

**OFFICE OF TAX APPEALS**  
**STATE OF CALIFORNIA**

In the Matter of the Appeal of:  
**SOURCING THEORY, LLC**

) OTA Case No. 18093837  
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**OPINION**

Representing the Parties:

For Appellant: Jaleh Marie Factor

For Respondent: Gi Nam, Tax Counsel

For Office of Tax Appeals: Matthew D. Miller, Tax Counsel III

T. LEUNG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324,<sup>1</sup> Sourcing Theory LLC (appellant) appeals actions by the respondent Franchise Tax Board (FTB) denying appellant’s claims for refund of \$515.83 for the 2015 taxable year<sup>2</sup> and \$494.07 for the 2016 taxable year.<sup>3</sup>

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

**ISSUES**

1. Whether appellant has established reasonable cause to abate: (1) the late-filing penalty under R&TC section 19131 for the 2015 and 2016 taxable years; and (2) the S corporation per shareholder late-filing penalty under R&TC section 19172.5 for the 2015 and 2016 taxable years.

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<sup>1</sup> All statutory references are to laws operative for the 2015 and 2016 taxable years.

<sup>2</sup> This amount consists of an S corporation late filing penalty of \$216, a late-filing penalty of \$200, an estimated tax penalty of \$22.01, and interest of \$77.82.

<sup>3</sup> This amount consists of an S corporation late filing penalty of \$216, a late-filing penalty of \$200, an estimated tax penalty of \$23.54, and interest of \$54.53.

2. Whether appellant has established that the estimated tax penalty for the 2015 and 2016 taxable years should be abated.
3. Whether appellant has established that interest for the 2015 or 2016 taxable year should be abated.

### FACTUAL FINDINGS

1. Appellant is a California-based limited liability company (LLC) that elected to be taxed as an S corporation, which had one shareholder.
2. Appellant filed its calendar year 2015 and 2016 tax returns on March 1, 2018, and March 5, 2018, respectively. For each taxable year, appellant filed a California S Corporation Franchise or Income Tax Return (Form 100S).<sup>4</sup>
3. For each taxable year, FTB imposed a late-filing penalty, an S corporation per shareholder late-filing penalty, an estimated tax penalty, and interest.
4. After paying its 2015 and 2016 tax liabilities in full, appellant submitted a claim for refund for each taxable year, requesting abatement of penalties and interest.
5. FTB denied appellant's 2015 and 2016 claims for refund.

### DISCUSSION

Issue 1: Whether appellant has established reasonable cause to abate: (1) the late-filing penalty under R&TC section 19131 for the 2015 and 2016 taxable years; or (2) the S corporation per shareholder late-filing penalty under R&TC section 19172.5 for the 2015 and 2016 taxable years.

When FTB imposes a penalty, the law presumes that the penalty was imposed correctly. (*Appeal of Xie*, 2018-OTA-076P;<sup>5</sup> *Appeal of Myers* (2001- SBE- 001) 2001 WL 37126924.) The taxpayer bears the burden of proving that reasonable cause exists to support an abatement of the penalty. (*Appeal of Xie, supra*; *Appeal of Beadling* (77-SBE-021) 1977 WL 3831.) To establish reasonable cause, the taxpayer must demonstrate that the failure to timely file its tax

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<sup>4</sup> When an LLC elects to be taxed as an S corporation for federal tax purposes, the LLC must file California Form 100S, Form 100-ES, Form FTB 3539, and/or Form FTB 3586. (FTB S Corporation Tax Booklet (2016) p. 15; FTB S Corporation Tax Booklet (2015) p. 14.) “The LLC will be subject to the applicable provisions of the Corporation Tax Law and should be considered a corporation for purposes of all instructions unless otherwise indicated.” (*Ibid.*)

<sup>5</sup> Precedential decision of the Office of Tax Appeals (OTA) may be found on OTA's website at: <https://ota.ca.gov/opinions>.

return occurred despite the exercise of ordinary business care and prudence. (*Appeal of Curry* (86-SBE-048) 1986 WL 22783; *Mars v. Commissioner* (1987) T.C. Memo. 1987-481, citing *Sanders v. Commissioner* (10th Cir. 1955) 225 F.2d 629, 636, affg. (1954) 21 T.C. 1012, cert. den., (1956) 350 U.S. 967.) In other words, a taxpayer must show that the failure to meet its tax obligation occurred despite the exercise of ordinary business care and prudence. (*Appeal of Bieneman* (82-SBE-148) 1982 WL 11825.) Unsupported assertions are not sufficient to satisfy an appellant’s burden of proof. (*Appeal of Magidow* (82-SBE-274) 1982 WL 11930.)

Generally, every corporation doing business within California shall annually pay to the state, for the privilege of exercising its corporate franchise within this state, a tax according to or measured by its net income or, if greater, the minimum franchise tax. (R&TC, § 23151(a).) For taxable years 2015 and 2016, the annual minimum franchise tax was \$800. (R&TC, § 23153(d).) The minimum franchise tax is due the first quarter of each accounting period.

