer or agent to timely file their taxes does not constitute reasonable cause because taxpayers have a personal, non-delegable obligation to file their tax returns by the due date. (*United States v. Boyle* (1985) 469 U.S. 241, 251-252 (*Boyle*)). The courts have applied this bright-line rule—as articulated in *Boyle*, a case involving a late-filing penalty—to the late-payment penalty, even in circumstances such as here, where taxpayers acted prudently in dealing with their agent or employee. (See, e.g., *Kimdun Inc. v. United States* (C.D. Cal. 2016) 202 F.Supp.3d 1136, 1144-1146 [reliance on payroll service to make payments was insufficient to establish reasonable cause under *Boyle*]; *Conklin Bros. of Santa Rosa Inc. v. United States* (9th Cir. 1993) 986 F.2d 315 [reliance on taxpayer's controller to make payments was insufficient to establish reasonable cause].) Thus, as the law makes clear, appellants had a non-delegable duty to ensure timely payment of their taxes and cannot delegate that duty to their accountant. Accordingly, the fact that appellants relied on their accountant to pay their taxes does not relieve them from liability for the late-payment penalty. We agree that taxpayers should be able to rely on their tax professionals for the services they provide. If the error was in fact the tax preparer's,

that is an issue to be resolved between the taxpayer and the tax preparer; however, the R&TC does not provide for abatement of the late-payment penalty for the errors of tax professionals.

Appellants also assert that the penalty is “overly punitive compared to the offense.” But there is nothing in the law that allows for abatement on this basis. The late-payment penalty is imposed by and calculated according to the statutes passed by the California Legislature. While we are sympathetic to appellants’ argument, their disagreement with the law should be directed to the Legislature, which is charged with formulating the law, rather than to those who are charged with enforcing the law as it is written. (See *Appeal of Samuel R. and Eleanor H. Walker* (73-SBE-020) 1973 WL 2752.)

Finally, appellants maintain they have a history of timely filing and paying their taxes. California, however, does not permit penalty abatement under these circumstances.⁵ Rather, reasonable cause must be shown, which is lacking here. While appellants paid their balance three days after the due date, the California Legislature has not made a three-day exception to the late-payment penalty.

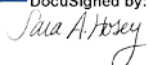
⁵ While the Internal Revenue Service has an administrative program called “First Time Abate,” under which it will abate timeliness penalties if a taxpayer has timely filed returns and paid tax for the past three years, neither the California Legislature nor FTB has adopted a comparable penalty abatement 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.).)

HOLDING

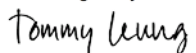
Appellants have not established reasonable cause to abate the section 19132 late-payment penalty.

DISPOSITION

FTB's action is sustained.

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Sara A. Hosey
Administrative Law Judge

I concur:

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Tommy Leung
Administrative Law Judge

Dissenting opinion of Jeffrey Margolis:

I find that appellants have shown that their late payment of tax for 2015 was due to reasonable cause and not willful neglect. There is no allegation, or basis for an allegation, that appellants willfully failed to pay their tax liability by the due date of April 18, 2016.⁶ Accordingly, whether appellants are liable for the late-payment penalty is entirely dependent upon whether appellants' failure to make a timely payment of tax was due to reasonable cause. (R&TC, § 19132(a).) In other words, appellants must show that the failure to make a timely payment of the proper amount of tax occurred despite the exercise of ordinary business care and prudence. (*Appeal of Roger W. Sleight* (83-SBE-244) 1983 WL 15615.) I conclude that appellants have made that showing.

Appellants, both "senior citizens" over 65 years of age during 2015, allege that they "are not knowledgeable in tax law or tax matters and have always engaged the assistance of a professional tax preparer to prepare and file their income tax returns." FTB has not disputed that allegation. Because appellants received substantial taxable income from the sale of two business entities during 2015, appellants were understandably concerned about paying their tax liability by the return due date. To this end, they requested their return preparer to schedule payments to both the IRS and FTB for the due date of their 2015 returns, April 18, 2016. It is undisputed that the federal return was timely transmitted electronically, together with a large payment of the balance due to the IRS. However, due to "oversight" by appellants' return preparer,⁷ the state tax payment was not successfully transmitted to the FTB. Apparently, however, appellants were diligently monitoring their bank balances to confirm whether the payments were successfully transmitted and realized that the FTB payment had not successfully been made. They took prompt steps to rectify the issue. Just three days after the payment due date, appellants' return preparer successfully initiated an electronic payment of the amount due, and received a message from FTB stating that appellants' payment, for \$449,220, would be applied the following day.

