

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)	
)	No. 95R-0129
Capitol Architectural Products)	
Co.)	
)	

Representing the Parties:

For Appellant:	Robert K. Stephenson
For Respondent:	Bruce R. Langston, Counsel

Counsel for Board of Equalization:	Craig R. Shaltes, Tax Counsel III
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O P I N I O N

This appeal is made pursuant to section 19324, subdivision (a),¹ of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claims of Capitol Architectural Products Company for refunds of franchise tax in the amounts of \$2,831.56, \$2,632.64, \$2,439.90, \$1,006.97 and \$9,121.71² for income years ended May 31, 1988, through May 31, 1992, respectively.

The issue to be decided is whether appellant is entitled to a refund of both late filing penalties and penalties for underpayment of estimated tax.

The facts of this case do not appear to be in dispute. On September 30, 1992, appellant filed a claim for refund of late filing penalties and penalties for underpayment of estimated taxes paid for the first four income years on appeal. On October 2, 1992, appellant submitted a claim for refund for all of the above income years (\$9,121.71). On September 12, 1994, and September 30, 1994, respondent sent notices to appellant disallowing the refund claims. On October 26, 1994, appellant submitted this timely appeal.

The returns for income years ended May 31, 1986, and May 31, 1987, are not in issue, and are shown in respondent's brief only because appellant is claiming a carryforward of large "overpayments" shown on those returns. Each return, except the return for income year ended May 31,

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.

² The record is unclear as to whether this amount of \$9,121.71 is the total amount of the claims for refund for 1987 through 1991, or a separate claim for refund for 1992. However, the result we reach herein makes the question moot.

1992, was filed late, and each return (except for income year ended May 31, 1992) was filed after the estimated tax payment installment due dates of the subsequent year’s return. However, respondent credited overpayments as of the date the returns were filed. For example, the return for income year ended May 31, 1988, was filed on October 15, 1991, and showed an overpayment of \$15,289.43, which appellant apparently directed respondent to apply to the next income year (May 31, 1989). (In each year’s return, appellant appears to have given respondent the same direction, i.e., apply the overpayment to the next income year.) The following is a chart of what we believe the evidence shows as to when appellant filed its tax returns for the income years at issue:

<u>Income Years Ended</u>	<u>Return Due Date</u>	<u>Date Return Filed</u>
5-31-86 ³	8-15-86	10-25-89
5-31-87	8-15-87	7-31-90
5-31-88	8-15-88	10-15-91
5-31-89	8-15-89	11-25-91
5-31-90	8-15-90	1-30-92
5-31-91	8-15-91	3-13-93
5-31-92	8-15-92	4-02-93

While it is not entirely clear as to when (and how much was paid) appellant made payments to respondent, it appears that the following payments were made:

<u>Description</u>	<u>Date Paid</u>	<u>Amount</u>	<u>Income Year to Which Payment Applied</u>
Estimated tax pmt.	9-27-85	\$ 200.00	5-31-86
Estimated tax pmt.	11-15-85	250.00	5-31-86
Estimated tax pmt.	2-15-86	250.00	5-31-87
Estimated tax pmt.	5-15-86	250.00	5-31-87
Estimated tax pmt.	9-10-86	250.00	5-31-87
Estimated tax pmt.	11-15-86	250.00	5-31-87
Levy	5-27-88	10,147.11	5-31-86
Levy	5-27-88	10,185.02	5-31-87
Payment (with extension request	8-15-91	2,450.00	for 5-31-91 income year)

³ As explained above, income years ended May 31, 1986 and 1987 are not at issue in this appeal, but are shown because appellant is claiming a carryforward of “overpayments” (made in those years) to the income years on appeal. Respondent apparently issued levies for these years, which appellant paid on May 27, 1988. However, appellant failed to file returns for these years until October 25, 1989 (for income year ended May 31, 1986), and July 31, 1990 (for income year ended May 31, 1987), which returns indicated overpayments of tax.

Because the returns were filed late, respondent assessed a late filing penalty for each income year, and subtracted that amount from the available credit from the previous year's overpayment. Where the returns were filed after the last date for making an estimated payment for the income year, respondent assessed an estimated tax penalty for that subsequent year.

Respondent argues that this situation is controlled by its Legal Ruling 94-4, dated September 30, 1994, which appears to state (in relevant part) that, until a taxpayer files a return for a particular year, there is no overpayment to credit to a different year. Respondent contends that it may not credit money paid toward one tax year to another until a return is filed, establishing the amount available for credit.

Appellant claims that respondent's Legal Ruling 94-4 is not applicable because it was issued some years after appellant's refund claims, and because it does not accurately reflect the law. In essence, appellant contends that because it "paid" money to respondent prior to the due dates for its estimated tax payments, that the estimated tax penalty should not apply (even though it filed its tax returns late). Further, because it "paid" enough money to respondent prior to the due dates of its returns, appellant appears to argue that it should not have to pay the failure to file penalties because it owed no taxes for the income years on appeal.

