OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **D. SMITH AND** **T. SMITH**	) OTA Case No. 21068043)))))

OPINION

Representing the Parties:

For Appellants: Jacob Hade, Tax Appeals Assistance Program (TAAP)[1]

For Respondent: Gi Jung Nam, Tax Counsel

E. LAM, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, D. Smith and T. Smith (appellants) appeal an action by respondent Franchise Tax Board (FTB) denying appellants' claim for refund of $3,891[2] for the 2019 tax year.

Appellants waived the right to an oral hearing; therefore, the matter is being decided based on the written record.

ISSUE

Whether appellants have established reasonable cause to abate the late-filing penalty for the 2019 tax year.

FACTUAL FINDINGS

1. In the 2019 tax year, appellant D. Smith owned a minority (0.2 percent) interest in Up the Street Partners, LP (UTS).[3]

[1] Appellants filed their appeal letter. Thereafter, David van den Berg of TAAP filed appellants' Reply Brief, and Jacob Hade of TAAP filed appellants' Additional Reply Brief.

[2] This entire amount consists of a late-filing penalty.

[3] In appellants' opening brief dated June 16, 2021, appellants refer to the partnership's name as Up the Street Partners LLC. However, on appellants' reply brief dated October 13, 2021, appellants refer to the partnership's name as Up the Street Partners LP.

2. Appellants attempted to obtain a 2019 Schedule K-1 from UTS so that appellants would have the information necessary to file their 2019 California Resident Income Tax Return.
3. On September 15, 2020, appellant D. Smith sent an email to UTS's manager H. Fernandini (UTS Manager) requesting information for the 2020 "arrears August and September payments" as well as the status of UTS's 2019 tax year filings. Appellants assert that UTS Manager did not respond.
4. On September 18, 2020, appellant D. Smith sent a text message to UTS Manager, requesting UTS Manager to respond to appellant D. Smith's emails. Appellants state that UTS Manager did not respond.
5. On September 30, 2020, appellant D. Smith sent another follow up text message to UTS Manager stating that appellant D. Smith was "in need of some feedback here" and requested that UTS Manager call or text appellant D. Smith the answers. UTS Manager responded, indicating that he would call appellant D. Smith back shortly. Appellants state that they still did not receive a finalized 2019 Schedule K-1 from UTS at the time.
6. On November 9, 2020, appellant D. Smith sent an email to UTS Manager requesting a telephone conference regarding the status of the 2020 "October and November distributions" and "where we are on tax filings" for the 2019 tax year. Appellant D. Smith stated that "[i]t [w]ould be welcome to get on a monthly rhythm for distributions like we had in the past. It's incredibly frustrating to have to message you several times every month to get any news or have the distribution paid." Appellant D. Smith further stated that "I have no inkling of how the properties are doing other than the income I see in appfolio which doesn't take into account the Airbnb stuff."
7. On November 10, 2020, appellant D. Smith sent an email to B. Slavinski, who appears to work for a third-party accounting firm. In the November 10, 2020 email, appellant D. Smith asked, "[I]s 2019 already filed? If so, can you forward me the final. If not lets [sic] speak." Appellants received the finalized 2019 Schedule K-1 on November 10, 2020, after this email was sent.
8. On November 19, 2020, appellants filed their 2019 California Resident Income Tax Return.
9. On December 11, 2020, FTB imposed a late-filing penalty in the amount of $3,891.

10. On December 19, 2020, appellants remitted payment in full and requested abatement of the late-filing penalty.
11. On March 24, 2021, FTB denied appellants' request for abatement of the late-filing penalty.
12. This timely appeal followed.

DISCUSSION

California imposes a penalty for the failure to file a return on or before the due date, unless it is shown that the failure is due to reasonable cause and not due to willful neglect. (R&TC, § 19131.) When FTB imposes a penalty, the law presumes that the penalty was imposed correctly. (*Appeal of Xie*, 2018-OTA-076P (*Xie*).) To overcome the presumption of correctness attached to the penalty, a taxpayer must provide credible and competent evidence supporting a claim of reasonable cause; otherwise, the penalty cannot be abated. (*Ibid*.)

