OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18010842
WRIGHT CAPITAL HOLDINGS LLC	) Date Issued: August 21, 2019

OPINION

Representing the Parties:

For Appellant: Russell Wright, Sole Member

For Respondent: Samantha Q. Nguyen, Tax Counsel

For Office of Tax Appeals (OTA): Neha Garner, Tax Counsel III

S. HOSEY, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC) section 19045, Wright Capital Holdings LLC (appellant) appeals an action by respondent Franchise Tax Board (FTB) against a proposed assessment of additional tax of $800, a partnership late-filing penalty of $432,[1] a notice and demand penalty (demand penalty) of $200, and a filing enforcement fee of $79, plus interest, for the 2013 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 is subject to the limited liability company (LLC) annual tax.
2. Whether appellant has shown that the demand penalty should be abated.
3. Whether the filing enforcement cost recovery fee may be abated.

[1] FTB has admitted that the partnership late-filing penalty was proposed in error (since appellant is a single-member limited liability company, not a partnership). Therefore, FTB has agreed to cancel the proposed partnership late-filing penalty of $432, and it is not at issue in this appeal.

FACTUAL FINDINGS

1. Appellant is a foreign single-member LLC domiciled in Georgia. It was not registered to do business in California.
2. Appellant did not elect to be taxable as a corporation; hence, it is classified as a disregarded entity for most, but not all, purposes of the R&TC. (See R&TC, §§ 18633.5(i)(1), 23038.)
3. During 2013, appellant held a 50 percent interest in Collegiate Consulting LLC (CC-LLC), a multiple-member LLC classified as a partnership for tax purposes.
4. CC-LLC was domiciled in Delaware.
5. CC-LLC was registered to do business in California and conducted business in California during 2013. It began conducting its business operations in California in 2013 and ceased them in 2014.
6. No evidence has been presented as to whether CC-LLC was a member-managed or manager-managed LLC, where the manager (if any) was located, or when appellant obtained its membership interest in CC-LLC. Nor has any information been presented concerning the members' rights under CC-LLC's organizational documents.
7. CC-LLC issued a California Schedule K-1 (565) to appellant for 2013 reflecting that appellant had distributive share California-source income of $1,188 and deductions of $25 from its 50 percent interest in CC-LLC.
8. Based on the Schedule K-1 information, on May 15, 2015, FTB issued a Demand for Tax Return (Demand) for the 2013 tax year. FTB requested that appellant respond by June 17, 2015, by filling out the enclosed form and stating whether appellant had previously filed a 2013 California tax return or, if no return had been filed, to either file a return or explain why it did not have a filing requirement.
9. Appellant did not respond to the Demand by the required response date.
10. On October 30, 2015, FTB issued a Notice of Proposed Assessment (NPA) to appellant for 2013. The NPA proposed to assess the LLC annual tax of $800, a partnership late-filing penalty of $432 (which FTB has since conceded), a demand penalty of $200, and a filing enforcement cost recovery fee of $79, plus applicable interest.
11. Appellant protested the NPA asserting that it was a single-member LLC domiciled in the state of Georgia and that it did not conduct business in California. FTB denied

appellant's protest and issued a Notice of Action (NOA) affirming the NPA. This timely appeal followed.

12. While this matter was on appeal, appellant filed its Form 568 for the 2013 tax yearand remitted a check for $800, paying the balance due reported on its return.[2]

13. OTA asked the parties to provide supplemental briefing on the following issues: (1) whether appellant was "doing business" in California within the meaning of R&TC section 23101; and (2) the impact on this appeal of the California Court of Appeal's decision in *Swart Enterprises, Inc. v. California Franchise Tax Bd.* (2017) 7 Cal.App.5th 497 (*Swart*). Appellant did not file a supplemental brief. FTB filed a supplemental brief in which it alleged that *Swart* was not inconsistent with its determination in thismatter.

DISCUSSION

Issue 1 - Whether appellant is subject to the LLC annual tax.