We believe the present case can be decided with our determination of whether the money appellant gave to respondent towards the levy amounts for income years ended May 31, 1986 and 1987, (which proved to be excessive once appellant filed its returns for those years in 1989 and 1990), constitute "payments" for purposes of Revenue and Taxation Code sections 25931.3 and 25952 for the income years on appeal.

Section 25931 (amended and renumbered as § 19131, operative Jan. 1, 1994) provides for the imposition of a late filing penalty unless the failure to file in a timely manner was due to reasonable cause and not willful neglect. Section 25931.3 (amended and renumbered as § 19131, operative Jan. 1, 1994) provides that the late filing penalty is computed on the difference between the taxpayer's liability and the amount of the tax paid on or before the due date for paying the tax.

Section 25951 (amended and renumbered as § 19142, operative Jan. 1, 1994) provides in relevant part that a penalty shall be added to the tax in the case of the underpayment of estimated tax. Section 25952 (amended and renumbered as § 19144, operative Jan. 1, 1994) provides in relevant part that, for the purposes of section 25951, the amount of the underpayment shall be the excess of the required installment payment over "the amount, if any, of the installment paid on or before the last date prescribed for payment." (Rev. & Tax. Code, § 25951, emphasis added.)

A corporation is required to make quarterly payments of its estimated tax during the income year. (Former Rev. & Tax. Code, § 25563, renumbered as §19025, operative Jan. 1, 1994.) Failure to timely make estimated payments triggers an underpayment penalty which is essentially equal to the interest on the required estimated payments not made. (Former Rev. & Tax. Code, § 25951, renumbered as § 19142, operative Jan. 1, 1994.) If the estimated payments are not made, the penalty is calculated based on 90 percent of the current year's liability. (Former Rev. & Tax. Code, § 25952, amended and renumbered as § 19144, operative Jan. 1, 1994.) To avoid the penalty, appellant needed

to pay 90 percent of the current year's liability in four equal installments, or 100 percent of the prior year's liability in four equal installments. (Rev. & Tax. Code, § 25954, amended and renumbered as § 19147, operative Jan. 1, 1994.) However, when the prior year's liability was only the minimum tax, appellant needed to pay 100 percent of the current year's minimum tax by the due date of the first installment to avoid a penalty. (Former Rev. & Tax. Code, § 25563, subd. (b), renumbered as § 19025, operative Jan. 1, 1994.)

We have held that a corporation must, at least, pay the minimum estimated tax by the first installment date to avoid the imposition of any penalties. (Appeal of Durao International Corporation, Cal. St. Bd. of Equal., May 21, 1980; Appeal of Lumbermans Mortgage Company, Cal. St. Bd. of Equal., Dec. 15, 1976.) Therefore, unless appellant's "payments" (made on May 27, 1988) towards respondent's levies for income years ended May 31, 1986 and 1987, are "payments" within the meaning of section 25952, the imposition of the estimated tax penalties was proper.

Further, under section 25931 a penalty is assessed for a taxpayer's failure to file timely returns, unless the taxpayer can show that it had reasonable cause for its failure to file. The taxpayer has the burden of proving it had "reasonable cause," which burden can be met by showing that its failure to file occurred despite the exercise of ordinary business care and prudence. (Appeal of Citicorp Leasing, Inc., Cal. St. Bd. of Equal., Jan. 6, 1976.) In the present case, appellant admits that it failed to timely file its tax returns, and has presented no evidence to show that it had reasonable cause for not filing its returns. Instead, appellant maintains that it timely "paid" its franchise taxes due for each income year, because of the May 27, 1988, levy payments to respondent, which appellant eventually demonstrated (via its returns) were "overpayments" of its tax liability. Therefore, appellant argues, that under section 25931.3 it is entitled to a deduction of its "overpayments" (made before the due date of its returns) in computing the applicable penalties under section 25931.

Appellants argue that, for purposes of sections 25931.3 and 25952, the term "paid" means when they gave money to respondent which (eventually) was determined to be "overpayments" for the years to which the money was originally applied. Respondent appears to contend that "paid," as used in sections 25931.3 and 25952, means money given to respondent towards a particular income year, or money which has been deemed an "overpayment" as stated in a tax return in which an overpayment has been designated to be applied toward another income year. We believe that respondent's view is correct.

It is clear to us that the two tax levy amounts appellant gave to respondent on May 27, 1988 (\$10,147.11 towards income year ended May 31, 1986, and \$10,185.02 towards income year ended May 31, 1987), were "paid" to respondent for the purpose of covering appellant's assessed tax liabilities for those two income years. In the present case, until appellant actually filed returns for income years ended May 31, 1986 and 1987, there was no way respondent could know that there was any overpayment which could be applied to the estimated tax payments of the income years on appeal.

