

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Consolidated Appeals of:) OTA Case Nos. 18042682, 18042961, 18053206
)
PARADIGM PUBLISHING, INC.;) Date Issued: December 23, 2019
CSBT CORP.; CSBT ENTERPRISES, INC.)
)
)

OPINION

Representing the Parties:

For Appellant: Sean R. Kenney, Esq.
John Shaeffer, Esq.

For Respondent: Mira Patel, Tax Counsel
Maria Brosterhous, Tax Counsel IV

R. TAY, Administrative Law Judge: Pursuant to Revenue and Taxation Code section 19324, Paradigm Publishing, Inc. (Paradigm), CSBT Corp (CSBT), and CSBT Enterprises, Inc. (CSBTE) (collectively, appellants)¹ appeal actions by respondent Franchise Tax Board (FTB) denying appellants’ claims for refund of \$4,231.32² for Paradigm, \$48,662.82 for CSBT, and \$23,170.97 for CSBTE for the 2014 tax year.³

Office of Tax Appeals Administrative Law Judges Kenneth Gast, Douglas Bramhall and Richard Tay held an oral hearing for this matter in Los Angeles, California, on September 19, 2019. At the conclusion of the hearing, the record was closed and this matter was submitted for decision.

¹ The Office of Tax Appeals consolidated the appeals of the listed parties on May 25, 2018.

² FTB indicates the updated amount on appeal for Paradigm Publishing is \$4,219.10, according to footnote 2 in FTB’s opening brief. However, since FTB’s and appellants’ briefs use \$4,231.32, this amount will be used for purposes of clarity.

³ Appellants’ claims for refund break down as follows:

- a. Paradigm: late payment penalty of \$2,999.88, collection cost recovery fee of \$334, and interest of \$885.22;
- b. CSBT: late payment penalty of \$37,575, and interest of \$11,087.82;
- c. CSBTE: late payment penalty of \$15,725.04, estimated tax penalty of \$2,768.22, and interest of 4,677.71.

ISSUE⁴

Whether reasonable cause exists to abate the late payment penalties.

FACTUAL FINDINGS

1. Appellants are S corporations wholly-owned by Dr. Ivan Misner and his spouse, Elisabeth Misner (the Misners). The Misners sold appellants' assets to BNI Holdings, LLC (BNI Holdings), an unrelated party, for \$36 million, per the terms set forth in the Asset Purchase Agreement (purchase agreement) dated December 8, 2014.
2. The purchase agreement gave BNI Holdings the right to allocate the purchase price among the assets.
3. Carolyn K. Denny of Denny & Company, LLP served as appellants' tax advisor for the asset sale. Ms. Denny is a licensed certified public accountant (CPA) who has provided tax services and advice to appellants and the Misners for many years.
4. On December 12, 2014, Dr. Misner requested advice from Ms. Denny as to whether appellants needed to pre-pay any tax resulting from the asset sale. Ms. Denny stated that she did not know how to allocate the tax liability among the three entities. Based on alleged conversations with FTB, Ms. Denny advised appellants and the Misners to pay the estimated tax to the Misners' individual tax account with the intent to later apply the payment to each of appellants' tax accounts after the seller provided the allocation of the asset sale purchase price.
5. On December 30, 2014, following Ms. Denny's instructions, the Misners made an estimated tax payment of \$950,000 to their individual tax account for the 2014 tax year.
6. Before appellants' tax payments were due, Ms. Denny communicated with BNI Holdings' representative regarding the allocation of the purchase price, but did not receive the purchase price allocation.
7. Appellants made the following estimated tax payments for their estimated tax obligations for 2014:
 - i. Paradigm: \$800 on April 9, 2014;

⁴ All other proposed assessments of additions to tax for appellants' 2014 tax year have been conceded by appellants.

