

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
USC Surgeons, Inc. ) No. 96R-0374  
)

Representing the Parties:

For Appellant: Tony A. Rose, CPA  
Vicki M. Robbins, CPA

For Respondent: Debra Petersen,  
Counsel

Counsel for Board  
of Equalization: Craig R. Shaltes,  
Tax Counsel III

O P I N I O N

This appeal is made pursuant to section 19324 of the Revenue and Taxation Code<sup>1</sup> from the action of the Franchise Tax Board on the claims for refund of USC Surgeons, Inc., in the amounts of \$553.00 and \$9,660.29 for the income years ended June 30, 1992, and June 30, 1993, respectively.

The issue in this appeal is whether a corporation, which has been given retroactive tax-exempt status, should be liable for a failure to pay estimated tax penalty imposed on one of the prior income years.

On or about September 7, 1994, respondent acknowledged that appellant qualified as a tax exempt organization under Revenue and Taxation Code section 23701d. Respondent agrees that this status applied retroactively to the date of incorporation,<sup>2</sup> which period includes the two income years on appeal. However, during income year ended June 30, 1993 (which was prior to being granted tax-exempt status), appellant had failed to make timely estimated tax payments, even though appellant reported a California tax liability of \$104,102 for that income year. On or about November 14, 1994, respondent refunded to appellant taxes paid for income year ended June 30, 1993. Later, respondent requested appellant to repay \$4,345.29, which was the amount of a failure to pay estimated tax penalty

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

<sup>2</sup> See California Code of Regulations, title 18, section 23701, subdivision (b)(4).

computed from appellant's previously reported California tax liability for income year ended June 30, 1993. Appellant repaid the money; it is this payment which is presently under dispute.

The parties agree that the only issue involved is whether respondent may impose a failure to pay estimated tax penalty on appellant after appellant had been granted retroactive tax-exempt status for the income years on appeal. Appellant contends that the term "retroactive" is normally defined as "made effective as of a date prior to enactment, promulgation, or imposition" (citing Webster's Ninth New Collegiate Dictionary), making its tax-exempt status effective for all of the income year on appeal. Therefore, appellant contends that because it owed no estimated tax payments for income year ended June 30, 1993, it could not owe any penalty for failing to make such payments it did not have to pay. Appellant does admit that it has no authority in support of its "retroactivity" argument, but it does point out that respondent has no authority directly on point for its position. Further, appellant contends that allowing respondent to assess such a penalty will not further a public purpose.

Respondent argues that the imposition of the penalty was correct, because during the income year on appeal, appellant was not an exempt organization. Therefore, appellant was required to make timely estimated tax payments based upon its income, at least equal to the minimum tax. (See former Rev. & Tax. Code, §§ 25561 through 25565, amended and renumbered as §§ 19023 through 19027, 19004 and 19010, operative Jan. 1, 1994.) Corporations which fail to make necessary estimated tax payments are subject to pay a penalty generally equal to a specific rate of interest on the underpayments. (See Rev. & Tax. Code, §§ 25951 through 25954, amended and renumbered as §§ 19142, 19144, 19145, 19147, 19148, 19149 and 19151, operative Jan. 1, 1994.) Respondent points out this Board has found that the imposition of the underpayment of estimated tax penalty was mandatory upon the finding of such an underpayment. (Citing: Appeal of Weaver Equipment Company, Cal. St. Bd. of Equal., May 21, 1980; Appeal of J. F. Shea Co., Inc., Cal. St. Bd. of Equal., Aug. 16, 1979; Appeal of Decoa, Inc., Cal. St. Bd. of Equal., April 5, 1976.) Therefore, argues respondent, appellant's apparent "reasonable cause" for failing to make estimated tax payments in a timely manner should fail. Further, respondent points out that this Board has previously imposed a failure to pay estimated tax penalty upon a tax-exempt organization. (See Appeal of Northridge Fashion Center, Inc., 89-SBE-026, Sept. 26, 1989.)

"Estimated tax" is defined, for purposes of appellant, as "the amount which the corporation estimates as the amount of the tax imposed" by the Bank and Corporations Tax part of the California Revenue and Taxation Code, but in no event should it be lower than the minimum tax. (Rev. & Tax. Code, § 25561 renumbered as § 19023, operative Jan. 1, 1994.) The payment required by the "estimated tax" code sections do not impose a new tax on corporations; said sections give a specific way to pay the tax owed. (See Jones-Hamilton Co. v. Franchise Tax Board (1968) 268 Cal.App.2d 343, 348-349.) Therefore, if the income on which the tax is determined is retroactively made exempt, there would no longer be any "estimated tax" owed, because "estimated tax" is not a tax unto itself, but a reflection of tax owed pursuant to California's taxing scheme on corporations. Further, corporations granted tax-exempt status, such as appellant, are also exempt from paying the minimum franchise tax. (Rev. & Tax Code, § 23701.)

Moreover, none of the cases cited by respondent are applicable in the present case. This is because all of those cases, including Northridge Fashion Center, Inc., supra, concerned corporations which failed to pay estimated taxes on taxable income.

Also, we note that the legislature, in setting up the laws governing “estimated tax” payments, and penalties based on not making those payments, included section 25954.5 (renumbered to § 19151, operative Jan. 1, 1994). Section 25954.5 provides that, notwithstanding the failure to make the estimated tax payments penalty sections, a corporation whose tax-exempt status is retroactively revoked will not have to pay the underpayment penalty for the previous years it was not an exempt corporation, unless that corporation had notice that the estimated tax should have been paid. Therefore, we believe that if a corporation which retroactively loses its tax-exempt status should not have to pay the underpayment (of estimated tax) penalty, then it follows that a corporation which is retroactively granted tax-exempt status should not have to pay the penalty as well.

Finally, we believe that there should be no problem with a corporation not making its estimated tax payments based upon an application for, or hope of gaining, retroactive tax-exempt status. This is because, should that corporation not be granted said status, it would then be liable for the underpayment penalty, plus any applicable interest on that penalty.

Therefore, based upon the foregoing analysis, the action of respondent regarding its denial of appellant’s refund claim for income year ended June 30, 1993, in the amount of \$4,345.29, is reversed. Respondent’s action, in regard to income year ended June 30, 1992, is sustained.

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 actions of the Franchise Tax Board on the claims for refund of USC Surgeons, Inc., in the amounts of \$553.00 and \$9,660.29 for the income years ended June 30, 1992, and June 30, 1993, respectively, be and the same is hereby reversed in the amount of \$4,345.29 for income year ended June 30, 1993, but is sustained as to all other amounts for income year ended June 30, 1993, and income year ended June 30, 1992.

Done at Sacramento, California, this 19th day of March, 1997, by the State Board of Equalization, with Board Members Mr. Dronenburg, Mr. Klehs, Mr. Andal, Mr. Halverson and Mr. Chiang present.

Ernest J. Dronenburg, Jr , Chairman

Johan Klehs \_\_\_\_\_, Member

Dean F. Andal \_\_\_\_\_, Member

Rex Halverson\* \_\_\_\_\_, Member

\_\_\_\_\_, Member

\*For Kathleen Connell, per Government Code section 7.9.