For the 2015 and 2016 taxable years, an S corporation was required to file its tax return on or before the 15th day of the third month following the close of its taxable year. (R&TC, § 18601(a) & (d)(1).) R&TC section 18604(a) provides for a reasonable extension of time to file a return, not to exceed seven months after the due date for filing a return, in the “manner and form as the Franchise Tax Board may determine.” R&TC section 18604(b) states that the payment of tax is due on the original due date of the return without regard to the extension. For both taxable years at issue, the extension of the time to file was conditioned on the filing of the return within the automatic extension period. (FTB Notice 92-11; FTB Notice 2016-04.) Here, the automatic extension periods did not apply because appellant filed its 2015 return on March 1, 2018, which was more than 23 months after the March 15, 2016 due date, and it filed its 2016 return on March 5, 2018, which was more than 11 months past the March 15, 2017 due date.

#### Late-filing Penalty

R&TC section 19131 provides that a late-filing penalty shall be imposed when a taxpayer fails to file a tax return on or before its due date, unless the taxpayer establishes that the late-filing was due to reasonable cause and was not due to willful neglect. The late-filing penalty is specified as 5 percent of the tax due for each month that a valid tax return is not filed after it is due (determined without regard to any extension of time for filing the return), not to exceed 25 percent of the tax. (R&TC, § 19131(a).) Here, appellant filed its 2015 return more than

23 months after the due date of March 15, 2016; therefore, respondent properly calculated appellant's late-filing penalty of \$200 (i.e., \$800 × 25 percent). Appellant filed its 2016 return more than 11 months after the due date of March 15, 2017; therefore, respondent properly calculated appellant's late-filing penalty of \$200 (i.e., \$800 × 25 percent).

Appellant contends that it was unable to timely file its 2015 or 2016 tax return because its owner underwent several surgeries and treatments for cancer, saw multiple doctors, and was not in the right mental framework to run the business responsibly. Illness and other personal difficulties may be considered reasonable cause if the taxpayer presents credible and competent proof that he or she was continuously prevented from filing a tax return or paying the tax. (*Appeal of Halaburka* (85-SBE-025) 1985 WL 15809.)

In support of its refund claims, appellant provided a letter from its owner's doctor dated September 5, 2016, which states that beginning on September 10, 2015, appellant's owner was under the doctor's care for a cancer diagnosis and she had surgery on October 15, 2015; no other dates are mentioned in the letter. The letter also states that appellant's owner was advised not to travel out of the country during this period of time. The letter further states, "We ask for your consideration in refunding her cost associate [*sic*] with travel." The dates referenced in the letter are not relevant to the filing deadlines at issue in this appeal, March 15, 2016, and March 15, 2017.

OTA held a conference with the parties on June 26, 2019 and requested additional documentation from appellant to establish the circumstances of its owner's illness or other personal difficulties that continuously prevented appellant from timely filing its 2015 and 2016 tax returns. However, appellant has not provided any additional documentary or third-party evidence to substantiate any illness or personal difficulty, such as medical records or declarations from medical professionals, which continuously prevented appellant from timely filing its 2015 and 2016 tax returns. While we are sympathetic to appellant's owner's illness, we find that appellant has not met its burden of proof to show that reasonable cause existed to support abatement of the late-filing penalties.<sup>6</sup>

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<sup>6</sup> In its claims for refund, appellant requested a one-time forgiveness of the late-filing penalties. We note that the Internal Revenue Service (IRS) administers a program called "First Time Abate" under which the IRS may administratively abate penalties for late payment and late filing if a taxpayer has timely filed tax returns and paid taxes due for the past three years. Neither the California Legislature nor FTB have adopted a comparable penalty abatement program, so the IRS penalty abatement program and a history of timely filing and paying California taxes

*S Corporation Per Shareholder Late-filing Penalty*

R&TC section 19172.5(a) provides that if any S corporation fails to file a tax return within the time prescribed (determined with regard to any extension of time for filing), then the S corporation shall be liable for a penalty unless that failure is due to reasonable cause. The amount of the penalty is calculated as \$18 multiplied by the number of persons who were shareholders in the S corporation during any part of the taxable year multiplied by the number of months (or fraction thereof) the return is late, up to 12 months. (R&TC, § 19172.5(b).)

Here, appellant filed its 2015 tax return more than 23 months after the due date of March 15, 2016; therefore, respondent properly imposed the penalty in the amount of \$216 (i.e.,  $\$18 \times 1 \text{ shareholder} \times 12 \text{ months}$ ). Appellant filed its 2016 tax return more than 11 months after the due date of March 15, 2017; therefore, respondent properly imposed the penalty in the amount of \$216 (i.e.,  $\$18 \times 1 \text{ shareholder} \times 12 \text{ months}$ ).

