BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
CFRWIN-VEGA **INTERNATIONAL**)

For Appellant: **Allan** Entous
Certified Public Accountant

For Respondent: Bruce W. Walker
Chief Counsel

David M. Hinman
Counsel

O P I N I O N

This appeal is made pursuant to section 26077 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of Cerwin-Vega International for refund of penalties and interest in the total amount of **$1,350.66** for the income year ended July 31, 1975.

Appeal of Cerwin-Vega International

Appellant was incorporated on October 4, 1974, for the purpose of selling domestic products for foreign export. It commenced doing business in California on or about that date. For California franchise tax purposes appellant elected to file its returns on the basis of a fiscal year ending July 31. Under the federal income tax law appellant qualified as a Domestic International Sales Corporation (DISC), eligible for preferential tax treatment of its export income. (Int. Rev. Code of 1954, §§ 991-997.)

On January 13, 1975, appellant made a $200.00 payment of estimated franchise tax for its first income year ended July 31, 1975. The normal due date for filing its return for that year was October 15, 1975, two months and fifteen days after the close of the income year. (Rev. & Tax. Code, § 25401, subd. (a).) On October 13, 1975, appellant filed a timely application for an extension of time to file that return, stating as a reason for the request: "Initial year of corporation and all pertinent data unavailable in order to file timely." On the application appellant reported a total estimated tax of $200.00 for the year and indicated its earlier remittance of that amount. No additional payment was submitted with the extension application. In due course res'pondent granted an extension to January 15, 1976.

On December 12, 1975, appellant filed its return for the income year ended July 31, 1975, reporting a self-determined franchise tax liability of $15,796.00. On January 15, 1976, appellant remitted $15,596.00, representing its total reported tax less the $200.00 estimated tax payment made in January 1975. After reviewing appellant's return, respondent assessed a penalty for underpayment of estimated tax ($275.33), a penalty for late payment of franchise tax due for the income year ended July 31, 1975 ($779.80), and interest on the delinquent tax and the penalties. Appellant paid these additional assessments on April 2, 1976, and filed a claim for refund of the amount paid. Respondent determined that the penalties and interest had been properly assessed and denied appellant's claim. The propriety of those additions to tax is now before us in this appeal.

Penalty For Underpayment of Estimated Tax

Since the State of California has not enacted legislation comparable to the special federal provisions regarding the taxation of corporations qualifying as DISCs, such corporations are subject to the regular

California rules of corporate taxation. Accordingly, as a general corporation doing business in California, appellant was obligated to estimate and prepay franchise tax during its first income year. (See Rev. & Tax. Code, §§ 25561-25565.) The term "estimated tax" means the amount which the corporation estimates as the amount of tax imposed for the year. (Rev. & Tax. Code, § 25561.) If the amount of the estimated tax exceeds $200.00, it is payable in installments as specified in section 25563, subdivision (d), of the Revenue and Taxation Code. A penalty is imposed on corporations which underpay their estimated tax. (Rev. & Tax. Code, § 25951.) There will be no underpayment and the penalty therefore will be avoided if the corporation has paid 80 percent of each installment otherwise due on the prescribed dates. (Rev. & Tax. Code, § 25952.)

Although on its application for an extension of time to file appellant indicated an estimated tax of $200.00, its actual self-determined tax liability for its first income year ended July 31, 1975, was $15,796.00. Makins appropriate adjustments for the fact that appellant's first taxable year was less than 12 months, respondent determined that appellant should have paid three equal installments of estimated tax in the amounts of $3,159.20 during its fiscal year ended July 31, 1975. In actuality appellant made only the one estimated tax payment of $200.00 on January 13, 1975. Consequently, respondent determined that a penalty for underpayment of estimated tax was due.

Section 25954 of the Revenue and Taxation Code sets forth certain exceptions to the general rules regarding the imposition of penalties for underpayment of estimated tax. None of those exceptions appears to be applicable in the instant case, nor has appellant argued their applicability. Furthermore, appellant does not appear to be contesting the computation of the penalty. Rather, appellant contends that it should be relieved of the penalty because, due to its federal income tax status as a DISC, it was impossible to estimate its income for the income year ended July 31, 1975, until some six months after the end of that fiscal period. It was not until then, appellant argues, that it and its parent producer corporation decided upon the accounting method to be used. Appellant also urges that if its parent had elected a different accounting method, appellant's franchise tax liability for the fiscal year ended July 31, 1975, might have been only $200.00, the amount of estimated tax it had paid. Finally, appellant suggests that since the

period in question was its first income year, making it impossible for it to avoid the penalty by estimating tax for that year on the basis of its tax liability for the preceding income year (Rev. & Tax. Code, § 25954, subd. (a)), it is unfair for respondent to impose the penalty.

