

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)	
)	No. 96R-0171
Eugene and Lily Heller)	
)	

Representing the Parties:

For Appellants:	Lawrence L. Greenberg, CPA
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For Respondent:	Jozel L. Brunett, Counsel
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Counsel for Board of Equalization:	Derick J. Brannan, Tax Counsel
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OPINION

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 claim of Eugene and Lily Heller for a refund of a penalty paid in the amount of \$6,075 for the 1990 taxable year. The primary issue on appeal is whether appellants have demonstrated reasonable cause to abate a late filing penalty.

During 1990, appellants resided in Colorado and owned a limited partnership interest in a Colorado limited partnership (the partnership). During that same year, the partnership realized income stemming from the sale of California real property. However, in spite of receiving a form K-1² from the partnership in connection with the 1990 tax year, appellants allege that they did not learn about the California income until being told about it by the general partner in late July of 1992. -Appellants did not file their 1990 California tax return until January 4, 1993, more than 20 months after the original due date for their 1990 return, and more than five months after being apprised of their California filing

¹Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the year at issue.

²Partnerships issue K-1 forms in part to inform individual partners of their distributive share of partnership income (or losses).

obligation. (See Rev. & Tax. Code, § 18432, renumbered as § 18566, operative Jan. 1, 1994.) On their 1990 return, appellants reported and paid a tax liability of \$24,302, as well as penalties and interest totaling \$3,510.

After reviewing appellants' return, respondent accepted the self-assessed tax liability but disagreed with the amount of self-assessed penalties and interest. On April 20, 1993, respondent issued a Notice of State Income Tax Due, which proposed a late filing penalty of \$6,075.00 and additional interest of \$5,789.97; allowing for appellants' prior payment, the notice reflected an outstanding amount due of \$8,354.97. Appellants subsequently paid the additional amount due and filed a claim for refund, seeking a return of the late filing penalty.³ Respondent denied the claim based on its determination that appellants failed to establish reasonable cause for filing a delinquent 1990 tax return.

Respondent may assess a delinquent filing penalty whenever a taxpayer fails to file a return in a timely fashion, unless it is shown that the failure was due to reasonable cause and not willful neglect. (Rev. & Tax. Code, § 18681, renumbered as § 19131, operative Jan. 1, 1994.) The amount of the late filing penalty is based on the amount of tax due on the date the return should have been filed; therefore, if the taxpayer did not owe tax, there would be no penalty. (Rev. & Tax. Code, § 19131.) For that reason, we must determine whether appellants owed any tax based on their limited partnership income before we may evaluate the propriety of the late filing penalty.

Nonresidents are taxable by California only upon taxable income derived from sources within California. (Rev. & Tax. Code, § 17951.) When a nonresident taxpayer is a partner in a partnership, the taxpayer's distributive share of partnership income is taxable by California to the extent the distributive share is derived from sources within California.⁴ (Cal. Code Regs., tit. 18, § 17951-1, subd. (b).) Income from sources within California includes income from real or tangible personal property located in the state. (Cal. Code Regs., tit. 18, § 17951-2.) In the partnership context, the source of a partner's income will be determined by the location of the partnership property and its activities. (Appeal of Estate of Marion Markus, Cal. St. Bd. of Equal., May 6, 1986; Appeal of H. F. Ahmanson & Company, Cal. St. Bd. of Equal., Apr. 5, 1965.)⁵

³Appellants paid the amount due on July 8, 1993, and filed an amended tax return on April 15, 1994. Respondent treated the amended return as a claim for refund in accordance with section 19307.

⁴The distributive share of partnership income (or loss) will generally be treated differently than gain (or losses) from the sale of a partnership interest. Because the ownership interest in a partnership is intangible personal property, gain (or loss) from the disposition of that ownership interest will be allocated to the taxpayer's domicile, unless the ownership interest has acquired a business situs in some other location. (Appeals of Amyas and Evelyn P. Ames, et al., 87-SBE-042, June 17, 1987; Appeal of Robert M. and Ann T. Bass, et al., 89-SBE-004, Jan. 25, 1989.)

⁵We note that our recent decision in the Appeals of Amman & Schmid Finanz AG, et al. (96-SBE-008), decided on April 11, 1996, may have caused some confusion due to its discussion of the Ahmanson opinion in connection with the attribution of limited partnership activity to a corporate limited partner for purposes of imposing the minimum franchise tax. (See Rev. & Tax. Code, § 23101.) The Ahmanson case dealt exclusively with the source of partnership income for purposes of attributing gain or loss to a particular geographic location, while the legal import of the Amman & Schmid opinion is limited to the "doing business" requirement. To the extent that language in the Amman and Schmid opinion may suggest a new interpretation of the Ahmanson opinion, it is hereby disapproved.

