

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:

S. MCLEOD AND
K. MCLEOD

) OTA Case No. 21078228
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OPINION

Representing the Parties:

For Appellants:

Gary L. Howard, CPA
Samantha Kittle, CPA
Stephen Sims, EA

For Respondent:

Joel M. Smith, Tax Counsel III
Eric A. Yadao, Tax Counsel IV

K. GAST, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, S. McLeod and K. McLeod (appellants) appeal an action by respondent Franchise Tax Board (FTB) denying appellants’ claim for refund of \$18,233.88, plus applicable interest, for the 2019 tax year.

Office of Tax Appeals (OTA) Administrative Law Judges Kenneth Gast, Asaf Kletter, and Ovsep Akopchikyan held an oral hearing for this matter in Cerritos, California, on September 15, 2022. At the conclusion of the hearing, the record was closed and this matter was submitted for a decision.

ISSUE

Whether appellants have established reasonable cause to abate the late-payment penalty.

FACTUAL FINDINGS

1. Appellants timely filed their 2019 joint California income tax return by the extended due date of October 15, 2020. On that return, they reported total tax of \$352,949, consisting of regular tax (after credits) of \$18,629, and alternative minimum tax (AMT) of \$334,320.

2. Appellants timely paid only \$21,424 of the \$352,949 in total tax.¹ They thus untimely paid the remaining tax of \$331,525 on August 14, 2020,² approximately one month after the July 15, 2020 payment due date for the 2019 tax year.³
3. After appellants filed their 2019 tax return, FTB issued a Notice of Tax Return Change – Revised Balance, informing appellants that it imposed, among other items, a late-payment penalty for the 2019 tax year.
4. Appellants paid the late-payment penalty and filed a claim for refund, seeking abatement of the penalty based on reasonable cause grounds. FTB denied the claim, and this timely appeal followed.

DISCUSSION

R&TC section 19132 imposes a late-payment penalty when a taxpayer fails to pay the amount shown as due on the return by the date prescribed for the payment of the tax. Generally, the date prescribed for the payment of the tax is the due date of the return (without regard to extensions of time for filing). (R&TC, § 19001.) Here, there is no dispute FTB properly imposed and computed the penalty. Rather, the only issue is whether there is reasonable cause to abate it.

The late-payment penalty may be abated if the taxpayer shows that the failure to make a timely payment of tax was due to reasonable cause and was not due to willful neglect.⁴ (R&TC, § 19132(a)(1).) The determination of whether reasonable cause exists for the late payment requires an analysis of the taxpayer's actions leading up to the late payment, the timing of those actions, and whether they reflect ordinary business care and prudence, such as those that an ordinarily intelligent and prudent businessperson would have performed under similar circumstances. (*Appeal of Moren*, 2019-OTA-176P.) The taxpayer bears the burden of proving an ordinarily intelligent and prudent businessperson would have acted similarly under the

¹ The \$21,424 was an overpayment transferred from appellants' 2018 tax year.

² Appellants made a payment of \$332,932 on August 14, 2020.

³ Due to COVID-19, FTB postponed the deadline for timely 2019 tax return payments from April 15, 2020, to July 15, 2020. (See *State Postpones Tax Deadlines Until July 15 Due to the COVID-19 Pandemic*, March 18, 2020, available at: <https://www.ftb.ca.gov/about-ftb/newsroom/news-releases/2020-3-state-postpones-tax-deadlines-until-july-15-due-to-the-covid-19-pandemic.html>.)

