BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of

AMERICAN PHOTOCOPY EQUIPMENT COMPANY, AKA CLAYTON CHEMICAL COMPANY

For Appellant: John F. O'Dea, Attorney at Law

For Respondent: Burl D. Lack, Chief, Counsel; Crawford H. Thomas, Associate Tax Counsel

O P I N I O N

These appeals are made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on protests of American Photocopy Equipment Company, also known as Clayton Chemical Company, against proposed assessments of penalties in the total amounts of $1,749.00, $1,749.00, $1,678.50, $2,307.50, $3,230.02 and $3,749.00 for the taxable years ended November 30, 1954, 1955, 1956, 1957, 1958 and 1959, respectively, and from the action of the Franchise Tax Board on American Photocopy Equipment Company's petition for reassessment of jeopardy assessments of penalties in the total amounts of $7356.50 and $9,343.00 for the taxable years ended November 30, 1960 and 1961, respectively.

Appellant concedes its liability for tax under the Bank and Corporation Tax Law of California during the years in question. The sole issue presented by these appeals, therefore, concerns the propriety of the penalties assessed for delinquent filing of tax returns and for failure to file such returns after notice and demand.

American Photocopy Equipment Company, also known as Clayton Chemical Company and hereafter referred to as "appellant," is an Illinois corporation with its principal office in that state. It was incorporated on January 5, 1954, and is engaged in the manufacture and sale of photocopy equipment

and supplies, Though appellant had commenced operations in California at some earlier date, it did not qualify to do business in this state until August 1961.

On June 17, 1958, respondent mailed a letter to appellant which stated that available information indicated it might be subject to taxation under the provisions of the Bank and Corporation Tax Law of California. This letter distinguished between the franchise tax and the corporation income tax, Indicating the typos of business activities in California which would render either state tax applicable to appellant. Respondent asked that appellant furnish it with certain information on a form which was enclosed.

Upon receipt of this letter, appellant consulted a Chicago attorney,, and requested an opinion as to its liability under California revenue laws. The attorney's written response to this inquiry is contained in the record, In that letter he stated his conclusion as follows:

> In summary, while it is impossible to give you a categorical answer in light of the uncertainty of the law in this area, it is my view that your activities in California do not subject you to either the California franchise tax or the California income tax. In view of this, we do not feel you are required to respond to the request of the California Franchise Tax Board for various data,,,,

Mr. Samuel G. Rautbord, president and chairman of the board of directors of appellant since 1954, was also a practicing attorney and had acted as general counsel for appellant during the years 1954 through 1958. He also advised appellant that although the question was not entirely free of doubt,, in his opinion appellant was not required to pay either California franchise or corporate income tax for any of the years here in question. Appellant made no reply to respondent's inquiry.

In two additional letters mailed during 1958, respondent again solicited data regarding appellant's California operations, warning appellant in a letter dated December 10, 1958, that its failure to submit the information might result, in an arbitrary assessment of tax, Appellant did not reply to either of those letters,

On March 27, 1959, respondent issued and mailed to

appellant a "Notice of Arbitrary Levy of Corporation Income Tax" for the taxable year ended December 31, 1958, in which the minimum tax of $100 was assessed, plus 25 percent penalties for delinquency in filing and for failure to file after notice and demand. Upon appellant's failure to respond to this assessment, respondent commenced a preliminary investigation of appellant's activities in California. This investigation revealed that appellant had been doing business in California for several years, and on December 29, 1960, respondent mailed a letter to appellant requesting that it file returns for all years since it first became active in the state. In early 1961 respondent sent two additional letters to appellant, each of which contained formal notice and demand to file. Appellant failed to reply and on June 23, 1961, jeopardy assessments were issued for the taxable years ended November 30, 1960, and November 30, 1961. At this time appellant filed its first response to respondent's letters, in the form of a protest and petition for reassessment of the above mentioned jeopardy assessments;

In March and April of 1962, appellant filed franchise tax returns for the taxable years ended November 30, 1954, to November 30, 1961, inclusive. In addition to the franchise tax shown to be due by these returns, respondent assessed for each year a 25 percent penalty for delinquent filing and a 25 percent penalty for failure to file after notice and demand.

The issue presented, for all years in question is the same: Were the 25 percent penalties for delinquent filing and for failure to file after notice and demand properly assessed?.

Section 25931 of the Revenue and Taxation Code provides:

> If any taxpayer fails to make and file a return required by this part on or before the due date of the return ... then, unless it is shown that the failure is due to reasonable cause and not due to wilful neglect, 5 percent of the tax shall be added to the tax for each 30 days or fraction thereof elapsing between the due date of the return and the date on which filed, but the total addition shall not exceed 25 percent of the tax.... (Emphasis added.)

