

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 19034478
RICHARD REED)
) Date Issued: November 5, 2019
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OPINION

Representing the Parties:

For Appellant: Jeffery M. Loff, CPA

For Respondent: David Kowalczyk, Tax Counsel

J. LAMBERT, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, Richard Reed (appellant) appeals an action by respondent Franchise Tax Board (FTB) denying appellant’s claim for refund of \$3,773.50 for the 2016 tax year.

Appellant waived the right to an oral hearing; therefore, the matter is being decided based on the written record.

ISSUE

Whether appellant has established reasonable cause for failing to timely file his tax return.

FACTUAL FINDINGS

1. Appellant and his wife were residents of Hawaii during 2016.
2. Appellant, through his revocable trust, held a 10 percent interest in a Kinaole Capital Partners LLC (KCP), which was a limited liability company taxable that was taxable as a partnership.
3. KCP generally held non-California assets until 2016, when it added income-generating assets in California.
4. KCP failed to timely file its 2016 California tax return or to issue Schedules K-1 for 2016 to its members.

5. During the period from March 2017 until February 2018, appellant sent at least 23 emails to KCP inquiring about when he would receive his K-1, and why it was taking so long to receive this information.
6. KCP emailed appellant a copy of his 2016 Schedule K-1, Member's Share of Income Deductions, Credits, etc., on February 27, 2018.
7. KCP late-filed its 2016 California tax return (Form 568) on March 1, 2018.
8. Three and a half months later, on June 15, 2018, appellant and his spouse filed their 2016 California nonresident tax return.¹ The return reported California adjusted gross income of \$200,906, which was his distributive share of income from KCP.
9. FTB imposed a late-filing penalty of \$3,773.50, plus interest.
10. Appellant paid the amount and filed a claim for refund, which FTB denied. This timely appeal followed.

DISCUSSION

California law imposes a penalty for the failure to timely file a return, unless it is shown that the late filing is due to reasonable cause. (Rev. & Tax. Code, § 19131, subd. (a).) For a taxpayer to establish that a failure to timely file was due to reasonable cause, the taxpayer must show that the failure occurred despite the exercise of ordinary business care and prudence. (*Appeal of Sleight* (83-SBE-244) 1983 WL 15615.)

Appellant states that he was a 10-percent owner in KCP, but did not know he would receive California-source income from KCP until he received a Schedule K-1 in the spring of 2018. Appellant alleges that KCP had not previously generated any income and had no income-generating assets in California prior to 2016. FTB does not dispute these allegations. Appellant sent numerous emails to KCP requesting a copy of the Schedule K-1, starting in March 2017 and continuing through February of 2018. Appellant either received no response or a reply that the information was not yet available but would be coming soon. For instance, on March 29, 2017, appellant wanted to confirm the K-1s would be ready by May and had to follow up on May 19 and May 24 after receiving no response. Appellant stated: "Not trying to be difficult. I'd just like an update." Appellant followed up again on May 31, and again on June 21, stating that he was still waiting on the K-1. Appellant asked again on June 29, "what is taking so long?"

¹ Appellant's spouse is not a part of this appeal.

On September 6, 2017, appellant asked if they broke even or if money was made. His email also indicated that he had been not a part of discussions related to KCP in the past eight months and that he knew “very little about what has transpired.” Appellant’s email stated that he was unsure whether KCP was even still in existence and that he did not know “how any of this works going forward.” The email dated October 20, 2017, stated: “Are you able at this time to determine if I had a capital gain or loss?” to which he was told “No.” Appellant’s requests for information continued into 2018 in multiple emails in which he expressed his frustration.

These emails indicate that appellant was unaware as to whether he would be receiving any California-source income and that such information was unavailable to him, despite his best efforts. Without this information, appellant was unable to reasonably determine whether he had a California-filing requirement, particularly since KCP had not previously generated any California-source income.

Reasonable cause may be found when a taxpayer is unable to acquire the information necessary to make a reasonably accurate estimate of a tax liability after prudent efforts to acquire such information. (See *Appeal of Moren*, 2019-OTA-176P.) Appellant has shown that he exercised ordinary business care and prudence by his persistent efforts to acquire the information necessary to determine whether he had a California filing requirement, despite the nonresponsive nature of KCP and its accountant. Therefore, appellant has shown that he acted in a manner matching that of an ordinarily intelligent and prudent businessperson given the situation in which he was placed. (*Id.*)

Taxpayers have an obligation to file timely returns with the best information, and then to subsequently file an amended return, if necessary. (*Appeal of Xie*, 2018-OTA-076P.) However, appellant was a nonresident and was not aware that he had a California filing requirement until he learned that he would be receiving California-source income from KCP. His only California-source income was from KCP. Without such information, appellant was unable to reasonably determine whether he had a California filing requirement. Accordingly, appellant has shown reasonable cause for the late filing of his tax return.

HOLDING

Appellant has established reasonable cause for failing to timely file his tax return.

DISPOSITION

FTB’s action is reversed.

DocuSigned by:
Josh Lambert
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Josh Lambert
Administrative Law Judge

We concur:

DocuSigned by:
Nguyen Dang
4D465973FB44469...
Nguyen Dang
Administrative Law Judge

DocuSigned by:
Jeffrey I Margolis
5E9822FBB1BA41B...
Jeffrey I. Margolis
Administrative Law Judge