⁴ FTB does not assert willful neglect is present.

circumstances. (*Ibid.*)

Appellants contend the following relevant facts occurred. In 2019, they received many Schedule K-1s from pass-through entities they owned.⁵ They held a 6 percent interest in one such entity called KCB Diversified Real Estate LP (KCB), a limited partnership. On July 13, 2020, just two days before the July 15, 2020 payment due date for the 2019 tax year, the CPA for KCB sent appellants a 2019 Schedule K-1 (KCB K-1). The KCB K-1, which was the last one needed to determine the correct amount of 2019 California individual income taxes appellants owed, reported a substantial gain of over \$3 million from transactions that occurred in the last quarter of 2019 (specifically, October and December).⁶

Also, on or about July 13, 2020, appellants sent their KCB K-1 to their CPA who prepared their 2019 joint California individual income tax return. At that time, their CPA estimated appellants' 2019 California tax liability and advised that because they made sufficient payments for that tax year, they did not need to make a 2019 extension payment by the due date of July 15, 2020.⁷ However, about a month later, on August 11, 2020, appellants' CPA informed them, for the first time, they owed California AMT and advised they make an additional 2019 tax year payment, which they did a few days later, on August 14, 2020.

Appellants assert their late payment on August 14, 2020, which was about a month after the payment due date of July 15, 2020, was due to reasonable cause. They appear to primarily contend they relied on their CPA, who had no way of estimating their correct tax by the payment due date because: their CPA was not the same CPA who prepared KCB's tax returns, including the KCB K-1, and both CPAs had no affiliation or contact with each other; their CPA had no knowledge of, or access to, the details of the transactions generating the large gain reported on the KCB K-1; and since their prior year 2018 KCB K-1 reported KCB generated no income or expenses, and KCB had only been in existence for two tax years (i.e., 2018 and 2019), they presumably believed no (or nominal) income was similarly expected for 2019.

As support, appellants submit a statement under penalty of perjury from Gary L. Howard, their CPA and representative in this appeal, in which he states appellants "relied on [his] advice

⁵ A Schedule K-1 is issued by a pass-through entity, such as a partnership, to an owner, such as a partner, that reports the owner's share of the entity's income, deductions, and credits.

⁶ The details of these alleged transactions, including the KCB K-1, are not in the record.

⁷ The record is unclear whether the CPA's estimate took into account the KCB K-1.

regarding the relative details relating to the preparation of their 2019 California personal income tax return and the payment of taxes due.” He “further state[s] that the information that led to the late payment of the taxes due were [sic] the result of [his] not having timely information from the CPA (of which [he had] no affiliation) who prepared [KCB’s] return that would have allowed [him] to better determine [appellants’] state income payment that was due.” Therefore, appellants argue they made a good faith effort to determine the proper amount of their 2019 California taxes by the payment due date.

However, asserted lack of documentation or difficulty in calculating a tax liability does not, by itself, constitute reasonable cause for a late payment of tax. (*Appeal of Moren, supra.*) Rather, if a taxpayer asserts he or she does not have the information necessary to make an accurate estimate of their tax liability, the taxpayer must show the efforts made to acquire that information from the source that held it (here, KCB’s CPA). (*Ibid.*) Appellants have not made such a showing. Although appellants received their KCB K-1 just two days before the payment due date, they have not shown what efforts they made, if any, before the payment due date to acquire relevant information from KCB’s CPA about their 2019 tax obligations.⁸ Even if, as appellants assert, their CPA was not affiliated with the CPA who prepared KCB’s returns and their CPA had no knowledge of the transactions apparently leading to the underpayment at issue, that does not mean appellants (or their CPA) were prevented from simply inquiring about KCB’s 2019 tax situation (i.e., whether it had taxable income or a loss, or whether there was anything unusual about 2019 compared to 2018).⁹ (See *Frias v. Commissioner*, T.C. Memo. 2017-139 [the most important factor in determining reasonable cause and good faith is the extent of a taxpayer’s effort to assess his or her proper tax liability].)

Under these facts, ordinary business care and prudence required appellants to make an effort to determine their tax liability with reasonable accuracy prior to the payment due date.

⁸ At the hearing, Mr. Howard testified that appellants made attempts to retrieve the KCB K-1 prior to the payment due date but it had not yet been prepared. However, the record does not contain any documentary evidence to support this, such as a contemporaneous email from appellants or their CPA to the CPA who prepared the KCB K-1 asking for 2019 tax year information or an affidavit or declaration from appellants or their CPA attesting to this fact. The record also lacks any detail concerning, for example, when these alleged attempts occurred, their context and frequency, and what was communicated.

