

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:
SMARTERFRESH, LLC

) OTA Case No. 21067907
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OPINION

Representing the Parties:

For Appellant: Kevin Thill

For Respondent: Christopher M. Cook, Tax Counsel

J. LAMBERT, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, Smarterfresh, LLC (appellant) appeals an action by respondent Franchise Tax Board (FTB) proposing additional tax of \$800, a limited liability company (LLC) fee of \$900, a late filing penalty under R&TC section 19131 of \$225, a per-partner late filing penalty under R&TC section 19172 of \$432, a notice and demand (demand) penalty of \$425, a filing enforcement cost recovery fee (filing enforcement fee) of \$97, and applicable interest, for the 2018 tax year.

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

ISSUES¹

1. Whether the late filing penalties under R&TC sections 19131 and 19172 should be abated.
2. Whether the demand penalty should be abated.
3. Whether the filing enforcement fee should be abated.
4. Whether interest should be abated.

¹ Appellant concedes that it is liable for the annual tax of \$800 and LLC fee of \$900. Hence, this Opinion will not address these two issues further.

FACTUAL FINDINGS

1. Appellant is an LLC that is taxed as a partnership and was not organized or commercially domiciled in California in 2018.²
2. Appellant did not timely file a 2018 California LLC Return of Income (Form 568).
3. FTB received third-party information from the California Department of Tax and Fee Administration that appellant had gross income of \$267,545 derived from sales to California customers for the 2018 tax year.
4. Based on this information, FTB issued a Demand for Tax Return (Demand) to appellant on October 20, 2020, requesting that by November 25, 2020, appellant either file a 2018 return, provide evidence a return had already been filed, or explain why no return was required. Appellant failed to respond to the Demand by the deadline.
5. FTB issued a Notice of Proposed Assessment (NPA) proposing an annual LLC tax of \$800, an LLC fee of \$900, a late filing penalty of \$225, a demand penalty of \$425, a per-partner late filing penalty of \$432, a filing enforcement fee of \$97, and interest.
6. Appellant timely protested the NPA and FTB affirmed the NPA in a Notice of Action.
7. This timely appeal followed.

DISCUSSION

Issue 1: Whether the late filing penalties under R&TC sections 19131 and 19172 should be abated.

For the year at issue, R&TC section 18633.5(a) provides that every LLC that is classified as a partnership for California tax purposes that is doing business in California, organized in California, or registered with the California Secretary of State is required to file a return on or before the 15th day of the third month following the close of its taxable year. Alternatively, an LLC may file its return on or before the automatic extended due date, which is seven months after the original filing due date. (R&TC, § 18567(a)(1), (a)(2)(B).)

The R&TC contains two penalties that are applicable when an LLC classified as a partnership for tax purposes files its return late. First, R&TC section 19131 imposes a late

² FTB states that, in a phone conversation, appellant indicated that it may have filed its federal return as a corporation. However, appellant provides no evidence in support or to show that it elected to be taxed as a corporation and is not taxed as a partnership.

filing penalty when a taxpayer fails to file its return on or before its due date, unless it is shown that the failure was due to reasonable cause and not willful neglect. The amount of the late filing penalty imposed by R&TC section 19131 is equal to five percent of the tax due,³ after allowing for timely payments, for every month or fraction of a month the return is late, not to exceed 25 percent of the tax due.⁴ (R&TC, § 19131(a).)

A second penalty, imposed under R&TC section 19172, takes into account the fact that an LLC classified as a partnership is a pass-through entity. R&TC section 19172 imposes a per-partner, late filing penalty when a partnership—or an LLC classified as a partnership—fails to file a return at the time prescribed unless it is shown that the failure was due to reasonable cause. The amount of the per-partner, late filing penalty under R&TC section 19172 is computed by multiplying \$18 by the number of partners and by the number of months, or fraction thereof, that the return is late (not to exceed 12 months). (R&TC, § 19172(a)(2).) When FTB imposes a penalty, the law presumes that the penalty was imposed correctly. (*Appeal of Xie*, 2018-OTA-076P.) Appellant does not dispute the amount of the penalties imposed and only provides reasonable cause type arguments.