- ii. CSBT: \$800 on April 9, 2014, \$1,300 and \$798 on September 15, 2014, \$1,300 on December 12, 2014, and \$2,000 on December 30, 2014, for a total of \$6,198; and
 - iii. CSBTE: \$800 on April 9, 2014, \$18,500 on September 18, 2014, \$8,300 on December 12, 2014, and \$3,000 on December 30, 2014, for a total of \$30,600.
8. Ms. Denny testified that BNI Holdings provided the purchase price allocation on or around September 1, 2015.
 9. On September 14, 2015, each appellant filed a California S corporation franchise income return (Form 100S) for the tax year ending December 31, 2014, but did not remit the balance due with the return. Ms. Denny prepared the returns on behalf of appellants.
 10. On September 28, 2015, Ms. Denny spoke with an FTB representative, requesting information on how to transfer an \$844,000 overpayment of the Misners from their personal income tax liability for the 2014 tax year and allocate the credit to appellants. FTB advised her to have the Misners sign the request, indicate which account contained the overpayment and which accounts were to be allocated that overpayment.
 11. In a letter dated October 29, 2015 to the FTB, Ms. Denny requested that \$900,378 of overpaid tax reflected on the Misners' 2014 individual tax return, dated October 7, 2015, be reallocated "to reflect payments of taxes due for two entities owned by Ivan R. Misner." Specifically, Ms. Denny requested the overpayment be reallocated as follows: (a) \$320,000 to the 2014 estimate due on January 15, 2015, for Business Networks International Franchise Corp. (i.e., CSBT); (b) \$5,100 to the 2014 estimate due on January 15, 2015, for BNI Enterprises Inc. (i.e., CSBTE); (c) \$50,000 to the Misners' individual 2015 estimated tax; and (d) refund the remaining balance of \$525,278 to the Misners.
 12. On December 1, 2015, Ms. Denny called FTB, requesting that FTB apply the Misners' 2014 overpayment to other tax accounts. FTB advised her that it was unable to do so.
 13. On January 7, 2016, Ms. Denny called to inform FTB that the Misners intended to pay the corporate tax liabilities with the credit on the Misners' 2014 individual tax return. FTB had not responded to Ms. Denny's prior letter, and now advised her that the Misners' credit cannot be transferred and can only be refunded after the Misners file their 2015 individual tax return.

14. On February 10, 2016, FTB issued a past-due notice to Paradigm,⁵ for a balance due of \$28,294.24, comprised of \$25,799 of tax, \$2,624.90 of penalty, and \$670.34 of interest, less \$800. FTB issued a final notice before levy dated March 11, 2016, for a balance due of \$28,518.71.
15. On May 2, 2016, FTB received the following payments from appellants for the 2014 tax year: Paradigm paid \$29,218.10; CSBT paid \$361,787.82; and CSBTE paid \$154,212.97.
16. Appellants filed claims for refund dated July 6, 2017, arguing that reasonable cause existed for their untimely payments. FTB denied the refund claims in September 2017. This timely appeal followed.

DISCUSSION

Generally, the date prescribed for the payment of the tax is the due date of the return without regard to extension of time for filing the return. (Rev. & Tax. Code, § 19001.) An S corporation is required to file its tax return on or before the 15th day of the third month following the close of its tax year. (Rev. & Tax. Code, § 18601.) A taxpayer may extend the time for filing a return, but an extension of time to file a return does not extend the time for payment of tax required to be paid on or before the due date of the return without regard to an extension. (Rev. & Tax. Code, § 18604(b).) As appellants' tax years ended on December 31, 2014, the due date for paying tax was March 15, 2015.

FTB assesses a late payment penalty if a taxpayer fails to timely pay the amount shown on the return by the payment due date. (Rev. & Tax. Code, § 19132.) The late payment penalty is calculated as 5 percent of the total tax unpaid plus one-half of one percent for every month the payment of tax is late, not to exceed 40 months. (Rev. & Tax. Code, § 19132(a)(2).) Here, appellants failed to timely pay their tax obligations for 2014 until May 2, 2016, and therefore, the penalty is properly imposed.

