96-SBE-009

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of	)	
	)	No. 94R-0145
BSR USA, Ltd., 0591344,	)	
Taxpayer, & BSR North America, Ltd.,	)	
1275221, dba Astec American, Inc.,	)	
Assumer and/or Transferee	)	

Representing the Parties:

For Appellant:	Conrad W. Krol Ernst & Young, LLP
For Respondent:	Cody C. Cinnamon, Senior Tax Counsel
Counsel for Board of Equalization:	Tommy Leung, Staff Counsel

O P I N I O N

This appeal is made pursuant to section 19324 (formerly section 26075), subdivision (a),[1] of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claims of BSR USA, Ltd., et al., for refund of penalties in the amounts of $13,573 and $16,162 for the income years ended December 31, 1983, and December 31, 1984, respectively.

[1] Unless otherwise specified, all section references hereinafter in the text of this opinion are to sections of the Revenue and Taxation Code as in effect for the income years in issue.

The sole issue in this appeal is whether reasonable cause exists for abating the failure to furnish information penalty with respect to a multinational entity's failure to provide details regarding its world-wide operations and corporate structure.

During the appeal years, BSR USA, Ltd. (BSR), filed combined California franchise tax reports with its domestic subsidiaries. These reports did not include the income and factor information for BSR's foreign parent and foreign subsidiaries. Respondent, during audit, attempted to ascertain whether appellants and BSR International PLC and Subsidiaries were conducting a world-wide unitary business. Respondent sent numerous letters and held many telephone conversations with appellants in order to gather the necessary information.

The written correspondence began on March 5, 1986, with a letter containing questions about the possible unitary relationships among the related corporations. The record indicates several follow-up letters were sent and many telephone messages were left with appellants' representative, all of which were either ignored or responded to with empty promises (e.g., the information was being typed and would be available in a week). Some of the questions were as general as appellants' corporate ownership and organizational structure.[2] However, appellants did not provide most of the information, which they characterized as detailed and overwhelming, required by respondent to make its unitary determination.

Finally, on October 3, 1986, respondent issued a formal letter to appellants demanding the requested information; otherwise, notices of proposed assessment (NPAs) would be issued and the failure to furnish information penalty would be imposed. On October 14, 1986, respondent received limited responses to its unitary questions, and in a letter dated October 15, 1986, appellants expressed a willingness to answer additional questions posed by respondent.

Based on the information appellants did provide, respondent conducted some further research and discovered appellants were part of a larger organization than was originally anticipated, which required further inquiry. Thus, in February 1987, respondent contacted appellants requesting further information, explaining that the answers given on October 14, 1986, were inadequate. Appellants indicated the second unitary questionnaire was unreasonable and that they could not comply with respondent's request. In March and May 1987, appellants informed respondent that they would attempt to complete the questionnaire, but were having some trouble. Therefore, respondent agreed to accept answers with respect to only one of the three years under audit. Despite appellants' promises in

[2] Respondent advises that, to date, appellants have still not provided much of this information.

July and September 1987 that the requested information would be forthcoming, none was received. When appellants did not return respondent's telephone calls, a formal demand letter asserting the penalty in dispute was issued on May 5, 1988.

Appellants responded, indicating that it would be too costly to provide the requested information, but were willing to settle. However, respondent needed information from appellants to identify the members of appellants' unitary group before a settlement could be broached, and a pattern of conduct consistent with the one outlined above commenced. Consequently, respondent used income information from Moody's International as the basis for its proposed assessments, and imposed a 25 percent penalty for failing to provide information. (See Rev. & Tax. Code, § 25933.) When respondent denied appellants' refund claims for these penalties, this appeal followed.