The burden of proof is on the taxpayer to provide credible and competent evidence supporting a claim of reasonable cause; otherwise, the penalty cannot be abated. (*Appeal of Xie, supra.*) For penalty abatement purposes, reasonable cause exists when the taxpayer acted as an ordinarily intelligent and prudent businessperson would have acted under similar circumstances. (*Appeal of Auburn Old Town Gallery, LLC*, 2019-OTA-319P.) In other words, a taxpayer must show that the failure to meet its tax filing obligation occurred despite the exercise of ordinary business care and prudence. (*Ibid.*) Unsupported assertions are insufficient to satisfy a taxpayer's burden of proof. (*Appeal of Talavera*, 2020-OTA-022P.)

The U.S. Supreme Court has held that “reasonable cause” is established when a taxpayer shows reasonable reliance on the advice of an accountant or attorney that it was unnecessary to file a return, even when such advice turned out to have been mistaken. (*U. S. v. Boyle* (1985) 469 U.S. 241, 250 (*Boyle*), *Appeal of Mauritzson*, 2021-OTA-198P.) California follows *Boyle* in

³ For penalty purposes, the LLC fee is “collected and refunded in the same manner as the taxes imposed [and is] subject to interest and applicable penalties.” (R&TC, § 17942(c).) Thus, the R&TC section 19131 penalty is applicable to the amount of any unpaid LLC fee.

⁴ FTB did not impose the R&TC section 19131 late filing penalty with respect to the \$800 late-paid annual LLC tax.

that a taxpayer's reliance on a tax adviser must involve reliance on substantive tax advice and not on simple clerical duties. (*Appeal of Mauritzson, supra.*) Reliance on a tax professional's advice for questions of substantive tax law, such as whether a liability exists, may constitute reasonable cause, where certain conditions are met, including where the tax professional has competency in the subject tax law and the tax professional's advice is based on the taxpayer's full disclosure of the relevant facts and documents. (*Boyle, supra* at 250, *Appeal of Summit Hosting*, 2021-OTA-216P.)

Here, appellant contends that starting October 2020, until the filing of the instant appeal, appellant's CPA was negligent in his communication with appellant and in his failure to prioritize the processing of this matter. Appellant asserts that its CPA stated he would be investigating the matter and provides email correspondence with the CPA from June and July of 2021. The emails show that the CPA told appellant it "should win the appeals and all penalties and interest will go away," that the CPA did not "have a final answer yet but from [the CPA's] discussions [FTB is] going to drop the case," and the CPA will "keep [appellant] posted...." Appellant argues that it relied on the advice of the CPA with respect to substantive tax law matters, which resulted in appellant missing the tax filing and payment deadlines causing penalties and interest to accrue.

Appellant has not shown reasonable cause for failing to timely file its return. Appellant argues that beginning in October 2020, it corresponded with its CPA as to its California return filing requirement for 2018 and the imposition of the tax, LLC fee, penalties, and interest. However, appellant does not allege, and the emails do not indicate, that the CPA provided advice to appellant that it did not have a California filing requirement at the time the return was due in 2019. The penalties had already fully accrued prior to the issuance of the Demand in October 2020, when appellant alleges that its representative's negligence began. The failure of the CPA to give advice also does not constitute reliance on advice given by the CPA.

Appellant provides no evidence of steps taken to timely file its return when it was due. If appellant was unaware of the filing requirement, ignorance of the law is not an excuse for failing to file a timely return. (*Appeal of GEF Operating, Inc.*, 2020-OTA-057P.) Although appellant now concedes that it did have a filing requirement in California for the 2018 tax year, appellant's mistaken belief at the time the return was due does not establish reasonable cause for the late filing of the return. As such, the late filing penalties should not be abated.