The late payment penalty may be abated, however, if a taxpayer shows that the failure to make a timely payment of tax was due to reasonable cause and not due to willful neglect. (Rev. & Tax. Code, § 19132(a)(1).) To establish reasonable cause for a late payment of tax, a taxpayer must show that the failure to make a timely payment occurred despite the exercise of ordinary

⁵ FTB did not include copies of the final notice due for either CSBT or CSBTE.

business care and prudence. (*Appeal of Scanlon* (2018-OTA-075P); *Appeal of Curry* (86-SBE-048) 1986 WL 22783.) The taxpayer bears the burden of proving that an ordinarily intelligent and prudent businessperson would have acted similarly under the circumstances. (*Appeal of Moren* (2019-OTA-176P).)

FTB contends that appellants have not shown that they had reasonable cause to excuse their late payments of tax for 2014. FTB argues that appellants' late receipt of the purchase price allocation from the purchasers did not excuse their late payment. Additionally, FTB argues that appellants do not have reasonable cause based on the advice from Ms. Denny or any alleged advice from an FTB representative. Finally, FTB characterizes appellants' failure to pay as a mere calculation error because appellants knew that they had a tax obligation, but did not know the amount they had to pay. Citing to *Appeal of Berolzheimer* (86-SBE-172) 1986 WL 22860 (*Berolzheimer*), FTB contends appellants did not have reasonable cause.

We disagree and find that appellants have met their burden of establishing reasonable cause because they exercised business prudence and did not act with willful neglect. At the oral hearing, Dr. Misner and Ms. Denny testified as to their efforts to timely pay appellants' tax liabilities, and their intention of making payments in excess of the Misners' anticipated personal tax obligation.⁶ We find their testimonies credible and supportive of appellants' position that they exercised business care and prudence.

In addition to the testimonies given at the hearing, the facts and documents show appellants acted with business prudence. The December 2014 emails between Ms. Denny's office and Dr. Misner show that appellants and Dr. Misner wanted to ensure that appellants paid "more tax than needed" to satisfy appellants' tax obligation. For appellants and the Misners, the asset sale was an extraordinary event. They were not in the business of engaging in this kind of transaction on a regular basis, and therefore appellants relied on their long-time tax advisor, Ms. Denny, to advise them on how to pay the tax. To require the Misners and appellants to inquire specifically about how to allocate the payment to the entities' (appellants') tax accounts since the entities were S corporations subject to an entity-level income tax for California purposes, but not for federal purposes, negates the very purpose of consulting an expert.

⁶ Appellants contend Ms. Denny's advice was based on incorrect information allegedly provided by FTB in 2014, although FTB's records show no record of the purported contact. While the source of Ms. Denny's incorrect advice is disputed, we note that appellants acted with ordinary business care and prudence in seeking a CPA's (i.e., Ms. Denny's) advice to determine their correct tax liability and to make proper timely payments.

It is also noteworthy that the Misners' efforts to comply with the tax laws resulted in payments in excess of their own tax liability (on the flow-through income from the sale of appellants' assets) *and* appellants' tax liabilities. The only uncertainty was the allocation of tax liability among the Misners' three entities (i.e., appellants).

Reasonable cause excuses a taxpayer's late payment of tax until actual payment is remitted "so long as the reason remains valid." (*Appeal of Triple Crown Baseball LLC* (2019-OTA-25P), quoting *Steven Bros. Foundation, Inc. v. Commissioner* (1962) 39 T.C. 93, 130, *affd.* in part & *revd.* in part on other grounds (8th Cir. 1963) 324 F.2d 633.) Reasonable cause does not exist if, after the facts and circumstances that explain the taxpayer's noncompliant behavior ceases to exist, the taxpayer fails to comply with the tax obligation within a reasonable period of time. (*Appeal of Moren, supra.*) Here, the facts show that appellants had reasonable cause until they remitted payment, which they did within a reasonable period of time. The Misners did not receive the purchase price allocation until September 2015, approximately six months after appellants' tax payments were due, and believed the \$950,000 payment was more than enough to cover their tax liability. Upon receiving the allocation, appellants proceeded to file 2014 tax returns and attempted to apply the Misners' prior payment to the appropriate entity. Appellants' representative contacted FTB and received inconsistent guidance proffered during documented phone calls in September 2015 and December 2015. After learning that a reallocation of their prior payment was not possible, appellants began the process of making substantial tax payments, which were submitted on May 2, 2016. Given the circumstances, we find that appellants acted reasonably and made proper payments within a reasonable amount of time to justify a reasonable cause finding.⁷

