OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18042977
BELLE BEAUTY BOUTIQUE, INC.	) Date Issued: September 17, 2019

OPINION

Representing the Parties:

For Appellant: Veronica Cappelletti, President

For Respondent: Maria Huseinbhai, Tax Counsel

M. GEARY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, appellant Belle Beauty Boutique, Inc. appeals an action by respondent Franchise Tax Board (FTB) proposing additional tax of $5,355.98, a late-filing penalty of $1,338.99, a demand penalty of $1,338.99, a filing enforcement fee of $85.00, and interest, for the 2015 taxable year.

Appellant waived its right to an oral hearing. Therefore, we decide the matter based on the written record.

ISSUES

1. Is appellant entitled to a reduction or abatement of the proposed tax assessment?
2. Is appellant entitled to abatement of the late-filing penalty?
3. Is appellant entitled to abatement of the demand penalty?
4. Is appellant entitled to abatement of the filing enforcement cost recovery fee?
5. Is appellant entitled to abatement of interest?

FACTUAL FINDINGS

1. Appellant is a registered Delaware corporation. According to the Certificate of Registration, the incorporator was Dottie Randazzo, whose address was a post office box in Wilmington, DE.

2. Appellant filed a 2015 federal income tax return reporting gross receipts of $103,453, cost of goods sold of $42,865, salaries and wages paid of $15,737, and "other deductions" of $44,851.[1] Because appellant's reported total deductions were equal to its reported total income, it reported no taxable income. Appellant's address on the federal return is the address stated on the Certificate of Registration (for Dottie Randazzo). A California H&R Block office prepared the return.
3. The Internal Revenue Service (IRS) "Account Transcript" indicates appellant's corporate address is in California.
4. Appellant also filed a 2015 state income tax return in Delaware. The corporate address on this return is the incorporator's address, but the address provided for the president who signed the return is the same address stated on the IRS Account Transcript.
5. Veronica Cappelletti, appellant's president, was the sole officer of appellant during the relevant time. Appellant paid 2015 compensation to Ms. Cappelletti totaling at least $15,737.
6. During this appeal, appellant's mailing address, at least for federal income tax purposes, is the same California address used by Ms. Cappelletti for California income tax purposes.
7. Appellant has not filed a California income tax return for the 2015 taxable year.
8. On June 7, 2017, FTB sent to appellant, at its president's California address, a "Demand for Tax Return" (Demand) which instructed appellant to respond by July 12, 2017, by filing its 2015 California return, providing a copy of its 2015 California return if already filed, or explaining why it had no filing requirement for 2015.
9. When appellant did not respond to the Demand, FTB sent appellant an August 11, 2012 "Notice of Proposed Assessment" (NPA) proposing $5,355.98 of tax, a late-filing penalty of $1,338.99, a demand penalty of $1,338.99, a filing enforcement fee of $85.00, and interest, based on estimated income for the 2015 taxable year of $60,588. According to the NPA, the $60,558 of estimated income was based upon "the income amount shown on your federal tax return."
10. Appellant filed a timely protest, indicating that it filed a tax return on April 15, 2016, but

[1] The other deductions are itemized on the return as follows: bank charges of $120, commissions of $31,036, shipping charges of $10,863, telephone expense of $1,752, and "other business deductions of $1,080.

failing to provide a copy of the return.[2] Appellant completed 29 of the 30 questions on FTB Form 4684, indicating that it had no connection with California for income tax purposes, but failed to respond to the one question that asked about officers, employees, commissioned agents, or independent contractors in California.

11. By letter dated November 3, 2017, FTB acknowledged appellant's protest and asked appellant to indicate in which state it was registered and appellant's relationship to the entity "located at the California address listed on the U.S. income tax return." Appellant did not respond to the request.

12. On March 16, 2018, FTB sent appellant a "Notice of Action on Proposed Assessment" affirming the NPA.

13. This timely appeal followed.

14. Appellant attached to its appeal letter a copy of its federal 2015 tax return. That return reported gross receipts of $103,453, costs of goods sold of $42,865, gross profit of $60,588, total deductions of $60,588, and no taxable income.

15. FTB attached to its opening brief a copy of appellant's 2015 federal Account Transcript. The transcript reflects the same income information reported on appellant's federal return. The transcript does not indicate that the IRS audited appellant's 2015 tax year or changed appellant's taxable income.

DISCUSSION

Issue 1 - Is appellant entitled to a reduction or abatement of the proposed tax assessment?