Issue 2: Whether the demand penalty should be abated.

R&TC section 19133 provides that if a taxpayer fails to make and file a return upon notice and demand by FTB, then FTB may impose a demand penalty unless the taxpayer's failure is due to reasonable cause. The requirements for imposing the demand penalty for the 2018 tax year were satisfied here; the issue is whether there is reasonable cause to abate the demand penalty. The burden of proving reasonable cause for failing to file upon demand is on the taxpayer. (*Appeal of GEF Operating, Inc., supra.*) To establish reasonable cause, a taxpayer must show that the failure to timely respond to a demand occurred despite the exercise of ordinary business care. (*Ibid.*) The taxpayer's reason for failing to respond to a demand must be such that an ordinarily intelligent and prudent businessperson would have acted similarly under the circumstances. (*Ibid.*)

Here, appellant contends that the demand penalty should be abated because its CPA was negligent and provided poor service from October 2020, onward. However, appellant provides no evidence of steps taken to timely respond to the Demand. Appellant does not explain or provide evidence to show why it did not respond to the Demand, or why its failure to respond was due to the CPA. Appellant provides evidence of correspondence with the CPA from 2021, but the Demand due date was November 25, 2020. Therefore, appellant has not provided any evidence to show the demand penalty should be abated.

Issue 3: Whether the filing enforcement fee should be abated.

R&TC section 19254(a)(2) provides that if a taxpayer fails or refuses to make and file a tax return within 25 days after FTB mails to that taxpayer a formal legal demand to file the tax return, FTB will impose a filing enforcement fee. Once properly imposed, there is no provision in the R&TC which would excuse FTB from imposing the filing enforcement fee under any circumstances, including reasonable cause. (*Appeal of Wright Capital Holdings LLC, 2019-OTA-219P.*)

Here, FTB informed appellant in its Demand that appellant would be subject to the filing enforcement fee if appellant did not file a 2018 return by the November 25, 2020 due date. Appellant did not file such a return. Therefore, FTB properly imposed the filing enforcement fee, and there is no basis to abate it.

Issue 4: Whether interest should be abated.

Imposing interest on a tax deficiency is mandatory. (R&TC, § 19101(a).) Interest is not a penalty but is compensation for the taxpayer's use of money after it should have been paid to the state, and it can only be abated in certain limited situations when authorized by law. (*Appeal of Moy*, 2019-OTA-057P.) There is no reasonable cause exception to the imposition of interest. (*Ibid.*) To obtain interest abatement or waiver, appellant must qualify under one of the following: R&TC sections 19104 or 21012.⁵ R&TC section 19104 does not apply here because appellant does not allege, and the evidence does not show, that the interest at issue is attributable, in whole or in part, to any unreasonable error or delay by an officer or employee of FTB when performing a ministerial or managerial act. R&TC section 21012 does not apply because FTB did not provide appellant with any requested written advice. Thus, appellant has not established any basis for interest abatement for the tax year at issue.

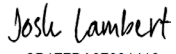
⁵ R&TC section 19112 generally provides that interest may be abated when an individual or fiduciary is unable to pay due to extreme hardship; however, appellant is not an individual or fiduciary and, therefore, R&TC section 19112 does not apply to it. In addition, OTA does not have jurisdiction to review FTB's denial of a request to waive interest under R&TC section 19112. (*Appeal of Moy, supra.*)

HOLDINGS

1. The late filing penalties under R&TC sections 19131 and 19172 should not be abated.
2. The demand penalty should not be abated.
3. The filing enforcement fee should not be abated.
4. Interest should not be abated.

DISPOSITION

FTB’s action is sustained.

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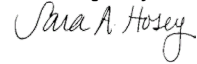
Josh Lambert
 Administrative Law Judge

We concur:

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Sara A. Hosey
 Administrative Law Judge

Date Issued: 12/21/2022