**OFFICE OF TAX APPEALS**

**STATE OF CALIFORNIA**

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| In the Matter of the Appeal of: | ) OTA Case No. 20076380 |
| **CLAREMONT BIOSOLUTIONS LLC** | ) |
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## OPINION

Representing the Parties:

For Appellant: Tracy Doebler, Director of Administration

For Respondent: Meghan McEvilly, Tax Counsel III

C. AKIN, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, Claremont BioSolutions LLC (appellant) appeals an action by respondent Franchise Tax Board (FTB) denying appellant's claim for refund of $15,527,[1] plus applicable interest, for the 2017 tax year.

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

## ISSUES

1. Whether appellant has established reasonable cause for the abatement of the late-filing penalties imposed under R&TC sections 19131 and 19172.
2. Whether appellant has established that it is entitled to abatement of the underpayment of estimated LLC fee penalty imposed under R&TC section 17942(d)(2).

## FACTUAL FINDINGS

1. For the 2017 tax year, appellant was an LLC classified as a partnership for tax purposes. Appellant had 74 members during the 2017 tax year.

[1] This is comprised of a late-filing penalty of $625 under R&TC section 19131, a per-partner, late-filing penalty of $14,652 under R&TC section 19172, and an underpayment of estimated limited liability company (LLC) fee penalty of $250 under R&TC section 17942(d)(2).

2. Appellant filed an untimely 2017 return (Form 568) on February 6, 2019, reporting an LLC fee of $2,500 and the annual LLC tax of $800.
3. Appellant timely paid the annual LLC tax of $800 on April 14, 2017. Appellant did not timely estimate and pay its $2,500 LLC fee on or before June 15, 2017, and the LLC fee remained unpaid until after the filing of appellant's 2017 return on February 6, 2019.
4. FTB imposed a late-filing penalty under R&TC section 19131 of $625, a per-partner, late-filing penalty under R&TC section 19172 of $14,652, and an underpayment of estimated LLC fee penalty of $250.
5. Appellant subsequently paid the balance due for the 2017 tax year and filed a claim for refund seeking abatement of the penalties.
6. FTB denied appellant's claim for refund and this timely appeal followed.

## DISCUSSION

Issue 1: Whether appellant has established reasonable cause for the abatement of the late-filing penalties imposed under R&TC sections 19131 and 19172.

When FTB imposes a penalty, the law presumes that the penalty was imposed correctly. (*Appeal of Xie*, 2018-OTA-076P.) The burden of proof is on the taxpayer to provide credible and competent evidence supporting a claim of reasonable cause; otherwise the penalty cannot be abated. (*Ibid.*) For penalty abatement purposes, reasonable cause exists when the taxpayer acted as an ordinarily intelligent and prudent businessperson would have acted under similar circumstances. (*Appeal of Auburn Old Town Gallery, LLC*, 2019-OTA-319P.) In other words, a taxpayer must show that the failure to meet its tax filing obligation occurred despite the exercise of ordinary business care and prudence. (*Ibid.*)

The R&TC contains two penalties that are applicable when an LLC classified as a partnership for tax purposes files its return late. First, R&TC section 19131 imposes a late-filing penalty when a taxpayer fails to file its return on or before its due date, unless it is shown that the failure was due to reasonable cause and not willful neglect.[2] The amount of the late-filing

[2] FTB is not asserting willful neglect is present in this case with respect to this penalty.

penalty imposed by R&TC section 19131 is equal to five percent of the tax and LLC fee[3] due, after allowing for timely payments, for every month or fraction of a month the return is late, not to exceed 25 percent of the tax due. (R&TC, § 19131(a).)

A second penalty, imposed under R&TC section 19172, takes into account the fact that an LLC classified as a partnership is a pass-through entity. R&TC section 19172 imposes a per-partner, late-filing penalty when a partnership—or an LLC classified as a partnership—fails to file a return at the time prescribed unless it is shown that the failure was due to reasonable cause. The amount of the per-partner, late-filing penalty under R&TC section 19172 is computed by multiplying $18 by the number of partners by the number of months, or fraction thereof, that the return is late (not to exceed 12 months). (R&TC, § 19172(a)(2).)

Here, appellant filed its 2017 tax return on February 6, 2019, which is more than 10 months beyond the original due date of March 15, 2018.[4] As a result, FTB imposed a late-filing penalty under R&TC section 19131 of $625 (25 percent of appellant's $2,500 unpaid LLC fee) and a per-partner, late-filing penalty under R&TC section 19172 of $14,652 ($18 times 74 members times 11 months).