Unless expressly exempted, every foreign corporation that is doing business in California is subject to at least the minimum franchise tax ($800) from the date it begins to do business in California until the date it ceases to do business in this state or the date it files a certificate of surrender, whichever occurs later. (R&TC, §§ 23151, 23153, subds. (a), (b)(3), (d)(1).) Every taxpayer subject to tax as indicated above is required to file a California income tax return with FTB. (R&TC, § 18601.) Since 2011, California law has contained two alternative bases for finding a taxpayer is doing business in this state. (R&TC, § 23101.) Under subdivision (a) of section 23101, a taxpayer is doing business in California if it is "actively engaging in any

[2] According to FTB, it has no record that appellant filed a California return and appellant concedes that it filed no California return in its subsequent September 21, 2017 letter to FTB.

transaction for the purpose of financial or pecuniary gain or profit" here. Under subdivision (b) of section 23101, a taxpayer also will be considered to be "doing business" in California if, as relevant here, it is organized or commercially domiciled in this state. "Commercial domicile" means the principal place from which the trade or business is directed or managed. (R&TC, § 25120.)

FTB argues that the evidence shows that appellant uses a California mailing address and telephone number, and that the address is the same address used by appellant's president, Ms. Cappelletti, its sole officer during the period at issue. Appellant's 2015 federal tax return reports total compensation paid to officers that is equal to the income reported by Ms. Cappelletti. FTB contends that the evidence establishes that appellant's sole officer is a California resident and that we should thereon conclude that Ms. Cappelletti managed appellant's business from her California residence, thus establishing that appellant was commercially domiciled, and therefore doing business, in California during 2015.

Appellant argues that it is a Delaware corporation, domiciled and doing business there and having no connection to California sufficient to subject it to a filing requirement in this state. It provided copies of its Delaware Certificate of Incorporation, 2015 Delaware income tax return, and 2015 federal tax return.

FTB has established a reasonable and rational basis for the assessment. It has produced evidence to establish that appellant's president and sole officer, Ms. Cappelletti, lived in California during 2015 and that appellant paid her $15,737 in salary or wages during 2015, concluding that the president managed appellant from here. Appellant has not addressed FTB's argument or the evidence that tends to support it. It failed to respond to the one question on the "Reply" to FTB's Demand that asks whether appellant had officers, employees, commissioned agents or independent contractors residing, selling, soliciting, or providing services in California, and it has not attempted to refute FTB's assertion that Ms. Cappelletti ran appellant's business from her home in California. Consequently, we conclude that FTB correctly proposed an assessment of tax.

Given appellant's failure to file a California return, and its failure to claim or substantiate any deductions on that return, FTB proposed its assessment based on appellant's gross profits,

which is after deduction of the cost of goods sold but before other deductions.[3] On appeal, FTB raises the fact that appellant paid its sole officer compensation of $15,737 in support of its position that appellant was doing business in California. Generally, wages or other compensation for personal services rendered are deductible. (Int.Rev. Code, § 162(a), incorporated by R&TC, § 24343.) While respondent has not conceded that the amount appellant reported as wages or salaries is accurate, it has certainly conceded that appellant paid its president for services rendered during the 2015 taxable year, and it appears from the evidence that the net profit was paid to the president, which is not unreasonable. Accordingly, FTB's proposed assessment based on appellant's gross income was not reasonable in that it did not allow a deduction for the $15,737 in compensation paid by appellant during the year. Consequently, we find that appellant is entitled to a reduction of the proposed tax assessment based on allowing a deduction of $15,737.[4] Appellant has not shown that the proposed assessment should be otherwise reduced or abated.

Issue 2 - Is appellant entitled to abatement of the late-filing penalty?

The law required appellant to file its 2015 California income tax return and pay the taxes due on or before March 15, 2016. (R&TC, §§ 18601, 19001.)[5] It also required FTB to impose a late-filing penalty when appellant failed to file a tax return by the due date, subject to relief of the penalty if the evidence establishes that the failure was due to reasonable cause and not to willful neglect. (R&TC, § 19131.) "Willful neglect" is indicated by evidence of a conscious, intentional failure or reckless indifference. (*United States v. Boyle* (1985) 469 U.S. 241, 245.) To obtain relief from the penalty, a taxpayer must provide credible and competent evidence supporting a claim of reasonable cause. (*Appeal of Tao Xie*, 2018-OTA-076P.) Whether appellant's failure to file its return was due to reasonable cause and not to willful neglect, are questions of fact on which appellant has the burden of proof. (*Appeal of La Salle Hotel Co.* (66-SBE-071) 1966 WL 1412.) To establish reasonable cause, the taxpayer must show the failure to

[3] Appellant filed a federal return, on which it claimed various business deductions, but appellant has not filed a California return or offered any argument or evidence to justify any deductions at protest or on appeal.