Burden of Proof

FTB's determination is presumed to be correct, and a taxpayer has the burden of proving error. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Aaron and Eloise Magidow* (82-SBE-274) 1982 WL 11930.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Aaron and Eloise Magidow, supra*.) FTB's determinations cannot be successfully rebutted when the taxpayer fails to provide credible, competent, and relevant evidence as to the issues in dispute. (*Appeal of Oscar D. and Agatha E. Seltzer* (80-SBE-154) 1980 WL 5068.)

LLC Annual Tax

R&TC section 17941 provides that every LLC is required to pay an annual tax to California for the privilege of "doing business" in this state if any of three requirements is met: (1) the LLC is "doing business" in this state within the meaning of R&TC section 23101; (2) the LLC's articles of organization have been accepted by the Secretary of State (SOS); or (3) a certificate of registration has been issued by the SOS. (R&TC, § 17941(a) & (b)(1).) For the 2013 tax year, this tax was $800.

[2] FTB noted that it would process appellant's return at the conclusion of the appeal and that the $800 payment had been credited to appellant's account.

Under R&TC section 17941(c), the annual LLC tax is due "on or before the 15th day of the fourth month of the taxable year." California law allows for the assessment of the LLC tax and LLC fee (if applicable) even when the LLC is a single-member LLC that is a disregarded entity for most tax purposes. (R&TC, § 23038(b)(2)(B)(iii); Cal. Code Regs., tit. 18, § 23038(b)-2(c)(2)(A).)

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 R&TC section 23101(a) as "actively engaging in any transaction for the purpose of financial or pecuniary gain or profit." (R&TC, § 23101(a).) The transaction does not need to result in an actual profit; 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; *Appeal of Columbia Supply Co*. (60-SBE-012) 1960 WL 1391.)

Under R&TC section 23101(b), effective for tax years beginning on or after January 1, 2011, a taxpayer also 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.[3] (R&TC, § 23101(b).)

It does not appear (and FTB does not contend) that appellant meets any of the requirements under R&TC section 23101(b). Thus, the determination of whether appellant was "doing business" in this state requires an analysis of whether appellant was "doing business" in this state within the meaning of R&TC section 23101(a). In other words, we must determine if appellant actively engaged in any transaction in California for the purpose of financial or pecuniary gain or profit during 2013.

There is no evidence to suggest that appellant was itself engaged in any transaction in California for profit. However, it is well established that the "doing business" activities—and status—of a general partnership is attributed to each of its partners. (*See Swart, supra*, 7

[3] These dollar threshold amounts are adjusted for inflation each year. (R&TC, § 23101(c)(1).)

Cal.App.5th at p. 505; *Appeal of H. F. Ahmanson* (65-SBE-013) 1965 WL 1350 (*Ahmanson*); *Appeals of Amman & Schmid Finanz AG, et al.,* (96-SBE-008) 1996 WL 281551 (*Amman & Schmid*); *Appeal of Custom Component Switches, Inc.* (77-SBE-009) 1977 WL 3820; see also FTB Legal Ruling 2014-01.) However, it is also well established that the doing business status of a limited partnership is not attributed to its limited partners. (*Swart, supra,* 7 Cal.App.5th at p. 508; *Amman & Schmid, supra,* 1996 WL 281551 at pp. 3-4.)[4]

In *Swart,* the court held that an out-of-state taxpayer was not "doing business" in California because it held a small (0.2 percent), non-managing member interest in a manager-managed LLC investment fund. The court reasoned that the taxpayer was not "doing business" in California because it had no interest in specific property of the LLC, was not personallyliable for the LLC's obligations, played no role in the LLC's management and had no right to, and could not act as an agent for the LLC or bind the LLC in any way. (*Swart, supra,* 7 Cal.App.5th at pp. 507-513.) In essence, the court found that the taxpayer in *Swart* was more akin to a limited partner than a general partner, and the law is clear that the doing business status of a limited partnership is not attributed to a partnership's limited partners. (*Ibid*.)