Section 25933 provides, in pertinent part, that when there is a failure to furnish any information requested in writing, then, unless the failure is due to reasonable cause and not willful neglect, respondent may add a 25 percent penalty to the amount of additional tax determined. While, for purposes of section 25933, there is no authority defining "reasonable cause," the United States Supreme Court, in a federal case involving a late filing penalty, defined reasonable cause as the "exercise of ordinary business care and prudence." (See United States v. Boyle, 469 U.S. 241, 250 [83 L.Ed.2d 622] (1985).) Under our interpretation of section 25933's counterpart in the Personal Income Tax Law, section 18683 (renumbered as section 19133, operative January 1, 1994), we have held that in order to show reasonable cause, the taxpayer must prove that he acted in the same manner as an ordinary, intelligent, and prudent business person would have acted under similar circumstances. (See Appeal of Loew's San Francisco Hotel Corp., Cal. St. Bd. of Equal., Sept. 17, 1973; Appeal of Joseph W. and Elsie M. Cummings, Cal. St. Bd. of Equal., Dec. 13, 1960.) Moreover, we have found that respondent's determination of the type of penalty involved in this case is presumptively correct, and the burden rests upon the taxpayer to prove it to be erroneous. (See Todd v. McColgan, 89 Cal.App.2d 509 [210 P.2d 414] (1949); Appeal of Ottar G. Balle, Cal. St. Bd. of Equal., Feb. 6, 1980; Appeal of Myron E. and Alice A. Gire, Cal. St. Bd. of Equal., Sept. 10, 1969.)

Appellants assert that while they disagreed with respondent's determination, they nevertheless paid the proposed assessments after considering the effort and expense required to obtain the needed information. However, appellants believe the assessments were prepared consistent with subdivision (e)(1) of regulation section 25137-6 and, thus, the 25 percent penalty should be abated. Appellants seem to imply that since respondent was able to obtain some financial information concerning appellants from Moody's International, appellants were not required to provide such information because the Moody's data was a reasonable substitute. Appellants also argue that California's method

of world-wide combined reporting was controversial and confusing until 1994, when the U.S. Supreme Court rendered its decision in Barclays Bank PLC.[3]

> Subdivision (e)(1) of regulation section 25137-6 provides as follows:
>
> In computing the income and any of the factors required for a combined report, the Franchise Tax Board shall consider the effort and expense required to obtain the necessary information. In appropriate cases, such as when the necessary data cannot be developed from financial records maintained in the regular course of business, the Franchise Tax Board may accept reasonable approximations.

We are not persuaded that this regulation and the alleged[4] controversy/confusion inherent in California's method of world-wide combined reporting serve to relieve appellants from liability for the penalty in question under the circumstances presented to us. Firstly, the information requested by respondent, especially after appellants offered to settle the case, concerned appellants' corporate structure, not detailed financial data; the requested information was needed so respondent could determine the constituent members of appellants' unitary group.[5] Surely, appellants are not suggesting that respondent base its audits solely upon data provided in financial publications. Secondly, appellants' behavior betrays their true intentions. Their conduct during the audit indicates a pattern of delay and misdirection which we cannot condone. If the requested records and data were not available or were too costly to obtain, a reasonable person under similar circumstances would have so informed respondent; it was not reasonable for appellants to tell respondent that they had the requested material and that it would be delivered, and then to not only fail to deliver such material, but fail to even return respondent's telephone calls. We can only conlude that appellants have not shown that there was reasonable cause for their failure to furnish information and we decline to sanction appellant's behavior by abating the penalty in this appeal.

According, respondent's action in this matter is sustained.

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[3] See Barclays Bank PLC v. Franchise Tax Board, 512 U.S. __ [129 L.Ed.2d 244] (1994), affirming the California Supreme Court's decision in Barclays Bank International, Ltd. v. Franchise Tax Board, 2 Cal.4th 708 [8 Cal.Rptr.2d 31] (1992).

[4] It is noted that California's method of world-wide combined reporting was upheld by the United States Supreme Court in Container Corp. v. Franchise Tax Board, 463 U.S. 159, 178-179 [77 L.Ed.2d 545], rehg. den., 464 U.S. 909 [78 L.Ed.2d 248] (1983), before respondent sent its letter of inquiry to appellants in 1986.

[5] Respondent even reduced the scope of its questionnaires to accommodate appellants.

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 19333 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claims of BSR USA, Ltd., et al., for refund of penalties in the amounts of $13,573 and $16,162 for the income years ended December 31, 1983, and December 31, 1984, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 11th day of April, 1996, by the State Board of Equalization, with Board Members Mr. Klehs, Mr. Droneburg, Mr. Andal, Mr. Sherman and Mr. Halverson present.

Johan Klehs , Chairman

Ernest J. Dronenburg, Jr. , Member

Dean F. Andal , Member

Brad J. Sherman , Member

Rex Halverson* , Member

*For Kathleen Connell, per Government Code section 7.9.