To establish reasonable cause for the late-filing of an S corporation return, a taxpayer must show that the failure to file a timely return occurred despite the exercise of ordinary business care and prudence, or that an ordinarily intelligent and prudent businessperson would have acted in the same manner under similar circumstances. (*Appeal of Quality Tax & Financial Services, Inc.*, 2018-OTA-130P; *Appeal of Tons (79-SBE-027)* 1979 WL 4068.) Appellant's arguments do not distinguish between the S corporation per shareholder late-filing penalty and the R&TC section 19131 late-filing penalty. We addressed appellant's arguments above in our discussion of the R&TC section 19131 late-filing penalty, and, for the same reasons, find that appellant has not shown grounds to abate the S corporation per shareholder late-filing penalty.

Issue 2: Whether appellant has established that the estimated tax penalties for the 2015 or 2016 taxable years should be abated.

An S corporation subject to the franchise tax imposed by Part 11 of the Revenue and Taxation Code must file a declaration of estimated tax and pay the estimated tax for each year. (R&TC, §§ 19023 & 19025.) If the amount of estimated tax does not exceed the minimum amount specified in R&TC section 23153, the entire amount of the estimated tax shall be due and payable on or before the fifteenth day of the fourth month of the taxable year. (R&TC,

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cannot be used as the basis for abatement of the late payment penalty at issue here. Instead, appellant must establish that its failure to timely file and pay its taxes was due to reasonable cause and not due to willful neglect, which it has failed to do.

§ 19025(a).) An S corporation that underpays its estimated tax is penalized by an addition to tax equal to a specified rate of interest applied to the amount of the underpayment unless a statutory exception applies. (R&TC, §§ 19142, 19144, 19147, & 19148.) A penalty for the underpayment of estimated tax is properly imposed where the taxpayer's installment payments are less than the amounts due at the end of the installment periods. (*Appeal of Bechtel, Inc.* (78-SBE-052) 1978 WL 3525.) There is no reasonable cause exception to the imposition of the underpayment of estimated tax penalty. (*Appeal of Weaver Equipment Co.* (80-SBE-048) 1980 WL 4976.)

Appellant does not dispute that it failed to remit 2015 or 2016 estimated payments by the due date, nor does it argue that respondent failed to properly compute the amount of the 2015 or 2016 estimated tax penalty. None of the statutory exceptions to the imposition of the estimated tax penalty apply to appellant. The only contention appellant makes, and the only evidence appellant produces, relates to reasonable cause. Therefore, appellant has not established that the 2015 or 2016 estimated tax penalty should be abated.

Issue 3: Whether appellant has established that interest for the 2015 and 2016 tax years should be abated.

Under California law, taxes are due and payable as of the original due date of the taxpayer's return without regard to the extension to file the return. (R&TC, §§ 18567(b) & 19001.) If tax is not paid by the original due date, or if FTB assesses additional tax and that assessment becomes due and payable, R&TC section 19101 requires the charging of interest on the resulting balance due. Interest is not a penalty but is simply compensation for a taxpayer's use of money after the due date of the tax. (*Appeal of Balch*, 2018-OTA-159P.) There is no reasonable cause exception to the imposition of interest. (*Appeal of Goodwin* (97-SBE-003) 1997 WL 258474.)

To obtain relief from the imposition of interest, under the facts presented, a taxpayer must establish eligibility for waiver or abatement of interest under provisions of R&TC sections 21012 or 19104. The relief of interest under R&TC section 21012 is not applicable here, as FTB did not provide appellant any written advice. Under R&TC section 19104, FTB is authorized to abate interest if there has been an unreasonable error or delay in the performance of a ministerial or managerial act by an employee of FTB. Such abatement can only occur if no significant aspect of the error or delay can be attributed to the taxpayer, and after FTB first contacts the taxpayer in writing with respect to the deficiency or payment. (R&TC, § 19104(b)(1).)


Appellant does not allege that FTB committed an error or delay in this matter or provide any basis for which an abatement of interest may occur in this appeal. Therefore, appellant failed to satisfy its burden of showing that FTB erred in not abating interest.

HOLDINGS


1. Appellant has failed to establish reasonable cause to abate: (1) the late-filing penalty under R&TC section 19131 for the 2015 and 2016 taxable years; and (2) the S corporation per shareholder late-filing penalty under R&TC section 19172.5 for the 2015 and 2016 taxable years.
2. Appellant has failed to establish that the estimated tax penalties for the 2015 and 2016 taxable years should be abated.
3. Appellant has failed to establish that interest for the 2015 and 2016 taxable years should be abated.


DISPOSITION

FTB’s actions denying the 2015 and 2016 refund claims are sustained.

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 Tommy Leung  
 Administrative Law Judge

We concur:

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 John O. Johnson  
 Administrative Law Judge

DocuSigned by:  
  
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 Amanda Vassigh  
 Administrative Law Judge

Date Issued: 4/14/2021