The record shows that appellants owned an interest in a Colorado limited partnership. That partnership sold California real estate and realized a taxable gain on the sale sometime during 1990. Because the gain arose from California real property, appellants' distributive share of that gain is subject to California tax. (*Ibid.*) Appellants did not report their share of the taxable gain in a timely fashion, and therefore, if a late filing penalty is appropriate, it should be computed based on the amount of outstanding California tax due as of April 15, 1991 (i.e., \$24,302).⁶

Appellants argue that the late filing penalty should be abated because their particular circumstances constitute reasonable cause for their failure to timely file the 1990 return. While this Board apparently has not ruled on this precise factual scenario, we do find some guidance from two of our earlier decisions. In the Appeal of Stephen C. Bieneman, decided on July 26, 1982, we refused to excuse penalties based on the taxpayer's assertion that he was unable to obtain the necessary partnership records because they were maintained out of state. Likewise, in the Appeal of Elixir Industries, decided by this Board on December 14, 1983, we refused to excuse penalties when the taxpayer did not discover its reportable income until after the filing deadline. In both cases, this Board felt that the taxpayers failed to present sufficient evidence of their efforts to discern the nature and extent of their income and the corresponding filing obligation. Considering those cases in the context of the instant situation, we must determine whether appellants knew, or should have known, about the partnership income early enough to file a timely 1990 return;⁷ if so, reasonable cause to abate the late filing penalty will not exist.

To make that determination, we must consider a number of factors related to appellants' relationship with the partnership. Therefore, we should consider the following factors:⁸ appellants' timely attempts to discern their proper tax liability; evidence of the late notification; the nature and scope of the partnership operations; appellants' personal involvement with the partnership operations; the extent of appellants' financial involvement in the partnership (both the dollar amount and the relative ownership percentage); the appellants' degree of financial sophistication; and/or the qualifications of the general partner responsible for handling tax matters.⁹

Further, and consistent with a taxpayer's burden of proof on appeal, appellants must do more than merely aver the facts necessary to establish reasonable cause, they must make an affirmative evidentiary showing to establish those facts before relief will be granted.¹⁰ (Appeal of Elixir Industries, supra.) Appellants' failure to provide evidence within their control gives rise to a presumption that such

⁶There is no dispute as to the calculation of the subject penalty amounting to 25 percent of the tax liability, or \$6,075.

⁷If the taxpayer is aware of taxable income, the taxpayer holds a nondelegable duty to file a proper return. (Appeal of Samuel R. and Eleanor H. Walker, Cal. St. Bd. of Equal., Mar. 27, 1973; Appeal of J. B. Ferguson, Cal. St. Bd. of Equal., Sept. 15, 1958.)

⁸These factors do not represent an exclusive list, nor must each factor be addressed in every situation; by its nature, a reasonable cause determination depends on the facts and circumstances of each individual case.

⁹The general partner responsible for tax matters owes a fiduciary duty to each of the individual partners to provide information sufficient to file timely and accurate income tax returns. Therefore, our inquiry must include whether a taxpayer's reliance on that partner is reasonable enough to excuse the subject penalty.

¹⁰While it seems self-evident, this burden may be particularly difficult to meet if the taxpayers fail to respond to respondent's requests for specific information during the protest and/or appeals process. Both this Board and respondent need evidence to reach the proper decision, and the taxpayers control that evidence. It is for that reason that the taxpayer generally carries the burden of proof on appeal.

evidence would be unfavorable were it to be produced. (Appeal of James C. Coleman Psychological Corporation, et al., Cal. St. Bd. of Equal., Apr. 9, 1985.)

In the instant case, appellants allege that they did not know the limited partnership owned property or earned income in California, or that they had a corresponding California filing obligation, until July 27, 1992, the date upon which they received such information from the partnership's general partner. Appellants were limited partners and owned less than one percent of the partnership. Appellants also claim that they were silent partners who contributed money to the partnership, but who had no management responsibilities or other involvement in the partnership's business affairs. According to appellants, the partnership filed its final partnership tax return in 1990 and distributed K-1 forms to each of the partners. In spite of that information, appellants assert that the partnership gave no indication that it earned income in California or that the partners had a corresponding filing obligation. Upon learning of the need to file a 1990 California income tax return in 1992, appellants assert that they "immediately" gathered the necessary documentation to prepare and file their 1990 California return.¹¹ Appellants contend that the foregoing circumstances constitute reasonable cause for the abatement of the late filing penalty and related interest charges.

