

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 19054746
DRH CONSTRUCTION GROUP)
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OPINION

Representing the Parties:

For Appellant: James G. Haskell, Attorney

For Respondent: Bradley J. Coutinho, Tax Counsel III

For Office of Tax Appeals: Neha Garner, Tax Counsel III

T. LEUNG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, DRH Construction Group (appellant) appeals the actions by respondent Franchise Tax Board (FTB) denying appellant’s claims for refund for the 2004 through 2017 taxable years (the “taxable years at issue”).

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

ISSUES

1. Whether appellant is subject to the minimum franchise tax for each of the taxable years at issue.
2. Whether appellant’s claim for the 2004 taxable year was timely filed.
3. Whether appellant has demonstrated reasonable cause for filing its tax returns for the 2005 through 2014 taxable years late.
4. Whether appellant has demonstrated reasonable cause for failing to file returns in response to FTB’s Demands for Tax Return (Demands) for the 2010, 2011, and 2013 taxable years.

5. Whether appellant has demonstrated reasonable cause for the abatement of the nonqualified, suspended, or forfeited (NSF) penalties for the 2010, 2011, and 2013 taxable years.
6. Whether appellant has demonstrated reasonable cause for paying taxes for the 2004, 2015, 2016, and 2017 taxable years late.
7. Whether appellant has demonstrated that the underpayment of estimated tax penalties (estimated tax penalties) for each of the 2004 through 2017 taxable years should be abated.
8. Whether appellant has established that the filing enforcement fees for the 2010, 2011, and 2013 taxable years should be abated.

FACTUAL FINDINGS

1. Appellant was registered with the California Secretary of State in August 2002 and elected to be treated as an “S corporation” for tax purposes.
2. Except for the 2004 taxable year, appellant did not remit any payments with its tax returns; instead, it made payments on October 22, 2018. Appellant satisfied the balances owed for the 2005 through 2017 taxable years on October 22, 2018.
3. Appellant’s 2004 California tax return was filed late on April 8, 2005, reporting total tax and balance due of \$800. Appellant remitted an \$800 payment with its return. FTB processed the return and imposed a late payment penalty of \$44.00 and an estimated tax penalty of \$30.88. On August 3, 2005, appellant satisfied the balance owed on its 2004 taxable year account.
4. Appellant filed its 2005 through 2009 California tax returns late on April 9, 2018. Appellant reported zero income and zero tax due on each of these returns. FTB processed appellant’s returns and revised the tax liability to include the annual minimum franchise tax of \$800. FTB also imposed estimated tax penalties and late filing penalties.
5. FTB received information indicating that appellant had a filing requirement for the 2010 and 2011 taxable years and issued Demands on March 21, 2014, and December 20, 2013, respectively. FTB did not receive a response to the Demands and, subsequently, issued Notices of Proposed Assessment (NPAs) for the 2010 and 2011 taxable years on May 30, 2014, and February 21, 2014, respectively.

6. The 2010 NPA proposed tax of \$2,274.27, a late filing penalty of \$568.56, a demand penalty of \$568.56, an S corporation late filing penalty of \$432.00, an NSF penalty of \$2,000.00, and a filing enforcement fee of \$96.00, plus interest.
7. The 2011 NPA proposed tax of \$2,105.94, a late filing penalty of \$526.48, a demand penalty of \$526.48, an S corporation late filing penalty of \$432.00, an NSF penalty of \$2,000.00, and a filing enforcement fee of \$96.00.
8. Appellant did not protest the NPAs and, thus, they became final.
9. On April 15, 2016, appellant filed its 2010 and 2011 tax returns.¹ Appellant's 2010 return reported zero income, an annual minimum franchise tax of \$800, an estimated tax penalty of \$29, and a total amount due of \$829. Appellant's 2011 return reported zero income, an annual minimum franchise tax of \$800, an estimated tax penalty of \$26, and a total amount due of \$826.
10. FTB processed the returns and imposed NSF penalties, demand penalties, late filing penalties, estimated tax penalties, and filing enforcement fees for both taxable years.
11. On April 15, 2016, appellant filed its 2012 California tax return late, reporting zero income, the annual minimum franchise tax of \$800, and an estimated tax penalty for a balance due of \$824. FTB processed the return and imposed a late filing penalty of \$200.00 and an estimated tax penalty of \$23.58.
12. FTB received information indicating that appellant had a filing requirement for the 2013 taxable year. Accordingly, FTB issued a Demand on September 11, 2015. FTB did not receive a response to the Demand and subsequently issued an NPA. The NPA proposed a tax of \$800, a late filing penalty of \$200, a demand penalty of \$200, an NSF penalty of \$2,000, and a filing enforcement fee of \$92. Appellant did not protest the NPA and the proposed tax liability became final.
13. On April 9, 2018, appellant filed its 2013 tax return, reporting zero income and no balance due. FTB processed the return, revised the tax liability to include the annual minimum franchise tax of \$800, and imposed an estimated tax penalty of \$21.96, a late filing penalty of \$200.00, a demand penalty of \$200.00, an NSF penalty of \$2,000.00, and a filing enforcement fee of \$92.00.