We conclude that *Swart* is distinguishable from the situation here. Unlike the situation in *Swart,* the taxpayer here has failed to show that it was not a managing member of CC-LLC. Moreover, by virtue of its holding a 50 percent interest in CC-LLC, appellant would have had significant authority over the activities of CC-LLC. Although appellant's interest was not a controlling interest, no other member had a larger interest, and appellant presumably could have used its 50 percent interest to block CC-LLC from taking action it disagreed with if it was so inclined. Accordingly, we uphold FTB's determination and find that the doing business status of CC-LLC is attributable to appellant by virtue of appellant's holding of a 50 percent ownership interest therein, and because appellant has not satisfied its burden of proving that it lacked the power or authority, directly or indirectly, to participate in CC-LLC's management or operations.

[4] *Ahmanson* stated that a partner was doing business wherever the partnership was doing business. (*Ahmanson, supra,* 1965 WL 1350 at p. 2.) However, the State Board of Equalization (SBE) in *Amman & Schmid* distinguished between the rights of limited partners and general partners. In *Amman & Schmid,* the SBE found that, while it was "arguably true" that general partners were doing business wherever the partnership was doing business, a limited partner would not be deemed to be doing business wherever the partnership was doing business. (*Amman & Schmid, supra,* 1996 WL 281551 at p. 4.) In *Swart,* discussed below, the court of appeal accepted the principles set forth in both *Ahmanson* and *Amman & Schmid*.

Issue 2 - Whether appellant has shown that the demand penalty should be abated.

R&TC section 19133 provides that, if a taxpayer fails or refuses to furnish any information requested in writing by FTB or fails or refuses to make and file a return upon notice and demand by FTB, then, unless the failure is due to reasonable cause and not willful neglect, FTB may add a penalty of 25 percent of the amount of tax determined pursuant to R&TCsection 19087 or of any deficiency tax assessed by FTB concerning the assessment for which the information or return was required. When FTB imposes a demand penalty, the law presumes that the penalty was imposed correctly. (*Todd v. McColgan*, *supra*.) The burden of proof is on the taxpayer to show that reasonable cause exists to support an abatement of the penalty. (*Appeal of Eugene C. Findley* (86-SBE-091) 1986 WL 22761.)

To establish reasonable cause, a taxpayer must show that the failure to reply to a demand occurred despite the exercise of ordinary business care and prudence. (*Appeal of Stephen C. Bieneman* (82-SBE-148) 1982 WL 11825.) 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 Eugene C. Findley*, *supra*.) Ignorance or a misunderstanding of the law generally does not excuse a taxpayer's noncompliance with California tax laws. (*Appeal of Diebold, Inc.* (83-SBE-002) 1983 WL 15389.) Appellant did not exercise reasonable cause when it failed to provide any response to FTB's Demand.

Issue 3 - Whether the filing enforcement cost recovery fee may be abated.

R&TC section 19254 provides that if FTB mails a formal legal demand for a tax return to a taxpayer, a filing enforcement cost recovery fee is required to be imposed when the taxpayer fails or refuses to file the return within the 25-day period. Once properly imposed, there is no provision in the R&TC which would excuse FTB from imposing the fee under any circumstances, including reasonable cause. (R&TC, § 19254.) Here, FTB informed appellant in the Demand that appellant may be subject to the filing enforcement cost recovery fee if appellant did not file a tax return. Appellant, however, did not file its return within the period prescribed in the Demand. Therefore, FTB properly imposed the filing enforcement cost recovery fee and we have no basis to abate the filing enforcement fee.

HOLDINGS

1. Appellant has failed to establish that it is not subject to the LLC annual tax.
2. Appellant has failed to show that the demand penalty should be abated.
3. Appellant has failed to show that the filing enforcement cost recovery fee should be abated.

DISPOSITION

Based on the foregoing, FTB's action is sustained, except that, as conceded by FTB on appeal, the partnership late-filing penalty shall be abated.

DocuSigned by:
Sara A. Hosey
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Sara A. Hosey
Administrative Law Judge

We concur:

DocuSigned by:
Jeffrey Margolis
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Jeffrey I. Margolis
Administrative Law Judge

DocuSigned by:
Daniel K. Cho
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