OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 19054836
HMSS INVESTMENTS	)
	)
	)
	)
	)

OPINION

Representing the Parties:

For Appellant: Howard Slayen, General Partner

For Respondent: Diane M. Deatherage, Specialist

J. LAMBERT, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, HMSS Investments (appellant) appeals an action by respondent Franchise Tax Board (FTB) denying appellant's claim for refund of a partnership late-filing penalty of $648 for the 2016 tax year.

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

ISSUE

Whether the partnership late-filing penalty may be abated.

FACTUAL FINDINGS

1. Appellant is a general partnership that consisted of three partners, all U.S. residents and members of the same family: Howard and Susan Slayen, Matthew Slayen, and Samuel Slayen.
2. Appellant untimely filed its 2016 California partnership tax return on September 10, 2018. On that return, appellant reported owning total assets at year end of $54,329 and having generated losses of $7,958 for 2016. Appellant claims that its partners all timely filed their returns and reported their distributive losses from appellant, and FTB does not dispute this allegation.

3. FTB imposed a partnership late-filing penalty of $648, pursuant to R&TC section 19172.
4. Appellant paid the balance due and filed a claim for refund of the penalty, which FTB denied. This timely appeal followed.

DISCUSSION

R&TC section 18633(a) provides that every partnership is required to file a return on or before the 15th day of the third month following the close of the taxable year. R&TC section 18567 provides for a six-month paperless extension for partnership returns, as long as the return is filed within six months of the original due date. R&TC section 19172(a) provides, in part, that if any partnership required to file a return under R&TC section 18633 for any taxable year fails to file the return at the prescribed time (determined with regard to any extension of time for filing), that partnership shall be liable for a penalty determined under R&TC section 19172(b) for each month (or fraction of each month) during which that failure continues (but not to exceed 12 months), unless it is shown that the failure is due to reasonable cause. To establish reasonable cause, a taxpayer must show that the failure to timely file the return occurred despite the exercise of ordinary business care and prudence, or that cause existed as would prompt an ordinarily intelligent and prudent businessperson to have so acted under similar circumstances. (*Appeal of Tons* (79-SBE-027) 1979 WL 4068.)

Appellant does not contest the calculation of the penalty. Instead, appellant argues that reasonable cause exists for the failure to timely file. Appellant contends that general partner Howard Slayen prepared the return but forgot to file the return. Appellant contends that Mr. Slayen completed a spreadsheet with the partnership information on April 12, 2017. Appellant also contends that Mr. Slayen completed the federal partnership tax return, Form 1065, on April 14, 2017. However, appellant asserts that he failed to take further action from that date. Appellant asserts that in 2017, Mr. Slayen's spouse, also a general partner, was suffering from Alzheimer's disease and that he was her primary caregiver through April 2017. Additionally, appellant asserts that Mr. Slayen underwent his own medical tests and treatments in July and August 2017. Appellant contends that Mr. Slayen believed the return was completed until the IRS informed him that the return was not filed, after which he filed as soon as possible. Appellant notes that its partners all timely filed their returns.

Illness or other personal difficulties that prevent taxpayers from filing a timely return or paying tax can be considered reasonable cause in some cases. (*Appeal of Halaburka* (85-SBE-

025) 1985 WL 15809.) However, taxpayers must present credible and competent evidence that the circumstances of the difficulties continuously prevented them from filing a timely return or paying tax. (*Ibid*.) While we are sympathetic to the hardships experienced by one of appellant's general partners during the filing period, Mr. Slayen was still able to prepare a spreadsheet with the partnership information and distribute such information to appellant's partners so that they could timely file. Appellant does not provide any documentation or medical records that establish that Mr. Slayen's circumstances continuously prevented the timely filing of its return. The evidence indicates that the general partner was still able to conduct his business affairs during the filing period, as he states that he simply forgot to file the return after preparing the necessary information. Moreover, there is no explanation as to why the other two partners failed to ensure appellant's return was filed on time. These circumstances do not establish reasonable cause. Therefore, the late-filing penalty may not be abated.

Appellant next contends that the penalty should be abated pursuant to Rev. Proc. 84-35, which sets forth the procedures by which the Internal Revenue Service (IRS) will abate an Internal Revenue Code (IRC) section 6698 penalty for a "small partnership" (as defined under IRC section 6231(a)(1)(B)). California, however, does not conform to IRC section 6231 and thus, recognizes no such exception for small partnerships. (*Appeal of Auburn Old Town Gallery, LLC*, 2019-OTA-319P.)[1] Therefore, the penalty may not be abated pursuant to Rev. Proc. 84-35.

