

**OFFICE OF TAX APPEALS
STATE OF CALIFORNIA**

In the Matter of the Appeal of:) OTA Case No. 18011412
DANIEL MCCAUL AND)
MARGOT MCCAUL) Date Issued: May 6, 2019
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OPINION

Representing the Parties:

For Appellant: Daniel McCaul
For Respondent: Eric Brown, Tax Counsel

D. BRAMHALL, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, Daniel and Margot McCaul (appellants) appeal an action by the Franchise Tax Board (FTB or respondent) denying appellants’ claim for refund of \$7,491.08¹ for the 2015 tax year.

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

ISSUES

1. Have appellants established reasonable cause for their late payment of tax for the 2015 tax year?
2. Have appellants established a basis for abatement of interest imposed for the 2015 tax year?

FACTUAL FINDINGS

1. During 2015, appellants were not residents of California.
2. On April 15, 2016, appellants remitted an extension payment of \$20,000 for California income tax for the 2015 tax year.

¹ This appeal amount is comprised of a late-payment penalty of \$6,183.45 and interest of \$1,307.63.

3. On October 16, 2016,² appellants filed their 2015 California Nonresident or Part-Year Resident Income Tax Return. They reported California taxable income of \$739,212 and total tax of \$88,705. After indicating total payments of \$20,000, appellants reported that they owed a balance of \$68,705.
4. Following the processing of appellants' return, on November 7, 2016, FTB sent a Notice of Tax Return Change to appellants, indicating that the balance of tax as reported on their return remained unpaid, and that respondent had imposed an underpayment penalty in the amount of \$5,839.93, plus interest.
5. Appellants remitted payment of \$68,705 on November 16, 2016.
6. By letter dated January 16, 2017, BDO USA, LLC (BDO letter) replied to the Notice of Tax Return Change on behalf of appellants, requesting abatement of the late payment penalty and interest based on reasonable cause and lack of willful neglect. According to the letter, BDO prepared the 2015 tax return of BMMC Holdings LLC (BMMC), and transmitted appellants' tax information to appellants' tax preparer.
7. Appellant-husband is a member and participates in the management of BMMC, which reported pass-through gain income for 2015 as \$8,850,184, the amount finally reported on appellants' California Schedule K-1 (568).
8. The Office of Tax Appeals requested additional briefing by letter dated October 24, 2018. In response, the following additional facts were established.
9. On April 16, 2016, appellants' tax preparer received a draft 2015 California Schedule K-1 (568) from BDO indicating BMMC's gain was \$9,028,846 and appellants' distributive share of California source gain as \$114,811.³
10. Based on this information, appellants' tax preparer provided computations of estimated California tax due in the amount of \$16,632 and recommended an extension payment of \$20,000, which amount was paid by check dated April 15, 2016.

²The automatic paperless extension for appellants to file their 2015 tax return was October 15, 2016. October 15, 2016, was a Saturday, so appellants' return, filed on October 16, 2016, was considered timely pursuant to Cal. Code Regs., tit. 18, section 18566.

³Copies of emails between BDO and appellants' tax preparer document continuing interchanges regarding appellants' California taxes prior to the April 18, 2016 original due date and again around the September 15, 2016, extended federal due date for the 2015 return. Finally, additional emails between those parties occurred prior to finally filing the California return on October 15, 2016.

11. On September 15, 2016, appellants' tax preparer received a revised 2015 California Schedule K-1(568) from BDO indicating BMMC's gain was \$8,850,184 and appellant-husband's distributive share of California source gain as \$729,466.
12. An exchange of emails between BDO and appellant's tax preparer on October 10 and 11, 2016 confirms discussions occurring subsequent to September 15, 2016 and confirms the California source gain attributable to appellant-husband as \$729,466.
13. It is noted that BDO's Chicago, Illinois office prepared the partnership return on which appellants' pass-through income was reported and characterized itself as BMMC's tax preparer. BDO stated that, in computing the income from a large partnership gain, for purposes of providing information for partners' extension payments, it inadvertently included the gross receipts from the transaction in the denominator of the apportionment sales factor. BDO further stated that, when it was preparing the final California partnership return, it discovered that California law required it to exclude those gross receipts and in doing so, the amount of California source income that passed through to appellant-husband increased from \$114,811 to \$729,466.
14. Subsequent notices of tax, penalty and interest due were sent by FTB on January 23, 2017 and April 26, 2017, and appellants remitted payment of \$7,483.29 on April 26, 2017.
15. Following payment, appellants' request for abatement was converted to a claim for refund, and by letter dated June 22, 2017, respondent denied appellants' claim for refund.
16. This timely appeal followed.