¹ We note that although appellant is an "S corporation," it used Form 100, and not Form 100-S, to file its returns.

14. On April 9, 2018, appellant filed its 2014 California tax return late. Appellant reported zero income and no balance due. FTB processed the return, revised the tax liability to include the annual minimum franchise tax of \$800.00, and imposed an estimated tax penalty of \$21.96, and a late filing penalty of \$200.00.
15. Appellant filed its 2015 California tax return late, on April 14, 2016. Appellant reported a total income of \$74,168, a total tax of \$6,556, an estimated tax penalty of \$128, and a total amount due of \$6,684. FTB processed the return and imposed an estimated tax penalty of \$127.81 and a late payment penalty of \$1,376.76.
16. Appellant timely filed its 2016 California tax return on March 15, 2017,² reporting total income of \$67,672, total taxes of \$5,982, an estimated tax penalty of \$149, and a balance due of \$6,131. FTB processed the return and imposed an estimated tax penalty of \$128.14 and a late payment penalty of \$867.39.
17. Appellant filed its 2017 California tax return late, on April 12, 2018, reporting total income of \$84,361, total taxes of \$7,458, an estimated tax penalty of \$193, and a balance due of \$7,651. FTB processed the return and imposed an estimated tax penalty of \$193.21 and a late payment penalty of \$633.93.
18. On January 3, 2019, FTB received appellant's claims for refund for the taxable years at issue. On February 1, 2019, FTB denied appellant's claims.

DISCUSSION

Issue 1: Whether appellant is subject to the minimum franchise tax for each of the taxable years at issue.

Generally, every corporation doing business within the limits of this state and not expressly exempted from taxation shall annually pay a tax according to or measured by its net income or if greater, the annual minimum franchise tax, for the privilege of exercising its corporate franchise within this state. (See R&TC, § 23151.) As relevant here, every corporation that is incorporated under the laws of the state of California is subject to the minimum franchise tax, from the earlier of the date of its incorporation or commencing to do business within this

² FTB erroneously states in its brief that appellant's 2016 and 2017 tax returns were due on April 15 following the close of each of these taxable years. Although R&TC section 18601 was amended to change the filing deadline to April 15 for corporations in general, no such change was made to the filing deadline for S corporations. (See R&TC, § 18601(d)(1).) Despite this mistake, FTB correctly computed the monthly late payment penalties for 2016 and 2017, 19 months and 7 months, respectively.

state, until the effective date of dissolution. (R&TC, § 23153(a), (b)(1).) R&TC section 23153(f)(1) provides that every corporation that incorporates or qualifies to do business in this state on or after January 1, 2000, shall not be subject to the minimum franchise tax for its first taxable year.

Appellant was registered with the California Secretary of State in August 2002 and thus was subject to the minimum tax for all taxable years at issue. Appellant's flow-through of its items of income and expenses to its shareholder's personal California tax returns for some of the taxable years would not absolve appellant of the annual minimum tax. Moreover, although appellant argues that its suspension should also suspend the annual minimum tax and associated penalties and interest, the law requires all such amounts be imposed until the corporation is dissolved; the record contains no evidence of appellant's dissolution. Therefore, FTB correctly imposed the minimum tax. Accordingly, appellant is not entitled to a refund or credit of the annual minimum tax.³

Issue 2: Whether appellant's claim for the 2004 taxable year was timely filed.

R&TC section 19306(a)⁴ provides in part that no refund shall be allowed after a period ending four years from the date the return was filed (if filed within the time prescribed by R&TC section 18567), four years from the last date prescribed for filing the return (determined without regard to any extension of time for filing the return), or after one year from the date of the overpayment, whichever is later unless, before the expiration of the period, the taxpayer files a refund claim.

The statute of limitations on claims for refund is explicit and must be strictly construed, without exception. (*Appeal of Meek* (2006-SBE-01) 2006 WL 864344.) There is no equitable tolling of the statute of limitations absent direction from the Legislature. (*Ibid.*) FTB does not have a duty to inform taxpayers of an overpayment or to inform taxpayers of the statute of limitations. (*Appeal of Gleason* (86-SBE-113) 1986 WL 22735.)

³ Appellant argues that the tax liabilities were discharged in its shareholder's personal Chapter 7 bankruptcy case. However, that shareholder's personal bankruptcy discharge only affects that individual's personal liabilities and does not discharge appellant's liabilities because appellant is a separate entity. Accordingly, appellant is not entitled to an abatement of penalties or fees on this basis.