Finally, appellant states that the IRS abated its federal late-filing penalty. However, according to appellant's federal Business Master File transcript, the penalty was removed not because appellant was a "small partnership," but for first time abatement. Under the IRS's First Time Penalty Abatement program, a taxpayer may be relieved of a federal late-filing penalty based on previous good filing behavior, rather than reasonable cause. Neither the California Legislature nor FTB have adopted a comparable penalty abatement program. Therefore, an IRS decision to abate a federal late-filing penalty under the IRS First Time Penalty Abatement program does not constitute grounds for abating the California late-filing penalty.

HOLDING

The partnership late-filing penalty may not be abated.

[1] Precedential opinions of the Office of Tax Appeals (OTA) may be found on OTA's website at: < https://ota.ca.gov/opinions >.

DISPOSITION

FTB's action is sustained.

DocuSigned by:
Josh Lambert
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Josh Lambert
Administrative Law Judge

I concur:

DocuSigned by:
Tommy Leung
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Tommy Leung
Administrative Law Judge

J. MARGOLIS, dissenting:

I dissent because appellant has satisfied the "reasonable cause" exception contained in Revenue & Taxation Code (R&TC) section 19172.

R&TC section 19172, California's per partner late-filing penalty, was enacted in 1983 as former R&TC section 18681.2.[1] It was modeled on the federal per partner late-filing penalty, Internal Revenue Code (IRC) section 6698, which was enacted in 1978.[2] Included in the legislative history file pertaining to the enactment of California's per partner late-filing penalty is a conformity "Task Force Team" report indicating that the Legislature intended for there to be "routine conformity" with IRC section 6698, the sole exception being the amount of the penalty (the state penalty was originally set at $10 per partner, which was 20 percent of the federal penalty amount at the time; the state penalty has since been increased to $18 per partner).

Because the California penalty provision is modeled on IRC section 6698, the federal legislative history and federal interpretations relating to IRC section 6698 are relevant in interpreting R&TC section 19172. "Our Legislature has generally followed the federal statutes in designing California's personal income tax system, making federal decisions interpreting substantially identical statutes unusually strong persuasive precedent on construction of our own laws." (*People v. Hagen* (1998) 19 Cal.4th 652, 661; see also *Calhoun v. Franchise Tax Bd.* (1978) 20 Cal.3d 881.) "In instances where federal law and California law are the same, … rulings and regulations dealing with the IRC are persuasive authority in interpreting the California statute." (*J. H. McKnight Ranch, Inc. v. Franchise Tax Bd.* (2003) 110 Cal.App.4th 978, 984, fn. 1.) "The obvious parallelism of the federal and state statutes … requires that one wishing to comply with the state provision look to the federal counterpart for guidance." (*Spurgeon v. Franchise Tax Bd.* (1984) 160 Cal.App.3d 524, 530.) "This policy makes available to the state a ground work of relevant federal experience and judicial pronouncements." (*Holmes v. McColgan* (1941) 17 Cal.2d 426, 430; see also *Rihn v. Franchise Tax Bd.* (1955) 131 Cal.App.2d 356, 360.)

[1] See Assem. Bill No. 399, Stats. 1983, ch. 498, § 150. An "item-by-item analysis" contained in the legislative history file pertaining to A.B. 399 that is maintained by the California State Archives also confirms the California per partner late-filing penalty was based on IRC section 6698.

[2] See the Revenue Act of 1978 (Pub.L. 95-600, 92 Stat. 2763, § 171 (Nov. 6, 1978)).