Further, until appellant indicated on its tax returns that it wanted to apply any resulting overpayments to the income years on appeal, appellant had the right to request that the overpayment amount be refunded. In other words, until appellant instructed respondent to apply the overpayments to the next income year's tax liability, the May 27, 1988, payments were simply payments towards appellant's May 31, 1986 and 1987, tax liability. Until appellant filed its tax returns for income years

ended May 31, 1986 and 1987, and instructed respondent to apply any remaining overpayment to the next income year, appellant simply made no “payment” towards any income years except May 31, 1986 and 1987.⁴

Appellant also argues that Revenue Rulings issued by the Internal Revenue Service (IRS), relating to the application of tax “overpayments” from a previous income year towards the required estimated tax payments of a subsequent income year, support its position. In Revenue Ruling 77-475, 1977-2 C.B. 476, the IRS stated that:

“If an overpayment of income tax for a taxable year occurs on or before the due date of the installment of estimated tax for the succeeding taxable year, the overpayment is available for credit against any installment of estimated tax for such succeeding taxable year and will be credited in accordance with the taxpayer’s election.”
(Emphasis added.)

In Revenue Ruling 84-58, 1984-1 C.B. 245, the IRS reaffirmed its holding in Revenue Ruling 77-475, and disaffirmed its holding in Revenue Ruling 83-111, 1983-2 C.B. 245, which involved a taxpayer with an extension of time to file a return for calendar year 1979 and the return being filed on June 15, 1980. In Revenue Ruling 83-111, the IRS had held that the taxpayer’s election to apply the overpayment shown on the 1979 return towards the 1980 estimated tax payments would only apply against the June 15 estimated tax installment for 1980, and not against the April 15 installment for 1980. Pursuant to Revenue Ruling 84-58, the overpayment shown by the taxpayer’s (described in Revenue Ruling 83-111) 1979 return would apply to the April 15 estimated tax installment for 1980.

Appellant therefore contends that Revenue Rulings 77-475 and 84-58 support its contention that its “overpayments,” as demonstrated in its (untimely) tax returns (for not only the income years ended that are on appeal, but also for income years ended May 31, 1986 and 1987), should be applied to its estimated tax installments for each subsequent year. However, as pointed out by respondent, appellant has failed to recognize a key fact: in all three Revenue Rulings (77-475, 83-111 and 84-58), the returns wherein an “overpayment” was claimed (in which the taxpayer had requested the application of any overpayments towards the taxpayer’s previously unpaid estimated tax installments for the income year subsequent to the year of the return in which the “overpayment” was claimed), the tax returns were timely filed. Therefore, in the Revenue Rulings there was a timely existing “overpayment” in which the taxpayer said to apply to the subsequent year’s estimated tax installments. In the present case the returns, wherein appellant claimed “overpayments” and asked respondent to apply said “overpayments” to the subsequent year’s estimated tax installments, were filed years after the estimated tax payments were due. Moreover, until the late returns were filed, no “overpayments” existed, only tax liability payments towards appellant’s May 31, 1986 and 1987, income years existed.

⁴ Nor could the May 27, 1988, payments be deemed “deposits” by appellant, because those payments were clearly for the tax levies imposed towards appellant’s income years ended May 31, 1986 and 1987. There is no indication in the facts that shows the May 27, 1988, “levy” payments were truly deposits to be set aside for future tax liabilities of appellant. (See Binder v. United States (1978) 590 F.2d 68, 70.) Moreover, even if the two “levy payments” could be construed as “deposits,” they would not be deemed to be “payments” until appellant directed respondent as to where to apply said deposits. (See Hays v. Commissioner (1996) ¶96,018 T.C.M. (RIA) fn.5.)

We conclude that, because of the factual differences in the IRS Revenue Rulings cited by appellant, we find that said Revenue Rulings are inapplicable in the present appeal.

Therefore, we find that, because appellant had not timely “paid” its estimated tax payments and franchise tax (because of the lateness of its returns), respondent properly imposed the subject penalties, and appellant’s refund claims were properly denied. However, we do disapprove of respondent’s reliance on its Legal Ruling 94-4 in denying appellant’s refund claims, because said legal ruling did not exist at the time appellant originally filed its claims for refund.

ORDER

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 Capitol Architectural Products Company for refunds of franchise tax in the amounts of \$2,831.56, \$2,632.64, \$2,439.90, \$1,006.97 and \$9,121.71 for the income years ended May 31, 1988, through May 31, 1992, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 4th day of December, 1996, by the State Board of Equalization, with Board Members Mr. Klehs, Mr. Dronenburg, Mr. Andal, Mr. Sherman and Mr. Halverson present.

Johan Klehs _____, Chairman

Ernest J. Dronenburg, Jr., Member

Dean F. Andal _____, Member

_____, Member

Rex Halverson* _____, Member

* For Kathleen Connell per Government Code section 7.9.