DISCUSSION

1. For the 2015 tax year, have appellants established reasonable cause to abate the late payment penalty?

R&TC 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 five 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).) The late-payment penalty may be abated if the taxpayer can show that the failure to make a timely payment of tax was due to reasonable cause and was not due to willful neglect. FTB 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 payment. (R&TC, § 19132(a).) The taxpayer bears the burden of proving reasonable cause exists. (*Appeal of Roger W. Sleight*, 83-SBE-244, Oct. 26, 1983.) 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. (*Ibid.*) The late-filing and the late payment penalties generally deal with the same questions and weigh the same evidence for purposes of making reasonable cause determinations. (*Appeal of Philip C. and Anne Berolzheimer*, 86-SBE-172, Nov. 19, 1986 [*Berolzheimer*].)

In *United States v. Boyle* (1985) 469 U.S. 241, 251-252, 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 . . .” The court, however, did observe 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, even when such advice turned out to have been mistaken. (*Id.* at pp. 250-251.) While good faith reliance on professional advice may provide a basis for a reasonable cause defense, it is not absolute. (*Repetto v. Comm’r*, T.C. Memo. 2012-168.) If a taxpayer relies on improper advice of an accountant or tax attorney as to a matter of tax law, failing to file a return in reliance on that advice may be considered reasonable cause if two conditions are met. These conditions are (1) that the person relied on is a tax professional with competency in the subject tax law; and (2) that the tax professional’s advice is based on the taxpayer’s full disclosure of the relevant facts and documents.

Appellants assert that they received a revised draft Schedule K-1 September 15, 2016⁴ but did not receive a final Schedule K-1 until October 12, 2016. Appellants have provided email correspondence from BDO to their tax preparer to support that assertion. Further, documentation was provided showing appellants’ tax preparer provided computations showing estimated tax due to California, on information from BDO as \$15,632 and recommending an extension

⁴ FTB has suggested that appellants may have been informed of the BDO error as early as August 2016. However, a close reading of the BDO correspondence referencing that date clearly notes the August information was related to federal tax, not state tax, matters

payment of \$20,000. They further assert that the underpayment at issue was a direct result of their reliance on the information provided by BDO to their personal tax preparer. Email correspondence between BDO and appellants' personal tax preparer confirms the reliance on information provided by BDO in the preparation of appellants' 2015 California extension payment and tax return. Finally, appellants assert that they had arranged with their tax preparer to pay directly from their bank account the correct balance of tax due when their return was filed on October 16, 2016; however, through oversight that did not occur and instead, appellants promptly paid the tax balance of \$68,705 upon notice from FTB. Appellants' view of these circumstances is that their reliance on their tax professional's expertise to compute the correct extension payment, in reliance upon Schedule K-1 information provided by BDO, constitutes reasonable cause under R&TC section 19132.

FTB views the above circumstances as failure to establish reasonable cause and as evidence of a mere computational error and cites *Berolzheimer* as controlling authority to support its conclusion that mere computational errors by a tax professional do not provide support for a reasonable cause determination.

The issue in *Berolzheimer* was an error by a tax professional in computing the amount of gain from a transaction resulting in an underpayment of tax, as in this case, for an extension payment. The circumstances involved the tax professional having all the correct information regarding basis and holding period, but in utilizing new software a basis error was made. The Board of Equalization (Board) characterized the error as a simple computational error, not as substantive legal advice. The Board also commented on the fact that the tax professional was an out-of-state law firm. It noted that even if it were to find the issue involved a legal interpretation, the Board was not prepared to find as a matter of law that reliance on an out-of-state law firm constitutes reasonable cause for failing to comply with California tax laws.

As reflected in the BDO letter, it erred in its computation of the proper apportionment for reporting a large gain, due in part to time constraints. In such a case, one must examine the sales factor rules and interpret whether a transaction falls within a set of inclusion or exclusion rules for apportionment purposes.⁵ BDO acknowledges that it initially erred in applying those rules when computing appellants' California source income from BMMC. We find BDO a competent

⁵ See R&TC section 25120 (is the gain business or non-business income), R&TC sections 25135-6 (is the gain from tangible or intangible property), and R&TC section 25137 (is there a special rule that may apply).

national tax firm,⁶ and that it possessed all relevant information, but made an error as to applicable law in its preliminary determination. Therefore, we disagree with FTB's conclusion that the error in this case was a mere mathematical error and instead conclude that this appeal involves an erroneous interpretation of law upon which appellant-husband's tax preparer reasonably relied in determining an adequate extension payment.

Thus, we find that appellants have met their burden to establish that they acted reasonably by relying on Schedule K-1 information provided to their tax preparer by BDO on April 16, 2016 to determine tax due as of that date and thus had reasonable cause for their late payment for the period from April 15, 2016 through October 10, 2016, when BDO confirmed its redetermination of appellants' California source income and thus increased California tax liability.

Appellants have asserted that the delay in making their acknowledged tax payment due of \$68,705 with their timely filed 2015 California tax return on October 16, 2016 was due to an oversight on the part of their personal tax preparer. This oversight was allegedly first discovered when notified of a payment due by FTB on November 7, 2016 and promptly corrected by payment on November 16, 2016.