[4] Any reduction in the amount of tax owed may also result in a recalculation and reduction in associated penalties and interest. The discussion of the penalties and interest below only contemplates the abatement of those penalties and interest on other grounds, and does not bar the reduction of those items based on the adjustment to the proposed assessment of additional tax.

[5] FTB would have allowed an automatic extension to October 15 to file a return. (R&TC, § 18604.)

timely file returns or make tax payments occurred despite the exercise of "ordinary business care and prudence." (*Appeal of Sidney G. Friedman and Ellen Friedman*, 2018-OTA-077P.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Aaron and Eloise Magidow* (82-SBE-274) 1982 WL 11930.)

We have already found, under Issue 1, above, that appellant had a filing requirement for the 2015 taxable year. The undisputed evidence, and appellant's admission, establishes that appellant has not filed a 2015 return. Therefore, FTB did what the law required of it: it imposed the late-filing penalty. The question now is whether the evidence establishes that appellant's failure to file a return was due to reasonable cause and not to willful neglect.

Although appellant does not specifically argue that it is entitled to abatement of the penalty, interpreting appellant's allegations liberally, it appears to argue that its failure to file has been due to its reasonable belief that it had no filing requirement. However, that belief is mistaken, and ignorance or a misunderstanding of California's tax law does not excuse a failure to follow the law. (*Appeal of LaVonne A. Hodgson* (2002-SBE-001) 2002 WL 245667.) Furthermore, although appellant has not specifically alleged that it relied upon its tax adviser to file all required returns, the duty to file a timely return is a nondelegable duty of the taxpayer, who cannot be relieved from that duty because of the mistake or negligence of a hired agent. (*United States v. Boyle, supra*, 469 U.S. at p. 252.) Based on the evidence, we find that appellant has failed to establish that its failure to file a 2015 California return has been due to reasonable cause and not to willful neglect. Consequently, we conclude that appellant is not entitled to abatement of the late-filing penalty.

Issue 3 - Is appellant entitled to abatement of the demand penalty?

If a taxpayer fails to make and file a tax return after notice and demand by the FTB, the FTB may add a penalty "of 25 percent of the amount of tax determined pursuant to Section 19087 or of any deficiency tax assessed by the [FTB] concerning the assessment of which the information or return was required." The penalty will be abated if the taxpayer establishes the failure was due to reasonable cause and not willful neglect. (R&TC, §19133.)

It is undisputed that FTB sent a Demand to appellant on June 7, 2017, and that appellant did not timely respond. Therefore, the evidence establishes that FTB properly imposed the demand penalty. We address whether appellant's failure to timely respond was due to reasonable cause and not to willful neglect.

Appellant has made no clear argument that the demand penalty should be abated, and based on our findings of fact, we can envision none. It appears that appellant ignored the Demand, and considering appellant's failure to offer any explanation, we find that appellant has not established that its failure to respond to the Demand was due to reasonable cause and not willful neglect. Consequently, we conclude that appellant is not entitled to abatement of the demand penalty.

Issue 4 - Is appellant entitled to abatement of the filing enforcement cost recovery fee?

R&TC Section 19254 requires FTB to impose a filing enforcement cost recovery fee when a taxpayer fails to file a tax return within 25 days after a formal legal demand to file a return is mailed to the taxpayer.[6] The amount of the fee is set annually to reflect actual enforcement costs. The statute does not allow for abatement of or relief from the fee, even on a showing that the failure to pay was due to reasonable cause. (See *Appeal of Michael E. Myers* (2001-SBE-001) 2001 WL 37126924.)

FTB mailed the Demand to appellant on June 7, 2017. Appellant has not filed a return. Consequently, FTB properly imposed the fee. We find that appellant is not entitled to abatement of the filing enforcement cost recovery fee.

Issue 5 - Is appellant entitled to abatement of interest?

FTB can abate interest when the interest is attributable to unreasonable error or delay by an FTB officer or employee while performing a ministerial or managerial act in his or her official capacity. (R&TC, § 19104(a).)

Appellant has not alleged or proved that there was unreasonable error or delay. Consequently, we conclude that appellant is not entitled to abatement of interest.

[6] While organizations that are exempt under R&TC section 23701 are not subject to the fee, appellant was not such an organization.