This section is substantially the same as section 6651 of the Internal Revenue Code of 1954 and its predecessor, section 291(a) of the 1939 Internal Revenue Code.

Section 25932 of the Revenue and Taxation Code provides:

> If any taxpayer, upon notice and demand by the Franchise Tax Board, fails or refuses to make and file a return required by this part, then, unless it is shown that such failure is due to reasonable cause and not due to wilful neglect, the Franchise Tax Board is authorized to make an estimate of the net income and to compute and levy the amount of the tax due from any available information. In such case 25 percent of the tax, in addition to the amounts added under Section 25931, shall be added to the tax and shall be due and payable upon notice and demand from the Franchise Tax Board. (Emphasis added.)

This section has no federal counterpart in the Internal Revenue Code.

Though appellant concedes its liability for the franchise tax assessed against it for the years in question, it contends that the 25 percent penalties for delinquency in filing and for failure to file after notice and demand were improperly assessed because its failure to file timely returns was due to reasonable cause, within the meaning of these words as they appear in the sections quoted above. It is argued by appellant that such failure was based "upon the advice of competent, independent counsel, who were advised of all the pertinent facts."

The burden is on the taxpayer to prove that there was reasonable cause for its failure to file timely returns. (William M. Bebb, 36 T.C. 170.) "Reasonable cause," as it is used in similar federal legislation, has been construed to mean such cause as would prompt an ordinarily intelligent and prudent businessman to have so acted under similar circumstances, or the exercise of ordinary business care and prudence. (Sanders v. Commissioner, 225 F.2d 629, cert. denied 350 U.S. 967 [100 L. Ed. 839]; Charles E. Pearsall & Son, 29 B.T.A. 747.)

As a general proposition, a taxpayer's reliance in good faith upon the considered advice of a tax expert, licensed accountant, or reputable attorney to whom he has given full information as to all the pertinent facts, constitutes reasonable

cause excusing the taxpayer's failure to file a tax return when due, even though such advice turns out to be erroneous as to the law, (See Orient Investment & Finance Co, v. Commissioner, 166 F.2d 601; Hatfried, Inc. v. Commissioner, 162 F.2d 626.) Such reliance constitutes the exercise of ordinary business care and prudence by the taxpayer. But that general rule is not absolute, and, in each case, whether or not there was reasonable cause is a question of fact.

The letter from the attorney who was consulted and the affidavits contained in the record indicate that he did, in fact, give the advice that appellant claims it relied upon in not filing timely California corporate tax returns. The same record raises some question, however, as to whether or not, at the time he advised appellant, the attorney was in possession of all the relevant facts concerning appellant's business operations in California.

The Tax Court has repeatedly refused to find "reasonable cause" which will excuse a taxpayer's failure to file a return or his delinquency in doing so, where it appears that the taxpayer failed to supply the tax advisor he allegedly relied upon with all pertinent information which would enable that consultant to properly advise him as to his tax liability or as to the necessity of filing a return. (Tarbox Corp., 6 T.C. 35; Simone Corp., T.C. Memo., Dkt. No. 20230, Jan. 25, 1951; 1040 Springfield Avenue Corp., T.C. Memo., Dkt. No, 16052, March 11, 1949, aff'd, 185 F.2d 406.) Though appellant alleges that the attorney was freely advised of all relevant facts, an investigation conducted by respondent revealed certain facts regarding appellant's operations in California which, if made known to the attorney, might well have caused him to render a different opinion as to appellant's liability for California corporate taxes.

The attorney stated in his letter of July 22, 1958, to appellant's president:

> In this connection it should be pointed out that the mere maintenance of an office within the state does not constitute "doing business" for the purposes of state taxation where the office is maintained in furtherance of interstate commerce. I understand that the bulk of your sales of equipment in California are in effect interstate sales, orders taken in California being subject to acceptance in the home office in Illinois and shipment being made

> from Illinois interstate.,.. It certainly appears that the nature of your business conducted in California is substantially of an interstate nature so as to justify a position that no liability exists under the California&ate taxes,.