However, under *Boyle*, appellants' reliance on their tax preparer to submit a timely payment does not establish reasonable cause. Furthermore, an oversight does not, by itself, constitute reasonable cause. (*Appeal of J. Ray Risser*, 84-SBE-044, Feb. 28, 1984.) Appellants also argued that they promptly paid the tax when, on November 7, 2015, the Franchise Tax Board first notified them that it had not been paid. However, appellants' prompt payment following notice from FTB occurred after the payment was due, and therefore cannot constitute reasonable cause for their failure to timely pay following confirmation of an increased tax liability.

In summary, appellants have met their burden to show reasonable cause for the late payment of 2015 tax in the amount of \$68,705 for the period from April 15, 2016 through October 10, 2016, but have failed to establish reasonable cause for the late payment for the period from October 11, 2016 through November 16, 2016.

⁶ In this respect, we note that BDO ultimately corrected its error.

2. For the 2015 tax year, have appellants established a basis for the abatement of interest?

Pursuant to R&TC section 19101, if the tax owed for a given year is not paid by the original due date, the law provides that interest must be computed and charged on the balance due until it is fully paid. Respondent's imposition of interest is mandatory, and respondent is not allowed to abate interest, except where authorized by law. (*Appeal of Amy M. Yamachi*, 77-SBE-095, June 28, 1977.) Interest is not a penalty and there is no reasonable cause exception to the imposition of interest. It is simply compensation to the State of California for the use of the money from the due date of the return until the date the tax is paid in full. (*Appeal of Audrey C. Jaegle*, 76-SBE-070, June 22, 1976.) R&TC section 19104(a) provides for the abatement of interest in certain defined circumstances if the taxpayer meets all the requirements to allow such abatement. Appellants have not alleged nor established any of the statutory grounds for interest abatement.


However, we note that by abating a portion of the delinquent penalty imposed for tax year 2015, the amount of interest due should be adjusted accordingly.

HOLDINGS

1. For the 2015 tax year, appellants have shown reasonable cause for the late payment of 2015 tax in the amount of \$68,705 for the period April 15, 2016 through October 10, 2016, but have failed to establish reasonable cause for the late payment of 2015 tax in the amount of \$68,705 for the period October 11, 2016 through November 16, 2016.
2. For the 2015 tax year, appellants have not established a basis to abate interest on their delinquent tax payment.


DISPOSITION

FTB’s action in denying appellants’ refund claim in the amount of \$6,183.45 is reversed and modified to sustain the denial only to the extent the penalty is calculated based on a delinquent payment for the period commencing October 11, 2016 through November 16, 2016. Further, FTB’s action in denying appellants’ refund claim for interest assessed in the amount of \$1,307.63 is sustained.

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Douglas Bramhall
Administrative Law Judge

I concur:

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Amanda Vassigh
Administrative Law Judge

CONCURRING OPINION

G. THOMPSON, Administrative Law Judge, concurring.

The majority finds that appellants established reasonable cause for not paying all their California income tax by April 15, 2016. I concur in this result (as well as the majority’s determination that there is no basis for the abatement of interest). On the basis of the emails provided, it appears to me that appellants, through their tax preparer, Ernie Peterek, diligently sought to receive California income estimates from BDO USA, LLC (BDO).¹ Further, prior to April 15, 2016, Mr. Peterek was able to obtain preliminary information from BDO that he and appellant-husband used to estimate the amount of California income tax that would be owed.²

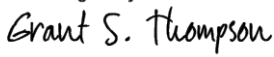
¹ While BDO submitted a letter on behalf of appellant in the appeal, it does not appear that BDO represented appellant with respect to the filing of his personal California tax return for the 2015 tax year.

² It appears that a draft Schedule K-1 may not have been received until April 16, 2016, which is after appellants’ payment, which occurred on April 15, 2016. However, based on the email correspondence provided by appellants, it appears that appellants received preliminary information prior to April 15, 2016 that they used to estimate the tax due, and that this preliminary information was the same or substantially the same as the information later reflected in a draft Schedule K-1.

Based on this information, Mr. Peterek estimated that appellants would owe approximately \$16,000 in California tax, and, apparently taking a cautious approach, appellants made a timely \$20,000 payment based on Mr. Peterek's recommendation. Thus, while the facts are not as clear as one would like, it appears to me that appellants have shown, by a preponderance of the evidence, that they diligently sought to obtain the information needed to accurately estimate the tax that would be owed and reasonably estimated the tax owed based on the information they were able to obtain.³

I do not believe it is necessary to reach the issue of whether BDO's error was based on a substantive legal determination by it, as opposed to an oversight, or whether BDO's provision of draft Schedule K-1 information should be viewed as substantive legal advice. It seems to me to be sufficient that appellants acted with ordinary business care and prudence to obtain the necessary information and reasonably estimated the tax owed based on the information they were able to obtain.

Concurring:

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Grant S. Thompson
Administrative Law Judge

³ Both the original draft Schedule K-1 and the later final Schedule K-1 apportioned less than 10 percent of income from the underlying partnership transaction to California, and it does not appear that appellants had any reason to believe that the amounts listed in the draft Schedule K-1 were too low.