To establish reasonable cause, a taxpayer must show that the failure to file a timely return occurred despite the exercise of ordinary business care and prudence, or that cause existed as would prompt an ordinarily intelligent and prudent businessperson to have so acted under similar circumstances. (*Appeal of GEF Operating, Inc*., 2020-OTA-057P.) A taxpayer has the burden of establishing reasonable cause. (*Xie*, *supra*.) The applicable standard of proof is by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(c).) To meet this evidentiary standard, a party must establish by documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (*Appeal of Belcher*, 2021-OTA-284P citing *Concrete Pipe & Prod. of Cal., Inc. v. Constr. Laborers Pension Tr. for S. Cal.* (1993) 508 U.S. 602, 622.)

There is no dispute that appellants filed their 2019 California Resident Income Tax Return late, and there is no dispute as to the calculation of the applicable late-filing penalty. The only issue on appeal is whether appellants have established reasonable cause for the late filing of their return.

Appellants argue that their case is akin to the facts in the *Appeal of Moren*, where Office of Tax Appeals (OTA) found in favor of the taxpayer in a late-payment penalty case.[4] (*Appeal of Moren*, 2019-OTA-176P (*Moren*).) To demonstrate reasonable cause, appellants assert that like *Moren*, they were unable to timely file their tax return because they did not receive their finalized 2019 Schedule K-1 until after the filing deadline.[5]

It is well established that taxpayers have an obligation to file timely returns with the best available information, and then to subsequently file an amended return, if necessary. (*Xie*, *supra*.) Appellants appear to argue that OTA would reach a different result in this matter if it applied *Moren*, rather than *Xie*; however, OTA finds this argument unconvincing. An important distinction in *Moren* is that it involves the late-payment penalty, while this appeal involves the late-filing penalty. It is acknowledged that the filing of a return and remittance of payment, have "different real-world effects." (*Moren*, *supra*, at fn. 12.) It is important to keep the differences in mind when applying the law pertaining to one penalty to that of the other because each case is unique and must be examined on its particular facts and circumstances.[6] With respect to the late-payment penalty cases, OTA has held that reasonably estimating a tax liability requires that a minimum level of information is available to the taxpayer. (*Moren, supra*.) While in late-filing

[4] In *Moren*, appellant received an email and attachment concerning the 2015 estate distributions on April 14, 2016, one day before the tax payment was due. In that email, the estate's accountant was unable to indicate to appellant which amounts received were classified as taxable distributions versus non-taxable inheritance. The determination of the taxable amount of the distributions was completely in control of the third-party estate's accountant. As a result, appellant *Moren* was unable to estimate his tax payments without receiving further information from the estate's accountant. In *Moren*, appellant presented evidence showing prudent efforts were made to acquire that information from the estate, but these efforts were met by continuous silence by the estate's accountant. It was not until appellant *Moren* received his finalized Schedule K-1 in late August 2016 that the estate accountant provided the taxable amount of the distributions. As a result, OTA found that appellant *Moren* did not have the information necessary to make a reasonable estimate of his tax liability and demonstrated that he had exercised ordinary business care and prudence in making efforts to acquire such information.

[5] Appellants point to appellant D. Smith's email to UTS Manager on September 15, 2020; follow up text messages sent on September 18 and September 30, 2020; and subsequent emails to UTS Manager and a third-party accountant on November 9 and November 10, 2020, respectively. Appellants contend that their repeated efforts to obtain the finalized Schedule K-1 was met with continuous silence and that the finalized 2019 Schedule K-1 was finally received following the last email on November 10, 2020. Appellants assert that they quickly filed their California return thereafter on November 19, 2020

[6] The concept of filing and paying timely based on reasonable estimates, if possible, with the information available, and making necessary adjustments at a later date when additional information is obtained, applies to both the filing of returns and payment of taxes. (*Moren*, *supra*, at fn. 12, citing *Appeal of Sleight* (83-SBE-244) 1983 WL 15615.) As such, *Moren* does not necessary conflict with the concept in *Xie* where it held that a taxpayer has an obligation to file timely returns with the best available information, and then to subsequently file an amended return, if necessary. However, the acts of remitting payment timely versus filing a return timely have "different real-world effects" that require an inquiry into the particular facts and circumstances of each case. (*Moren*, *supra.*)

penalty cases, "the law dictates that the appropriate path is to file a timely return and amend it later, if needed" because "to hold otherwise would be to make the [late-filing penalty] optional for any taxpayer" who claims to be writing for tax information. (*Xie*, *supra*.)