Appellant does not contest the computation of these penalties. Instead, appellant makes a reasonable cause-type argument in contending that its tax return was filed late due to a miscommunication between its officer and the accountant regarding the electronic filing authorization forms and whether or not the officer had signed and returned the forms to the accountant (which would have permitted the accountant to timely file appellant's return). Appellant further asserts that this error was an unintentional oversight, and that it did not intend to disregard the filing deadline. However, neither reliance on one's agent to timely file its tax return nor mere oversight qualify as reasonable cause. (*Appeal of Auburn Old Town Gallery, LLC*, *supra*.)

Appellant also has not substantiated what efforts, if any, it took to verify and ensure that its 2017 tax return had been timely filed. An ordinarily intelligent and prudent businessperson

[3] For penalty purposes, the LLC fee is "collected and refunded in the same manner as the taxes imposed [and is] subject to interest and applicable penalties." (R&TC, § 17942(c).) Thus, the R&TC section 19131 penalty is also applicable to the amount of any unpaid LLC fee.

[4] R&TC section 18633.5(a) requires every LLC that is classified as a partnership for California tax purposes that is doing business in California, organized in California, or registered with the California Secretary of State to file a tax return on or before the 15th day of the third month following the close of the tax year.

would have verified that its tax return was in fact timely filed prior to the end of the extension period.[5] (See *Appeal of Auburn Old Town Gallery, LLC*, *supra*; *Quality Tax & Financial Services, Inc*., 2018-OTA-130P.) Accordingly, appellant has failed to establish reasonable cause to abate the late-filing penalties.

In addition to the above reasonable cause arguments, appellant also contends that the penalties are "exorbitant" and "extraordinary given [appellant's] history of compliance" and requests that we "reconsider the amount" of the penalties imposed for the 2017 tax year. However, there is nothing in the law that allows for abatement of either late-filing penalty (in whole or in part) on this basis. The late-filing penalties are imposed by and calculated according to the statutes passed by the California Legislature. While we are sympathetic to appellant's argument, its disagreement with the law should be directed to the Legislature, which is charged with formulating the law, rather than to those who are charged with enforcing the law as it is written. (See *Appeal of Walker* (73-SBE-020) 1973 WL 2752.) Additionally, while appellant further suggests that the per-partner, late-filing penalty should be abated because its members were not impacted by the late filing of its 2017 tax return,[6] again there is nothing in the law that permits abatement of the penalty on this basis. (See *ATL & Sons Holdings, Inc. v. Commissioner* (2019) 152 T.C. 138, 148 [late-filing penalty imposed on pass-through entity despite the fact that its owners timely received information needed to file their returns, as the statute "does not include a condition of harm before the penalty is imposed; it simply imposes a penalty when the filing is late"].)

Appellant also notes its timely filing history and requests that we consider or adopt a first-time abatement program in this case. While we recognize the many benefits such a first-time abatement program could potentially provide to both taxpayers and the state of California in the administration of timeliness-related penalties such as the late-filing penalties at issue here,[7] the California Legislature has considered and declined to adopt bills that would change California law to allow a first-time abatement of timeliness-related penalties for taxpayers based

[5] An LLC is provided an automatic extension to file, which is six months after the original filing date, as long as the return is filed within those six months. (R&TC, § 18567; Cal. Code Regs., tit. 18, § 18567.)

[6] It is undisputed that the appellant's members timely received their California Schedule K-1s from appellant in March 2018.

[7] See Freeman & Akopchikyan, *A Proposal for First-Time Abatement of Timeliness Penalties* (2020) Vol. 29, No. 2, Cal. Tax Lawyer 23.

solely on their history of timely filing and payment. (See, e.g., Assem. Bill No. 1777 (2013-2014 Reg. Sess.).) Absent such legislative action to adopt a first-time abatement program in California, we are unable to abate the late-filing penalties unless appellant establishes reasonable cause, which is lacking here.