⁶ Although the normal due date would have been April 15, 2016, because that day fell on a Saturday, and the following Monday was a holiday in the District of Columbia, appellants' payment would have been timely if submitted on April 18, 2016.

⁷ At the hearing, appellants' representative explained that the oversight actually was a "key punch error inside the tax software."

The notice also indicated that appellants should “[a]llow up to two business days for your payment to be debited from your account.”

As the majority opinion makes clear, numerous cases, from the United States Supreme Court to the California State Board of Equalization, have held that the taxpayer has a nondelegable duty to file returns and pay the taxes in a timely fashion. The premise underlying these decisions is:

[O]ne 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 is of course common; but that reliance cannot function as a substitute for compliance with an unambiguous statute.

(*United States v. Boyle* (1985) 469 U.S. 241, 251.) Here, however, appellants took reasonable actions to ensure that their payment was timely made, not only by entrusting that task to their qualified tax preparer, but also by checking up on the preparer afterwards in a prompt fashion to ensure that the preparer had in fact completed the assigned task.⁸ When appellants discovered, just three days later,⁹ that the payment had not been made, appellants immediately rectified the issue by full paying the amount they unsuccessfully attempted to pay on the due date. The payment was successfully transmitted and received by FTB on the following day, April 22.

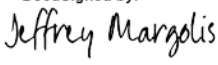
Appellants’ representative (who was also appellants’ return preparer) argues that it is in the tax agency’s interest to have tax returns prepared by, and tax payments electronically submitted by, qualified tax professionals on behalf of their clients. He contends that this interest is undermined by FTB imposing, essentially, a “no fault” rule upon tax return preparers that FTB does not impose if taxpayers had made the same error themselves. FTB, however, contends that

⁸ Our decisions have faulted taxpayers for failing to monitor their bank accounts to verify that attempted electronic payments were successfully transmitted. For example, in *Appeal of Scanlon*, 2018-OTA-075P, July 25, 2108, we rejected a contention that there was reasonable cause for the taxpayers’ late payment of tax (attributable to an attempted, but unsuccessful, electronic payment using the FTB’s Web Pay system) because, at least in part, the taxpayers had failed to exercise diligence in “monitor[ing] their bank account and quickly ascertain[ing] whether a scheduled electronic payment from their account to FTB was in fact paid.” Appellants here, however, clearly did diligently monitor their bank account, ascertained that their timely attempted payment had not been successful, and rectified the problem – all within four days from the payment due date. These facts stand in marked contrast to those involved in *Scanlon* and most other late payment penalty cases. They warrant abatement of the late payment penalty.

⁹ As is apparent from the FTB’s notice stating that it can take up to two business days to process electronic payments, the fact that appellants apparently were not able to determine that their attempted payment to FTB was unsuccessful until three days after the scheduled payment day, is understandable.

a late payment attributable to an “oversight” is subject to penalty regardless of whether the oversight was made by the taxpayer or the taxpayer’s agent. Appellants’ representative also notes that many taxpayers, perhaps appellants among them, are not even permitted to pay their taxes by check anymore and, instead, they must navigate (or have someone navigate for them) an electronic payment system (here, FTB’s Web Pay program). These policy considerations raised by appellants’ representative are interesting, perhaps valid, but not determinative.

Nevertheless, I find that appellants took reasonable steps to comply with their unambiguous obligations, yet, through no fault of their own, their attempt to comply was not successful. Because the evidence in this case establishes (and FTB does not dispute) that appellants acted entirely in good faith, and that appellants monitored the success (or lack thereof) of their payment and immediately caused payment to be made just three days after the original payment was due, I find that they have shown reasonable cause for the underpayment and would abate the late payment penalty. Accordingly, I dissent.

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Jeffrey I. Margolis
Administrative Law Judge