In this case, appellants argue that they were powerless to force UTS to timely provide the finalized 2019 Schedule K-1 because appellant D. Smith only owned a fractional (0.2 percent) interest in UTS. However, it is well established that difficulty in obtaining information does not constitute reasonable cause for the late filing of a return. (*Xie*, *supra*.) Also, appellants did not provide any evidence to show that they tried to obtain any alternative information (other than the 2019 tax filings or finalized 2019 Schedule K-1s) that would have permitted appellants to estimate their income from UTS for the purposes of timely filing their return. Moreover, the onus was on appellants to timely file their 2019 tax return using the best information available; appellants could then file an amended return, if necessary, once they received the finalized Schedule K-1. (*Xie, supra*.)

Furthermore, unlike the taxpayer in *Moren*, appellants did not provide evidence to establish that they lacked the minimum level of information necessary to make a reasonable estimate of their taxable income from UTS. As noted in the November 9, 2020 email, appellants had access to income information from a management system called "appfolio." While this information may not have been complete, appellants have not shown that they could not have estimated at least a portion of their 2019 income based on the information available to them in "appfolio" (or any other means) and the remainder of their UTS income from other current or historical information.[7]

It also appears from the November 9, 2020 email that UTS previously had a "monthly rhythm for distributions in the past" and that appellants knew the total amount of distributions appellant D. Smith received in 2019 tax year. However, appellants have not explained why they could not have used any of this information to estimate appellant D. Smith's distributive share of UTS income for the 2019 tax year.[8] Moreover, aside from evidence showing that appellants

[7] It is noted from the November 9, 2020 email that "appfolio" does not "take into account of the [income from] Airbnb . . . ." However, appellants did not provide any reason or evidence that the income from Airbnb cannot be reasonably estimated from either historic or current information.

[8] The regular monthly payments or distributions by UTS to its partners suggests that the distributions may have been based on UTS's performance or income each month and that UTS was either required to or had a pattern or practice of distributing its net income to its partners each year.

were unable to obtain the finalized 2019 Schedule K-1 prior to the filing deadline, appellants have not established that they tried and were unable to obtain any other alternative information (i.e., an estimated 2019 Schedule K-1, income statements, other financial information, etc.) from UTS between September 30, 2020 (the date of the last text message sent by appellant D. Smith), and October 15, 2020 (the extended filing deadline), which would have allowed appellants to reasonably estimate their taxable income for a timely filing.[9] Moreover, appellants did not show that they could not have estimated their partnership income based on the best information available to them.

Appellants argue against a rule that would require taxpayers to file a tax return first with the best available information and amend later, if necessary, to establish reasonable cause. However, OTA does not find any of appellants' arguments convincing.

Appellants first argue that while filing first and amending later is the most cautious approach, it "does not mean that it is the only reasonable and prudent option" citing to *Moren*, *supra*. Appellants also contend that requiring them to file first and amend later would result in a *per se* rule, which would swallow the reasonable cause statute where taxpayers could never have their late-filing penalty abated. This is not true. There are many instances where taxpayers have demonstrated reasonable cause in a late-filing penalty case without filing first and amending later.[10] Additionally, based on the facts and circumstances in this appeal, appellants have not

[9] It is also noted that on November 10, 2020, appellants requested information from B. Slavinski (a third-party accountant) and subsequently received the finalized Schedule K-1 on that same date. This suggest the 2019 Schedule K-1 may have been completed prior to appellants' request on November 10, 2020, or that appellants could have potentially obtained it earlier. Nonetheless, appellants did not establish with documentation or other evidence that other, alternative information unavailable to them or that they were met by continuous silence leading up to the October 15, 2020 extended filing deadline. Appellants did not provide any evidence of what was discussed during the telephone conference with UTS Manager on or around September 30, 2020, or that any additional attempts were made to acquire the tax information from UTS between September 30, 2020, and the October 15, 2020 extended filing deadline.