When one takes into consideration the relevant legislative history and the interpretations of the federal statute upon which the California penalty provision is based, it becomes clear that the majority errs in rejecting appellant's claim that it qualifies under the reasonable cause exception to the penalty that is contained in both state and federal law. The legislative history underlying IRC section 6698 shows that Congress intended that the penalty's reasonable cause exception be interpreted broadly to apply to small partnerships whose partners properly reported their shares of partnership income on their individual returns:

> The penalty will not be imposed if the partnership can show reasonable cause for failure to file a complete or timely return. Smaller partnerships (those with 10 or fewer partners) will not be subject to the penalty under this reasonable cause test so long as each partner fully reports his share of the income, deductions, and credits of the partnership ….[3]

(H.R.Rep. No. 95-1800 (Conf. Report), 2d Sess. 221 (1978), 1978-3 C.B. (Vol. 1) 521, 555.) The Senate Report pertaining to the enactment of IRC section 6698 also explained the provisions of the statute, and how the "reasonable cause" exception contained in the penalty provision should be applied. The Report states:

> The penalty will not be imposed if the partnership can show that failure to file a complete or timely return is due to reasonable cause. The committee understands that small partnerships (those with 10 or fewer partners) often do not file partnership returns, but rather each partner files a detailed statement of his share of partnership income and deductions with his own return. *Although these partnerships may technically be required to file partnership returns, the committee believes that full reporting of the partnership income and deductions by each partner is adequate and that it is reasonable not to file a partnership return in this instance*. [Italics added.]

(Sen.Rep. No. 95-1263, 2d Sess., p. 106 (1978), 1978-3 C.B. (Vol. 1) 315, 403.) The House report contains similar language. (H.R.Rep. No. 95-1445, 2d Sess. 75 (1978), 1978-3 C.B. (Vol. 1) 181, 249; see also H.Rep. No. 95-1800, 2d Sess. p. 221 (1978).)

Based upon this clear legislative history, the IRS promulgated Rev. Proc. 81-11, which provides, in pertinent part, as follows:

> A partnership composed of ten or fewer partners of a type that has not historically filed a partnership return … *will be considered to have met the reasonable cause test* and will not be subject to the penalty imposed by section 6698 of the Code for

[3] The record indicates that appellant's partners were all members of the same family, and there is no dispute that the partners reported their distributive shares of partnership income/loss for the year at issue.

> the failure to file a partnership return, provided that the partnership or any of the partners establishes, if so requested by the Service, that all partners have fully reported their shares of the income, deductions, and credits of the partnership on their timely-filed income tax returns. [Italics added.]

(*Id.* at § 3.01.) Rev. Proc. 81-11 also states that:

> For purposes of section 3.01, a partnership will not be considered to be of a type that has not historically filed a partnership return unless it is a domestic partnership composed entirely of noncorporate general partners. Required to file partnership returns are partnerships with significant financial holdings, tier partnerships, and partnerships where each partner's interest in the capital and profits are not owned in the same proportion or where all items of income, deductions, and credit are not allocated in proportion to such pro rata interests.

(*Id.* at § 3.02.) Finally, section 3.04 of Rev. Proc. 81-11 states that:

> In determining whether a partner has fully reported the partner's share of the income, deductions, and credits of the partnership, ... all the relevant facts and circumstances will be taken into account. In making this determination, the nature and materiality of any error or omission will be considered . . . . If the error or omission results in a de minimis understatement of the net amount payable with respect to any income tax, the penalty will not be asserted. However, if the error or omission results in a material understatement of the net amount payable with respect to any income tax, the partner generally will not be considered to have fully reported and the penalty will be applied.

According to FTB Notice 88-692, 1988 WL 188431, FTB appears to have agreed with the IRS's interpretation of reasonable cause as set forth in Rev. Proc. 81-11, at least until 1984, when that ruling was modified and superseded by Rev. Proc. 84-35. (See FTB Notice 88-692, 1988 WL 188431 ["In the case of general partnerships of a type which have not historically filed a tax return, as described in Rev. Proc. 81-11, 1981-1 C.B. 651, reasonable cause for failure to file returns may be found"].)

Furthermore, when, in 1983, California adopted the California per partner late-filing penalty based upon IRC section 6698, the Legislature is presumed to have been aware of the IRS interpretation of the federal penalty provision to which it had conformed. "When the Legislature adopts the substance of a non-California statute, the Legislature is presumed to have acted with knowledge and in light of decisions interpreting the adopted statute." (*Hodge v. Kirkpatrick Development, Inc.* (2005) 130 Cal.App.4th 540, 555.) Therefore, "the Legislature must have intended that they should have the same meaning, force and effect ...." (*Id.* at p. 556; see also

Kahn v. Kahn (1977) 68 Cal.App.3d 372, 384.) The IRS's interpretation of the per partner late-filing penalty, originally reflected in Rev. Proc. 81-11 and later in Rev. Proc. 84-35, gave effect to the clear legislative intention that the penalty's reasonable cause exception should apply to the type of small partnership that is at issue in this appeal.