⁴ All section references are to versions of the Revenue and Taxation Code operative for the taxable years at issue.

Appellant's tax return for 2004 was due on March 15, 2005. Appellant filed its 2004 return on April 8, 2005, within the extended due date of October 15, 2005. Since appellant filed its return on April 8, 2005, the four-year statute of limitations to file a claim for refund expired on April 8, 2009, four years after appellant's actual filing date. Appellant filed its claim for refund on January 3, 2019, after the four-year statute of limitations expired. Therefore, the claim for refund was untimely.⁵ Consequently, only the payments made within one year preceding the filing of the claim are subject to refund or credit. Appellant made its most recent payment on its 2004 taxable year account on August 3, 2005, more than 13 years before appellant filed its refund claim and beyond all allowable time periods under the law. Thus, appellant's 2004 claim is not timely and need not be discussed further.

Issue 3: Whether appellant has demonstrated reasonable cause for filing its tax returns for the 2005 through 2014 taxable years late.

An S corporation is required to file its tax return on or before the 15th day of the third month following the close of the taxable year, or on or before the extended due date (for calendar year S corporations, that would be October 15th following the close of the taxable year). (R&TC, §§ 18601, 18604.) 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 not due to willful neglect. (R&TC, § 19131.)

To establish reasonable cause, the taxpayer must show that the failure to timely file occurred despite the exercise of ordinary business care and prudence, or that cause existed as would prompt an "ordinary intelligent and prudent" businessperson to have so acted under similar circumstances. (*Appeal of GEF Operating, Inc.*, 2020-OTA-057P, quoting from *Appeal of Tons* (79-SBE-027) 1979 WL 4068.) Ignorance of the law does not establish reasonable cause. (*Appeal of Diebold, Inc.* (83-SBE-002) 1983 WL 15389.) As stated in the *Appeal of Diebold, Inc.*, *supra*, "appellant did not exercise ordinary business care and prudence when it failed to acquaint itself with the California tax law requirements."

⁵ FTB noted that it correctly denied appellant's refund claim on February 1, 2019; however, it failed to indicate that the claim was denied because it was untimely.

FTB properly imposed the late filing penalties because appellant did not timely file a return for the 2005 through 2014 taxable years. Since appellant did not present persuasive evidence of reasonable cause, the late filing penalties will be sustained.

Issue 4: Whether appellant has demonstrated reasonable cause for failing to file returns in response to FTB's Demands for the 2010, 2011, and 2013 taxable years.

A demand penalty may be imposed when a taxpayer fails or refuses to make and file a return upon notice and demand by FTB unless the taxpayer can show that its failure to file a return is due to reasonable cause and not willful neglect. (R&TC, § 19133.) FTB may add a penalty of 25 percent of the amount of tax determined pursuant to R&TC section 19087 or of any deficiency tax assessed by FTB concerning the assessment of which the information or return was required. (*Ibid.*)

When FTB imposes a demand penalty, the law presumes that FTB's action was correct. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509.) The burden of proof is on the taxpayer to show that reasonable cause exists to support an abatement of the penalty. (*Appeal of Findley* (86-SBE-091) 1986 WL 22761.) To establish reasonable cause, a taxpayer must show that the failure to reply to the notice and demand or to the request for information occurred despite the exercise of ordinary business care and prudence. (*Appeal of Bieneman* (82-SBE-148) 1982 WL 11825.) The demand penalty is designed to penalize the failure of the taxpayers to respond to a notice and demand, and not their failure to pay the proper tax. (*Appeal of Hublou* (77-SBE-102) 1977 WL 4093.)

FTB properly imposed the demand penalties because appellant did not timely respond to the Demands. Furthermore, appellant did not argue that it had reasonable cause for failing to respond to the Demands.

Issue 5: Whether appellant has demonstrated reasonable cause for the abatement of the NSF penalties for the 2010, 2011, and 2013 taxable years.

In addition to the demand penalty under R&TC section 19133, California imposes an NSF penalty which is a corporate demand penalty under R&TC section 19135. For purposes of this appeal, R&TC section 19135 provides that when a domestic corporation which has been suspended and is doing business in this state fails to make and file a return, FTB shall impose a penalty of two thousand dollars per taxable year, unless the failure to file is due to reasonable

cause and not willful neglect. The NSF penalty is in addition to the late filing penalty and the demand penalty under R&TC section 19133. (R&TC, § 19135.) The NSF penalty shall be imposed if the return is not filed within 60 days after FTB sends the taxpayer a notice and demand to file the required tax return. (*Ibid.*) The NSF penalty is analogous to the demand penalty of R&TC section 19133, which, as discussed above, also may be abated only if the taxpayer demonstrates the existence of reasonable cause. The burden of proving “reasonable cause” for failure to file upon demand is on the taxpayer. (*Appeal of Beadling (77-SBE-021) 1977 WL 3831.*)

FTB asserts that appellant failed to file its tax returns within 60 days after it sent appellant Demands to file the required tax returns for the 2010, 2011, and 2013 taxable years, and that appellant's failure to file was not attributable to reasonable cause; appellant does not dispute this. Accordingly, we find no basis for abating the NSF penalties.