⁹ It is unclear whether the alleged transactions in October and December 2019 caused the underpayment at issue, whether appellants knew about those transactions prior to the payment due date, and if so, whether they disclosed this information to their CPA.

This includes asking KCB's CPA whether they should expect income from KCB, even if the KCB K-1 had not yet been prepared and KCB reported no income in 2018.¹⁰ (Cf. *Appeal of Moren, supra* [reasonable cause found for late-payment penalty where appellant made efforts to acquire the information necessary to determine the tax liability, despite the nonresponsive nature of the third-party's accountant that withheld the necessary information].) Ultimately, appellants' assertion that records were difficult to obtain because they were prepared by another CPA is insufficient to show reasonable cause in this case, as there is no substantiation of efforts made to retrieve those records and no showing that they were unobtainable. (*Ibid.*)

To the extent appellants argue they relied on their CPA's advice, it is well settled that a taxpayer's failure to make a timely payment or file a return is not excused by the taxpayer's reliance on a tax preparer because a taxpayer has a personal, non-delegable obligation to meet statutory deadlines. (See *U.S. v. Boyle* (1985) 469 U.S. 241 (*Boyle*); see also *Appeal of Rougeau*, 2021-OTA-335P [applying *Boyle*, a case involving a late-filing penalty, to the late-payment penalty].) Reasonable cause may exist, however, if a taxpayer reasonably relies on a tax professional for substantive tax advice as to whether a tax liability exists and the following conditions are met: (1) the person relied on by the taxpayer is a tax professional with competency in the subject tax law; and (2) the tax professional's advice is based on the taxpayer's full disclosure of the relevant facts and documents. (*Appeal of Summit Hosting LLC*, 2021-OTA-216P, citing *Boyle*.)

But, here, there is no evidence appellants' CPA provided *substantive* tax advice, such as advice on a debatable tax position related to calculating the AMT. Rather, it appears appellants' receipt (and their immediate forwarding to their CPA) of the KCB K-1 just two days before the payment due date was not enough time, for reasons unrelated to interpreting the tax code, to enable their CPA to compute an accurate estimate of California personal income tax. (See *Boyle, supra* [reliance on an expert cannot function as a substitute for compliance with an unambiguous statute]; see also *Appeal of Sleight* (83-SBE-244) 1983 WL 15615 [taxpayer's difficulty in determining income with exactitude does not constitute reasonable cause for a late payment of

¹⁰ For similar reasons, OTA finds as unconvincing appellants' contention they made a tax payment within 30 days of receiving the KCB K-1 from the CPA who prepared KCB's tax returns and they did so during delays caused by COVID-19. In addition, there is no explanation why a reasonably accurate estimate of tax could not have been made when appellants' CPA had access to the KCB K-1 two days prior to the payment due date.

tax].) Accordingly, the record appears to support “[a]ll that was left to be determined was the simple computation of tax due,” and not an issue of legal interpretation. (*Appeal of Berolzheimer* (86-SBE-172) 1986 WL 22860.)¹¹

HOLDING

Appellants have not established reasonable cause to abate the late-payment penalty.

DISPOSITION

FTB’s denial of appellants’ claim for refund is sustained.

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Kenneth Gast
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Kenneth Gast
Administrative Law Judge

We concur:

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Asaf Kletter
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Asaf Kletter
Administrative Law Judge

DocuSigned by:
Ovsep Akopchikyan
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Ovsep Akopchikyan
Administrative Law Judge

Date Issued: 10/18/2022

¹¹ Appellants also contend they have good tax compliance history. However, for the tax year at issue, there is no California legal authority that allows for an abatement of the penalty on that basis. (But see R&TC, § 19132.5 [for tax years beginning on or after January 1, 2022, an individual taxpayer shall receive, under certain conditions, a one-time abatement of the late-payment penalty under R&TC section 19132].)