HOLDINGS

1. Appellant is entitled to a reduction of the proposed tax assessment based on the allowance a $15,737 deduction for compensation paid in 2015.
2. Appellant is not entitled to abatement of the late-filing penalty.
3. Appellant is not entitled to abatement of the demand penalty.
4. Appellant is not entitled to abatement of the filing enforcement cost recovery fee.
5. Appellant is not entitled to abatement of interest.

DISPOSITION

We modify the proposed assessment to allow a deduction of $15,737, and otherwise sustain FTB's proposed assessment.

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Michael F. Geary
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Michael F. Geary
Administrative Law Judge

I concur:

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John O Johnson
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John O. Johnson
Administrative Law Judge

J. MARGOLIS, concurring in part and dissenting in part:

R&TC section 19087 allows FTB to estimate a taxpayer's "net income" from "any available information" where, as here, the taxpayer fails and refuses to file a California tax return. Here, however, FTB's proposed assessment is based upon its estimate of appellant's *gross* income, not its *net* income, resulting in a significant overstatement of appellant's tax liability ($5,355.98 instead of $800). Because FTB has not made a reasonable and rational estimate of appellant's "net income" from the information available to it, I dissent from the majority's Opinion.

I do agree with the majority's conclusion that appellant was doing business in California and obligated to file a California return. As a result, appellant is liable for the $800 annual minimum tax and late-filing and demand penalties based on that minimum tax amount.[1] However, FTB's estimate of appellant's net income as $60,558, instead of the net income of zero that was reported on appellant's federal return (from which FTB drew its income estimate), lacks a reasonable and rational foundation.

The only information FTB appears to have had in its possession when it proposed its assessment against appellant was federal account transcript information that was extracted from appellant's 2015 federal income tax return, and the information provided by appellant in response to FTB's Demand for Tax Return. Appellant's federal account transcript information showed that appellant's federal return reported gross receipts of $103,453, cost of goods sold of $42,865, total income of $60,588, total deductions of $60,588, and "net taxable income" of zero. However, FTB did not base its estimate of appellant's net income upon the net taxable income of zero that was reported to and accepted by the IRS. Instead, FTB based its estimate upon appellant's *total* income of $60,588. In this manner, FTB effectively disallowed *all* the deductions claimed by appellant and allowed by the IRS. FTB's action might be justifiable had FTB informed appellant that it was questioning the $60,588 of deductions claimed on appellant's return for, inter alia, compensation paid to appellant's owner/officer, commissions, freight and telephone expense. But FTB did not do that. In fact, there is no indication that FTB did anything other than take the incorrect figure—for appellant's *total* income—from appellant's federal income transcript and base its estimate of appellant's *net* income upon that figure.

[1] For the reasons set forth in the majority opinion, I also agree that appellant is liable for the filing enforcement cost recovery fee and interest on the amounts due as provided by law.

FTB's error in not allowing (perhaps inadvertently) all the deductions claimed and allowed on appellant's federal return is erroneous and unreasonable. The error in FTB's action is best highlighted by the fact that FTB did not allow the $15,737 expense claimed for officer compensation paid to appellant's president, Ms. Cappelletti, while it simultaneously—and inconsistently—argues that this payment proves that Ms. Cappelletti was performing services in California on appellant's behalf.

Fortunately, my colleagues have modified FTB's determination to allow appellant a deduction for the $15,735 compensation amount reported on appellant's federal return. However, I see no reason to distinguish between that deduction and the other $44,851 of deductions claimed on appellant's return, *all of which were allowed by the IRS* (for commissions, $31,036; freight, $10,863; telephone, $1,752; bank charges, $120; and "other," $1,080). Certainly, FTB was not barred from auditing and disallowing those deductions. But where, as here, FTB is simply relying on the numbers that appeared on a federal tax account transcript and tax return, and did not clearly communicate to the taxpayer that its claimed deductions would not be allowed entirely unless it filed a California return,[2] I cannot sustain FTB's determination. I conclude that FTB's determination is an estimate of appellant's gross income, not its net income, in violation of R&TC section 19087.

Accordingly, I dissent in part from the majority's decision.

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Jeffrey I. Margolis
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Jeffrey I. Margolis
Administrative Law Judge

[2] Because FTB did not ask appellant to substantiate its claimed deductions and simply demanded appellant file a California return, it is unclear whether FTB's position is that no deductions are allowable unless a California return is filed, or whether FTB would have allowed the deductions reflected on the federal return if appellant had provided acceptable substantiation for them.