Issue 6: Whether appellant has demonstrated reasonable cause for paying its taxes for the 2015, 2016, and 2017 taxable years late.

R&TC section 19132(a)(1)(A) imposes a late payment penalty when a taxpayer fails to pay the amount shown as due on the return by the date prescribed for the payment of the tax unless the taxpayer establishes that the late payment was due to reasonable cause and not due to willful neglect. (R&TC, § 19132.) The late payment penalty has two parts. The first part is five percent of the unpaid tax. (R&TC, § 19132(a)(2)(A).) The second part is a penalty of one-half percent per month, or portion of a month, not to exceed 40 months, calculated on the outstanding balance.⁶ (R&TC, § 19132(a)(2)(B).) The aggregate amount of the penalty may not exceed 25 percent of the total unpaid tax. (R&TC, § 19132(a)(3).)

For the 2015, 2016, and 2017 taxable years, full payment was due on March 15, 2016, March 15, 2017, and March 15, 2018, respectively. FTB properly imposed the late payment penalties because appellant did not timely pay taxes for these taxable years. Appellant did not present any persuasive evidence of reasonable cause. Accordingly, the late payment penalties imposed cannot be abated.

⁶E.g., for the 2004 taxable year, appellant made an \$800 payment on April 8, 2005, that satisfied the tax liability reported on its 2004 tax return. Accordingly, the \$44 late payment is calculated as follows: underpayment penalty of \$40 (i.e., \$800 x .05) plus the monthly penalty of \$4 (i.e., \$800 x .005 x 1 month).

Issue 7: Whether appellant has demonstrated that the estimated tax penalties for each of the 2005 through 2017 taxable years should be abated.

A corporation that is subject to the franchise tax imposed by Part 11 of the R&TC 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 franchise tax, 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, § 19025(a).) A 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. (R&TC, §§ 19142, 19144.) An estimated tax penalty 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 for the estimated tax penalty. (*Appeal of Weaver Equipment Company* (80-SBE-048) 1980 WL 4976.) Here, appellant's estimated tax payments of \$800, the minimum corporate franchise tax, were not timely remitted by the 15th day of the fourth month of each of the 2005 through 2017 taxable years; appellant did not make its payment on its 2005 through 2017 taxable year accounts until October 22, 2018. Thus, the estimated tax penalties were properly imposed.

Issue 8: Whether appellant has established that the filing enforcement fees for the 2010, 2011, and 2013 taxable years should be abated.


If FTB mails a formal legal demand for a tax return to a taxpayer, a filing enforcement fee is required to be imposed when the taxpayer fails or refuses to file the return within the 25-day period after the formal legal demand. (R&TC, § 19254(a)(2).) There is no reasonable cause exception for the filing enforcement fee. (R&TC, § 19254.) Here, FTB informed appellant in the Demands for the 2010, 2011, and 2013 taxable years that appellant may be subject to the filing enforcement fee if appellant did not file a tax return. FTB did not receive returns from appellant for the 2010, 2011, and 2013 taxable years by the prescribed deadline in the Demands. Therefore, FTB properly imposed the filing enforcement fee, which we cannot abate.

HOLDINGS

1. Appellant is subject to the minimum franchise tax for each of the taxable years at issue.
2. Appellant did not establish that its claim for refund for the 2004 taxable year was filed on time.
3. Appellant did not demonstrate reasonable cause for filing its 2005 through 2014 tax returns late.
4. Appellant did not demonstrate reasonable cause for failing to file returns in response to FTB’s Demands for the 2010, 2011, and 2013 taxable years.
5. Appellant did not demonstrate reasonable cause for the abatement of the 2010, 2011, and 2013 NSF penalties.
6. Appellant did not demonstrate reasonable cause for paying its 2015, 2016, and 2017 taxes late.
7. Appellant did not demonstrate that the estimated tax penalties for each of the 2005 through 2017 taxable years should be abated.
8. Appellant did not establish that the 2010, 2011, and 2013 filing enforcement fees should be abated.


DISPOSITION

FTB’s actions are sustained.

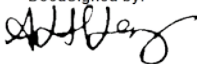
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 Administrative Law Judge

We concur:

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 Administrative Law Judge

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 Andrea L.H. Long
 Administrative Law Judge

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