The majority opinion ignores the relevant legislative history and rejects the federal interpretation of the reasonable cause exception to the penalty. It reasons that because in 1984 the IRS "modified and superseded" Rev. Proc. 81-11 by issuing Rev. Proc. 84-35, and the latter ruling referred to IRC section 6231 (a federal statute enacted in 1982 to which California has not conformed), California ceased to recognize the "exception for small partnerships" and, therefore, "the penalty may not be abated pursuant to Rev. Proc. 84-35." But the legislative intention to except small partnerships from the per partner late-filing penalty *predated* the adoption of IRC section 6231 and was unaffected thereby.[4]

Contrary to the reasoning in the majority opinion, whether California conformed to IRC section 6231 or not is simply irrelevant to the issue presented in this appeal. IRC section 6231 defines the type of small partnerships that would not automatically be subject to the federal consolidated partnership audit provisions.[5] It has nothing to do with the requirement that all partnerships must file partnership returns, nor does it exempt them from filing returns. IRC section 6031(a), not section 6231, requires that partnerships—*all* partnerships as defined in IRC section 761(a)—file partnership returns. California law is the same. It also requires that *all* partnerships defined in IRC section 761(a) file California partnership returns. (See R&TC, § 18633 [all partnerships must file partnership returns]; see also R&TC, §§ 17008, 17851 [conforming to the federal definition of "partnership" contained in IRC section 761(a)].)

Simply put, the adoption of IRC section 6231 in 1982 had *no effect* upon the small partnership exception to the per partner late-filing penalty that existed under both federal and

[4] See FTB Notice 88-692, 1988 WL 188431, which acknowledged that Rev. Proc. 81-11 had been applicable for California tax purposes, but erroneously concluded that its principles became inapplicable after Congress enacted IRC section 6231. That error was based upon FTB's erroneous conclusion that the small partnership exception contained in IRC section 6231(a)(1)(B)(1) meant that small partnerships were no longer obligated to file federal partnership returns. As discussed below, that conclusion was incorrect.

[5] IRC section 6231 was enacted in 1982 as part of the Tax Equity and Fiscal Responsibility Act of 1982, known as "TEFRA." (Pub.L. No. 97–248, 96 Stat. 324.) California neither adopted nor conformed to TEFRA's consolidated partnership audit provisions.

California law prior to that time.[6] Moreover, the IRS's modification of Rev. Proc. 81-11 in 1984 simply reflected the IRS's decision to use the small partnership definition contained in IRC section 6231(a)(1)(B) as a shorthand reference to define the type of small partnership that previously had been described in Rev. Proc. 81-11. Although Rev. Proc. 84-35 "modified and superseded" IRS Rev. Proc. 81-11, the basic principles of Rev. Proc. 81-11 remained in place. Small partnerships with 10 or fewer partners generally would come within the reasonable cause exception contained in IRC section 6698 so long as the partners duly reported their income, deductions, and credits from the partnership.[7]

In sum, the federal interpretation of the reasonable cause exception to the per partner late-filing penalty was and is a reasonable one in light of the clearly expressed legislative intent underlying the IRC section 6698 penalty. FTB has not shown a valid reason for departing from that interpretation in construing California's counterpart to the federal penalty provision. To the contrary, FTB's (and the majority's) stated reason for rejecting the federal interpretation is misplaced; it is based entirely upon California's failure to adopt the TEFRA consolidated partnership audit provisions (in particular, IRC section 6231), which is irrelevant to the issue of reasonable cause. Accordingly, I respectfully dissent.

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Jeffrey I. Margolis
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Jeffrey I. Margolis
Administrative Law Judge

Date Issued: 2/19/2020

[6] See FTB Notice 88-692, 1988 WL 188431, discussed above in footnote 4.

[7] The Arizona Department of Revenue, in Partnership Tax Ruling 94-1, also reached this conclusion in interpreting the Arizona partnership late-filing penalty. (Arizona PTR 94-1, accessible at <www. https://azdor.gov/sites/default/files/RULINGS_PARTNER_1994_ptr94-1.pdf> ["a partnership that fails to file an Arizona partnership return will satisfy the Arizona reasonable cause standards if the partnership satisfies the federal reasonable cause standards set forth in federal Rev. Proc. 84-35 when the same conditions apply"].)