Evaluating appellants' argument in the context of the foregoing legal standard, we cannot sustain their position on appeal. Although appellants owned less than one percent of the partnership, they obviously held a rather substantial interest in the partnership as demonstrated by a California tax liability of more than \$24,000. Further, we note that appellant-husband is a doctor, whom we must assume is a reasonably sophisticated taxpayer. Additionally, appellants provide no evidence as to the partnership operations, the nature of the partnership property, or the qualifications of the general partner responsible for tax matters. Appellants' limited interest in the partnership suggests that they were not in a position to know detailed financial information about the partnership; however, absent such information, appellants were obligated to make a reasonable attempt to learn the information necessary to file the proper state and federal returns. Other than an assertion that the partnership failed to provide that information, appellants offer no evidence that they made any affirmative efforts to fulfill their personal obligations. Appellants do not even provide a copy of the K-1 form upon which they apparently relied in making the filing decision. It is upon this limited factual record that we must decide the instant case.

In so deciding, we specifically note appellants' failure to respond to at least two specific requests by respondent for information that may have helped this Board arrive at a decision in this case.¹² In particular, appellants should have submitted their personal income tax returns for 1990, the final partnership tax return and the K-1 form. In the absence of these documents, appellants must, at a

¹¹We view appellants' use of the term "immediately" to describe their efforts with skepticism in light of the roughly five month lapse which occurred between learning about the subject income on July 27, 1992, and filing the proper return on January 4, 1993. Although appellants suggest that it took that much time to gather the information necessary to file the subject return, this Board is not privy to the nature of the information which allegedly caused this delay, or of what efforts appellants made to obtain that information.

¹²On June 17, 1996, as part of a review process associated with this appeal, respondent specifically asked appellants to provide, "any documentation provided [by the partnership] to appellants prior or subsequent to April 15, 1991, concerning the property owned by the partnership during tax year 1990." In respondent's opening brief, submitted to the Board on October 9, 1996, respondent noted that "appellants have failed to provide respondent with a copy of the documentation provided to them by the partnership prior (or subsequent) to the due date of the 1990 return concerning the property owned and/or sold by the partnership during tax year 1990."

minimum, have provided an explanation as to why such evidence was otherwise not available. Other than appellants' representative's unsworn assertions to the effect that they had no knowledge of the California source income, appellants have not submitted any evidence to support a conclusion that their failure to file a timely return resulted from reasonable cause and not willful neglect. Such unsubstantiated allegations are not sufficient to meet the burden of proof on appeal. (Appeal of Aaron and Eloise Magidow, Cal. St. Bd. of Equal., Nov. 17, 1982; Appeal of Bernard J. and Elia C. Smith, Cal. St. Bd. of Equal., Jan. 9, 1979.) Under these circumstances, we cannot allow the absence of information, nor the absence of cooperation with respondent, to benefit the taxpayer.

Like most governmental entities, California relies on individuals to self-assess and pay their proper taxes. This method of collection imposes certain burdens on taxpayers, including both the obligation to stay apprised of one's investments and the corresponding tax consequences, and the obligation to cooperate with respondent in an effort to arrive at the proper tax.¹³ It is the unreasonable failure to fulfill these obligations that results in the imposition of penalties under the California Revenue and Taxation Code.

Our decision to sustain respondent's position is bolstered by the relative clarity of the law in this area, as well as the fact that appellants originally made a conscious business decision to invest in a partnership and take advantage of the related tax advantages of that investment mechanism. That decision carries with it certain responsibilities and obligations, not the least of which is the timely payment of any and all taxes arising from that investment vehicle. It would be unreasonable to conclude that appellants could avail themselves of the beneficial economic climate in this state, and yet claim ignorance of the circumstances of their own investment as an excuse from a related penalty. In short, we will not allow appellants' own investment decision to shield them from a penalty which would be properly imposed against a taxpayer with a more direct interest in the income generating property. Any other conclusion offends common sense and would allow taxpayers to absolve themselves of responsibility for their own business decisions.

For all of these reasons, we find that appellants have not met their burden of proof to establish reasonable cause sufficient to abate the late filing penalty. Accordingly, we sustain respondent's prior determination in this matter.

¹³Our society has rejected the alternative method brought to mind by the unpleasant image of the hooded tax collector from medieval times.

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 claim of Eugene and Lily Heller for refund of personal income tax in the amount of \$6,075 for the year 1990 be and the same is hereby sustained.

Done at Sacramento, California, this 20th day of November, 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

John Chiang**, Member

*For Kathleen Connell, per Government Code section 7.9.

**Acting Member, 4th District.