Respondent's investigation disclosed that appellant American Photocopy Equipment Company, doing business as Clayton Chemical Company, was engaged in the manufacture and sale of photographic and x-ray chemicals and photographic solutions at two locations in Los Angeles, and at one in San Francisco. It was also found that appellant had warehousing facilities in Los Angeles and that most of the sales were made from local inventory. In addition, the following information was set forth on the allocation schedules of the returns filed by appellant after the jeopardy assessment8 were issued:

Income year	Tangible Property Located in California	California Payroll	California Sales
Nov. 30; 1954	$ 8,954.02	$104,108.92	$ 676,092.47
Nov. 30, 1955	8,416.54	114,598.40	727,680.62
Nov. 30, 1956	10,997.22	156,391.59	935,810.62
Nov. 30, 1957	12,000.37	197,210.40	1,240,246.70
Nov. 30, 1958	30,522.89	189,007.30	1,331,923.02
Nov. 30, 1959	96,689.00	272,648.00	1,648,770.00
Nov. 30, 1960	113,069.00	305,016.00	1,863,627.00

It is true that prior to 1959, when the United States Supreme Court affirmatively answered the question (Northwestern States Portland Cement Co. v. Minnesota. and Williams v. Stockham Valves and Fittings, Inc., 358 U.S. 450 [3 L. Ed. 2d 421]) ,there was uncertainty in some quarters as to the extent to which a state could constitutionally tax a-foreign corporation on income derived from interstate-commerce. (But see West Publishing Co-. v McColgan, 27 Cal. 2d 705 [166 P.2d 861], aff'd per curiam, 328 U.S. 823 [90 L. Ed. 1603].) The confusion lay, however, in the area of those cases in which a foreign corporation was either engaged exclusively' in interstate commerce or had only very limited business activities within a state, e.g., the "solicitation" cases, and not in those situations in which a substantial portion of such a corporation's activities had assumed an intrastate'. nature, as in the instant case.

It can fairly be inferred from the evidence In the

record before us that appellant maintained a sizeable staff of salesmen and a substantial inventory of its products here in California, accepted a large number of the orders taken by those salesmen at its offices within this state, and filled many of such orders from local warehouse stock. These facts do not put appellant in either of the categories in which some confusion prevailed as to what the law was or should be. It seems unlikely that the attorney would have rendered the opinion as to appellant's tax liability to the State of California if he had been fully aware of the nature and the extent of appellant's business activities within this state.

The record in this case raises another question as to whether or not appellant's reliance on the advice was that "good faith" reliance which has consistently been required to constitute "reasonable cause." Respondent's investigation revealed that in 1957 Photo Paper Products, Inc., and Clayton Chemical & Packaging Co. merged, with appellant as the surviving corporation. Clayton Chemical & Packaging Co. had done business here before the merger and had filed California franchise tax returns for its income years 1955, 1956 and 1957. Mr. Clayton L. Rautbord, presently the senior vice president and a director of appellant, had owned 50 percent of the stock of Clayton Chemical & Packaging Co., and Mr. Robert A. Rautbord, presently a vice president and director of appellant, had owned the other 50 percent of that corporation's stock. Though the activities of Clayton Chemical & Packaging Co. in California were merged into and became a part of appellant's local activities, appellant did not file California tax returns following the merger. We believe that an alleged reliance on the advice of an attorney does not constitute "reasonable cause" which will excuse failure to file timely tax returns when the taxpayer, or its officers, had firsthand knowledge of facts which would reasonably cast some doubt on the accuracy of that advice. (See Arcade Realty Co., 35 T.C. 256.)

Over a three-year period appellant was repeatedly apprised of respondent's belief that some tax might be due. Yet appellant failed to respond in any way, either by supplying respondent with the information which it requested, by filing returns or by communicating in a serious effort to resolve the question of its tax liability. This background of laxity further reduces the possibility of finding that appellant acted in good faith or with ordinary care and prudence.

We must conclude, on the record before us, that appellant has not met its burden of establishing reasonable cause under section 25931 for its failure to file timely returns. It necessarily follows that it has not shown reasonable cause under section 25932, which imposes an additional penalty for failure to file after notice and demand.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of American Photocopy Equipment Company, also known as Clayton Chemical Company, against proposed assessments of penalties in the total amounts of $1,749.00, $1,749.00, $1,678.50, $2,307.50, $3,230.02 and $3,749.00 for the taxable years ended November 30, 1954, 1955, 1956, 1957, 1958 and 1959, respectively, and on American Photocopy Equipment Company's petition for reassessment of jeopardy assessments of penalties in the total amounts of $7,356.50 and $9,343.00 for the taxable years ended November 30, 1960 and 1961, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 18th day of December, 1964, by the State Board of Equalization.

Paul R. Leake, Chairman

Geo. R. Reilly, Member

John W. Lynch, Member

Richard Nevins, Member

_____, Member

Attest: _____, Secretary