The thrust of these contentions is that there were "extenuating circumstances" which should excuse appellant from the penalty. It is settled law, however, that relief from the penalty for underpayment of estimated tax is not available upon a showing of reasonable cause and lack of willful neglect, or extenuating circumstances. (Estate of Barney Ruben, 33 T.C. 1071 (1960); Appeal of Decoa, Inc., Cal. St. Bd. of Equal., April 5, 1976; Appeal of Alden Schloss, Cal. St. Bd. of Equal., Oct. 27, 1971.) We have applied this rule even in the case where, at the time the estimate must be made, the taxpayer corporation filing its first franchise tax return allegedly lacks the information necessary to estimate its income accurately. (Appeal of Decoa, Inc., supra.) The same rule must be applied in the instant case, and we therefore conclude that respondent properly assessed the penalty for underpayment of estimated tax.

Penalty for Late Payment of Tax

Section 25934.2 of the Revenue and Taxation Code provides, in pertinent part:

> (a) If any taxpayer fails to pay the amount of tax required to be paid under Sections 25551 and 25553 by the date prescribed therein, then unless it is shown that the failure was due to reasonable cause and not willful neglect, a penalty of 5 percent of the total tax unpaid as of the date prescribed in Sections 25551 and 25553 shall be due and payable upon notice and demand from the Franchise Tax Board. (Emphasis added.)

Section 25551 of the Revenue and Taxation Code, which is applicable to appellant, provides:

> Except as otherwise provided in this chapter, the tax imposed by this part shall be paid not later than the time fixed for filing the return (determined without regard to any extension of time for filing the return).

As noted earlier, the normal due date for filing appellant's return for its income year ended July 31, 1975,

was October 15, 1975. (Rev. & Tax. Code, § 25401, subd. (a).) Since appellant failed to pay $15,596.00 of its total franchise tax liability for that year until January 15, 1976, respondent's imposition of the penalty for late payment of tax was proper, unless such untimely payment was due to reasonable cause and not due to willful neglect. Appellant bears the burden of proving that both of those conditions existed. (Rogers Hornsby, 26 B.T.A. 591 (1932); see Appeal of Telonic Altair, Inc., Cal. St. Bd. of Equal., May 4, 1978.) In order to establish reasonable cause, the taxpayer must show that its failure to act occurred despite the exercise of ordinary business care and prudence. (See Sanders v. Commissioner, 225 F.2d 629 (10th Cir. 1955), cert. den. 350 U.S. 967 [100 L. Ed. 839] (1956); Appeal of Citicorp Leasing, Inc., Cal. St. Bd. of Equal., Jan. 6, 1976; Appeal of Loew's San Francisco Hotel Corp., Cal. St. Rd. of Equal., Sept. 17, 1973.)

For California franchise tax purposes, a corporation qualifying as a DISC under the federal income tax law is treated the same as any other general corporation doing business in this state. As such, it has an obligation to maintain adequate accounting records which will enable it to,compute its California franchise tax liability in a timely fashion. Even if it is true that, for reasons not entirely clear to us, appellant was unable to resolve accounting problems incurred in complying with the federal income tax law until some six months after the close of its first fiscal year, this inability had no effect on its obligation to maintain accounting records of its California business activity. Although the maintenance of such separate records might have been more burdensome for appellant, it has not been established that such record keeping was impossible due to any lack of information regarding appellant's business activity in this state. (See Appeal of Normandy Investments Limited , Cal. St. Bd. of Equal., Sept. 12, 1968.) Presumably the maintenance of such records would have enabled appellant to arrive at a reasonably accurate calculation of its California franchise tax liability and to timely pay that amount. We believe that its failure to do so demonstrated something less than ordinary business care and prudence. Under the circumstances, there was no reasonable cause which would justify relief from the penalty for late payment of tax imposed under section 25934.2 Of the Revenue and Taxation Code. 1/

1/ In view of our determination that there was no reasonable cause for appellant's failure to pay the tax when due, we need not consider whether or not such failure was due to willful neglect.

Interest

The interest assessments here in issue were imposed pursuant to sections 25901 and 25901c of the Revenue and Taxation Code. Since appellant has not questioned the amount of the interest, we will assume it has been properly computed under the above sections. Appellant concedes its liability for interest on $15,596.00 from October 15, 1975, the normal due date of the tax, to January 15, 1976, the date of payment. Appellant's dispute with the remaining interest is based solely upon its belief that the penalties were improper. In view of our conclusion that those penalties were properly imposed, respondent's assessments of interest must also be sustained.

Appeal of Cerwin-Vega International

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 26077 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of Cerwin-Vega International for refund of penalties and interest in the total amount of $1,350.66 for the income year ended July 31, 1975, be and the same is hereby sustained.

Done at Sacramento, California, this 15th day of August, 1978, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member