[10] See, e.g., *Appeal of Richard Reed*, (Nov. 5, 2019) 2019 WL 9656377 [in a non-precedential summary decision, OTA found reasonable cause where a California nonresident received California sourced income for the first time, but such information was unavailable to him until he received his California Schedule K-1 despite his best efforts to obtain the information before the filing deadline]; *Hayes v. C.I.R.* (1967) 26 T.C.M. 393 [a series of hardships, including physical incapacity of the taxpayers and the inability to obtain any of the necessary records, was found to be reasonable cause.]; *Barker v. C.I.R.* (1963) 22 T.C.M. 634 [reasonable cause found where petitioner wife was misled by her husband into thinking that a joint return had been filed on behalf of both of them.]

established that it was reasonable for them to wait for a finalized 2019 Schedule K-1 before filing their return.[11] Therefore, appellants' first argument is unavailing.

Appellants' second argument is that they should not be required to file first and amend later because this "sounds more like a standard that should be applied to someone who is a lawyer or tax preparer -- not an ordinary business person." Appellants pointed out that a search on the IRS website would reasonably lead appellants to believe that the inability to "obtain records" is a "sound reason" for reasonable cause.[12] Appellants further contend that when one searches FTB's website for "reasonable cause," nowhere does the result mention *Xie*, or provide specific guidance for the taxpayer on what constitutes reasonable cause. However, a taxpayer's ignorance of the law is not reasonable cause for a failure to company with statutory requirements. (*Appeal of Porreca*, 2018-OTA-095P.) Additionally, in this matter, appellants in fact engaged a CPA to prepare their tax return. Appellants have not shown that they researched the above referenced websites when deciding to wait for the finalized 2019 Schedule K-1 before filing their return or that they consulted with their CPA regarding the approaching filing deadline and their difficulty in obtaining the finalized 2019 Schedule K-1 from UTS. In sum, OTA would expect a reasonably prudent businessperson to make every effort to timely file their return, even if they were required to file an amended return when additional information became available.

Appellants' third assertion is that filing first and amending later would go against the acknowledgment that the information on the tax return is true to the best of the taxpayer's knowledge upon signing and that there are penalties for falsifying such information. OTA does not find this argument convincing. As noted above, a similar argument was rejected in *Xie* because "to hold otherwise would to be to make the [late-filing penalty] optional for any taxpayer who claims to have delayed failing based on attorney advice that the return must be true, correct and complete." Appellants have not shown that they could not have reasonably estimated their taxable income from UTS in order to timely file their tax return.

Appellants' last argument is that their good filing and payment history supports that they acted as ordinarily intelligent and prudent businesspersons. Appellants concede that their history of compliance does not by itself establish reasonable cause, but rather argue that it bolsters

[11] As previously discussed, appellants have not explained that they could not have estimated the 2019 income by any other means.

[12] See Small Business and Self Employed: *Penalty Relief Due to Reasonable Cause* available at https://www.irs.gov/businesses/small-businesses-self-employed/penalty-relief-due-to-reasonable-cause.

appellants' claim that their late filing was not due to willful neglect. While OTA commends appellants for having a good filing history, appellants have not established reasonable cause based on the evidence provided; therefore, OTA does not find appellants' good filing and payment history establishes that appellants acted as ordinarily intelligent and prudent businesspersons with respect to their 2019 tax filing.

HOLDING

Appellants have not established reasonable cause to abate the late-filing penalty for the 2019 tax year.

DISPOSITION

FTB's action in denying appellants' claim for refund is sustained.

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Eddy Y.H. Lam
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Eddy Y.H. Lam
Administrative Law Judge

We concur:

DocuSigned by:
Natasha Ralston
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Natasha Ralston
Administrative Law Judge

DocuSigned by:
Daniel Cho
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Daniel K. Cho
Administrative Law Judge

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