Finally, the concurring and dissenting opinion argues that the late-filing penalty under R&TC section 19131 should not be imposed when a per-partner, late-filing penalty under R&TC section 19172 is also imposed. However, the plain language of R&TC sections 19131 and 19172 show that they both, by their unambiguous terms, provide for a penalty under the facts of this appeal, and neither penalty is conditioned upon the non-imposition of the other.[8] The dissent's position that the Legislature intended to disable the R&TC section 19131 penalty when a taxpayer is subject to the per-partner, late-filing penalty of R&TC section 19172, amounts to finding an implied partial repeal of the former statute by the latter. But implied repeal is "strongly disfavored" and will be found "only when there is no rational basis for harmonizing two potentially conflicting statutes, and the statutes are irreconcilable, clearly repugnant, and so inconsistent that the two cannot have concurrent operation." (*Pacific Palisades Bowl Mobile Estates, LLC v. City of Los Angeles* (2012) 55 Cal.4th 783, 805, internal citations and quotations omitted.) That is not the situation here. We must follow the clear, easily-reconcilable language of the statutes involved and, under article III, section 3.5, of the California Constitution, we have no power to refuse to enforce the clear and unambiguous language of these statutes unless and until there is a determination from an appellate court declaring that they may not be enforced. As there is no appellate court authority stating that either penalty should not be enforced under these facts, we find that both apply here.

[8] Both penalties statutes are clear on their face, and provide that the penalties "shall" apply unless reasonable cause is established (and in the case of the late-filing penalty under R&TC section 19131, an absence of willful neglect is shown). Furthermore, if as the dissent contends, the Legislature intended the general late-filing penalty not to apply in situations where the per-partner, late-filing penalty has been imposed, it would have expressly stated this in the statute as it does with respect to the late payment penalty. (See, e.g., R&TC, § 19132(b) [statute provides that the late payment penalty under R&TC section 19132(a) shall not be assessed in certain situations where the late-filing penalty under R&TC section 19131 and/or the failure to file a return after demand penalty under R&TC section 19133 have been imposed].)

Issue 2: Whether appellant has established that it is entitled to abatement of the underpayment of estimated LLC fee penalty imposed under R&TC section 17942(d)(2).

R&TC section 17942 imposes an LLC fee based on total California source income of LLCs that are doing business in California. The LLC fee is required to be estimated and paid on or before the 15th day of the sixth month of the current taxable year. (R&TC, § 17942(d)(1).) When the estimated payment of the LLC fee is less than the amount of LLC fee due for the taxable year, a penalty equal to 10 percent of the underpayment is imposed unless the fee amount that was timely estimated and paid was equal to or greater than the total amount of the LLC fee for the preceding taxable year. (R&TC, § 17942(d)(2).) The statute does not provide for a reasonable cause defense to imposition of the penalty.

Here, FTB assessed a $250 underpayment of estimated LLC fee penalty because appellant's $2,500 LLC fee for the 2017 tax year was required to be estimated and paid by June 15, 2017, but was not. Appellant again raises reasonable cause-type arguments for the abatement of the underpayment of estimated LLC fee penalty. However, the only defense to the penalty authorized by statute is the safe harbor provision, which provides that the penalty will not be imposed if the fee amount that was timely estimated and paid is equal to or exceeds the LLC fee due for the prior tax year. (R&TC, § 17942(d)(2).) Appellant did not make any timely estimated payments of its LLC fee and makes no claim that it qualifies for the safe harbor. Hence, there is no basis for abating the penalty.

## HOLDINGS

1. Appellant has not established reasonable cause for the abatement of the late-filing penalties imposed under R&TC sections 19131 and 19172.
2. Appellant has not established that it is entitled to abatement of the underpayment of estimated LLC fee penalty under R&TC section 17942(d)(2).

## DISPOSITION

FTB's action denying appellant's claim for refund is sustained.

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Cheryl Akin
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Cheryl L. Akin
Administrative Law Judge

I concur:

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Jeffrey I. Margolis
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Jeffrey I. Margolis
Administrative Law Judge

T. STANLEY, concurring in part and dissenting in part:

I concur with the Opinion with respect to the proper imposition of the per-partner, late-filing penalty assessed pursuant to Revenue and Taxation Code (R&TC) section 19172. I further agree that appellant has not established a basis to abate either the per-partner, late-filing penalty or the underpayment of estimated LLC fee penalty. However, I respectfully dissent from the conclusion and holding that the late-filing penalty under R&TC section 19131 was properly imposed in this case for the following reasons:

1. FTB assessed two separate penalties for the same misdeed by the same entity. Although the statutes at issue in this case (R&TC, §§ 19131 and 19172) were adopted in California using substantially the same language as their federal counterparts (Internal Revenue Code (IRC), §§ 6651(a)(1) and 6699, respectively), FTB assesses both penalties while the Internal Revenue Service (IRS) declines to aggregate the general and specific penalties. An IRS Chief Counsel Memorandum states that IRC section 6699 "was added to the Code because Congress believed that there was previously no effective penalty regime for the failure to file an S corporation return." (See PMTA 2013-15, https://www.irs.gov/pub/lanoa/PMTA_2013-15.pdf, citing H.R. Rep. No. 110-426, at 35 (2007).) In that Memorandum, the IRS concluded there was nothing in the legislative history of IRC section 6699 to suggest that Congress intended to penalize a particular entity twice for the same failure, and therefore it declined to assess the general late-filing penalty against an "S" corporation when the more specific per-partner, late-filing penalty applied. While we are not bound by the IRS policy, we can use it as guidance in interpreting a statute that California mirrors.
2. When a penalty is both duplicative and ambiguous, the "rule of lenity" applies. Ambiguity exists in the interplay between R&TC sections 19131 and 19172, and whether one section, the other, or both, may be applied to a particular taxpayer for the same misdeed. The rule of lenity is an interpretive canon providing that " '[a]mbiguity in a statute defining a crime or imposing a penalty should be resolved in the defendant's favor.' " (*Mohamed v. Commissioner,* T.C. Memo. 2013-255, at p. 25, quoting Scalia & Garner, Reading Law: The Interpretation of Legal Texts (2012) p. 296.) Applying the R&TC penalty statutes strictly, lenity applies, and FTB may not simultaneously apply

both the per-partner, late-filing penalty and the general late-filing penalty against the same entity, for the same act.

3. The California Legislature clearly articulated that the per-partner, late-filing penalty may be aggregated with another penalty, the criminal penalty sanction imposed under R&TC section 19706. (R&TC, § 19172(a).) The absence of similar language with respect to R&TC section 19131 implies the absence of such intent. In other words, the inclusion of the phrase "in addition to the penalty imposed by Section 19706" shows that the California Legislature intentionally excluded other penalties that might be applicable to the same act, with respect to one subset of taxpayers.

4. "[W]hen a general and particular provision are inconsistent the latter is paramount to the former." (Code Civ. Proc., § 1869.) Thus, a more particular provision will control a more general one that is inconsistent with it. Further, it is a "fundamental principle of statutory construction that a new law supersedes an old law on the same subject." (*Appeal of West Valley Land Management Co.* (93-SBE-014) 1993 WL 409833*,* citing *Union League Club v. Johnson* (1941) 18 Cal.2d 275.) The per-partner, late-filing penalty is both a later-enacted statute and a more specific one and is thus the only one that should be applied in this case.

I disagree with the majority's position that this interpretation would create an implied repeal of R&TC section 19131 if both penalties are not applied to a late-filing LLC that is classified as a partnership. In order for an implied repeal to be at issue, one of two situations must exist; first, two statutes are in irreconcilable conflict; and second, where the "later statute covers the whole subject of the earlier one and is clearly intended as a substitute." (*Radzanower v. Touche Ross & Co.* (1976) 426 U.S. 148, 154, internal quotes omitted.) The simple fact that there are two statutes that penalize the same conduct does not create an irreconcilable conflict to support a claim of implied repeal. (See *U.S. v. Edmonson* (9th Cir. 1986) 792 F.2d 1492, 1498 (*Edmonson*).) Similar to the statutes at issue in *Edmonson*, R&TC sections 19131 and 19172 are not in irreconcilable conflict; rather, the two statutes are easily harmonized and can mutually coexist in that FTB may choose to apply either of them to the specific taxpayers as defined in R&TC section 19172. Although I believe that the Legislature intended R&TC section 19172 to apply a different formula to calculate a penalty that is more useful when dealing with multi-member entities, such as an LLC classified as a partnership, FTB may choose to forego

that penalty and instead apply the penalty laid out in R&TC section 19131. There is, therefore, no implied repeal.

In summary, I conclude that the per-partner, late-filing penalty under R&TC section 19172 is the appropriate penalty to apply to appellant due to the late filing of its return.[9] Based on statutory construction and the principles expressed above, I conclude that FTB may not apply two, separate late-filing penalties to the same entity for the same taxable year.

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Teresa A. Stanley
Administrative Law Judge

Date Issued: 3/5/2021

[9] The application of only one penalty statute to one act (late filing) is not a refusal to enforce a statute in violation of the California Constitution. Rather, I believe it was the intent of the California Legislature when enacting the later statute (R&TC section 19172) to not impose dual penalties for the same act.