We find that FTB's arguments do not demonstrate that appellants failed to act with business prudence. FTB contends appellants' reliance on Ms. Denny's advice was unreasonable and makes much of the fact that appellants knew approximately the aggregate amount of tax due, but did not allocate tax to each appellant involved in the asset sale. FTB cites to *Berolzheimer, supra*, to support their position that appellants' reliance on Ms. Denny's advice was not reasonable cause because the amount of tax due was a mere computational problem. We find

⁷ FTB does not assert appellants acted with willful neglect, and we find no evidence to support such a conclusion. Willful neglect is a "conscious, intentional failure or reckless indifference." (*United States v. Boyle* (1985) 469 U.S. 241, 245.) Considering all the facts and circumstances in this appeal, as discussed above, we find that appellants made a good faith attempt to submit timely payments of tax for the 2014 tax year, and appellants' failure to do so was not conscious, intentional or due to reckless indifference.

Berolzheimer distinguishable from this appeal because, here, appellants were required to allocate the purchase price between assets in a sale of three businesses, which is far more complex than applying the correct capital gains rate, as was the issue in *Berolzheimer*. Further, we note that in *Berolzheimer*, the taxpayer failed to make any payment attributable to the capital gain, estimated or computed, on a timely basis. Here, the Misners made a substantially larger payment than was actually due – albeit to a personal account as opposed to corporate accounts – on the total calculated gain.

We also find that FTB’s argument regarding appellants’ ability to estimate the proper allocation unpersuasive. We find appellants made reasonable efforts in requesting the allocation from the purchaser before and after their tax payments were due. While we acknowledge that an asserted lack of documentation or difficulty in calculating a tax liability does not, by itself, constitute reasonable cause for a late payment of tax, we find appellants’ efforts to make a timely tax payment, in spite of the lack of information, significant. (*Appeal of Sleight* (83-SBE-244) 1983 WL 15615.) “The most important factor in determining reasonable cause and good faith is the extent of the taxpayer’s effort to assess his or her proper tax liability.” (*Appeal of Moren, supra*, quoting *Frias v. Commissioner* (2017) T.C. Memo. 2017-139 at pp. *16-17.)

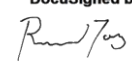
Appellants could not, despite their efforts, obtain the information required, nor could they allocate the purchase price (which, contrary to FTB’s assertion, is more than a mere calculation error) on their own. Yet, they still made a good faith effort to pay more than enough of their tax liability. The fact that appellants could not keep their own records to determine their tax liability (because the allocation was determined by the purchaser) is not insignificant. (*Appeal of Moren, supra*.) Furthermore, although the Misners had the ability to make payments to each of appellants’ tax accounts, we find that the accountant’s error does not negate reasonable cause as the Misners’ efforts to make proper tax payments were consistent with reasonable business prudence. As such, we find appellants have shown reasonable cause exists to abate the late payment penalties.

HOLDING

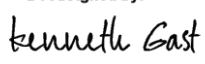
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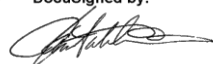
DISPOSITION

FTB’s actions in denying appellants’ claims for refund relating to the late payment penalties are reversed. In all other respects, FTB’s actions are sustained.

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Richard Tay
Administrative Law Judge

We concur:

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Kenneth Gast
Administrative Law Judge

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James S. Whitehouse
Staff Services Analyst on behalf of
Douglas Bramhall
Administrative Law Judge