OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Consolidated Appeals of: **D. LOOBER**	)	OTA Case Nos. 18032371 & 21047555

OPINION

Representing the Parties:

For Appellant: Lydia B. Turanchik, Attorney

For Respondent: Natasha S. Page, Tax Counsel IV

For Office of Tax Appeals: David Kowalczyk, Tax Counsel

K. GAST, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, D. Loober (appellant) appeals actions by respondent Franchise Tax Board (FTB) proposing the following: tax of $16,686.00 and a late-filing penalty of $4,171.50, plus applicable interest, for the 2013 tax year; tax of $28,633.00 and a late-filing penalty of $7,158.25, plus applicable interest, for the 2014 tax year; and tax of $30,105.00 and a late-filing penalty of $7,526.25, plus applicable interest, for the 2015 tax year.

Appellant waived the right to an oral hearing; therefore, Office of Tax Appeals (OTA) decides the matter based on the written record.

ISSUES

1. Whether appellant has established error in FTB's proposed assessments.
2. Whether appellant has established reasonable cause to abate the late-filing penalties.
3. Whether appellant has established a basis to abate interest for the 2014 and 2015 tax years.

FACTUAL FINDINGS

1. During the tax years at issue, appellant was a California nonresident who resided in Washington.
2. Appellant was a licensed CPA who operated her CPA practice as a sole proprietorship. Her CPA practice did not have any property (real or tangible) or employees or agents in California. She did not advertise her CPA services in California. Appellant performed all her services (i.e., tax return preparation and business management services) in Washington.
3. FTB received information from third-party sources indicating appellant received Forms 1099 for the disputed tax years from clients (businesses and individuals) with California addresses that paid over $200,000 for 2013 and over $300,000 for each of 2014 and 2015. Because FTB believed appellant received sufficient income to trigger a California filing requirement, but she had not filed a return for the 2013, 2014, or 2015 tax year, in 2017, FTB issued to appellant a Request for Tax Return (Request) for each of those years. Each Request required that by a certain date, appellant either file a California tax return, provide a copy of a return if one had already been filed, or explain why a return was not required to be filed. Appellant responded she had no California tax filing obligation because her office prepared all Forms 1099 on behalf of her clients (which she issued to herself as the recipient of the income), she was a Washington resident, and she only performed her CPA services in Washington.
4. Also in 2017, FTB issued a Notice of Proposed Assessment (NPA) for the 2013, 2014, and 2015 tax years. Each NPA estimated appellant's California source income, based on Forms 1099 listing business and individual payors with California addresses, and proposed to assess tax and a late-filing penalty, plus applicable interest.[1]
5. Appellant protested each NPA,[2] but FTB affirmed its 2013 NPA with a Notice of Action (NOA) issued in 2017 and affirmed its 2014 and 2015 NPAs with NOAs both issued in March 2021. This timely appealed followed.

[1] Some of the Forms 1099 that FTB used to estimate appellant's California source income listed a Washington address for certain business payors. FTB provided evidence indicating these payors were incorporated in California based on information from the California Secretary of State.

[2] It appears appellant protested the 2014 NPA in October 2017, and the 2015 NPA in November 2017.

6. On appeal, appellant untimely filed 2013, 2014, and 2015 California nonresident tax returns.[3] FTB states these returns show tax of $8,783.00 for 2013, $8,264.00 for 2014, and $11,076.00 for 2015, and that it will accept these returns as filed.[4] FTB indicates that based on these principal tax amounts, it will reduce the late-filing penalties to $2,195.75 for 2013, $2,066.00 for 2014, and $2,769.00 for 2015. FTB also indicates it will abate interest from July 6, 2018, through November 20, 2019.[5]

DISCUSSION

Issue 1: Whether appellant has established error in FTB's proposed assessments.

An assessment based on unreported income is presumed correct when FTB introduces a minimal factual foundation to support the assessment. (*Appeal of Bindley*, 2019-OTA-179P (*Bindley*).) Once FTB has met its initial burden, the proposed assessment of tax is presumed correct and the taxpayer has the burden of proving it to be wrong. (*Ibid*.) Unsupported assertions are insufficient to satisfy a taxpayer's burden of proof. (*Ibid*.) In the absence of credible, competent, and relevant evidence showing error in FTB's determination, the determination must be upheld. (*Ibid*.)

Appellant does not contest that under applicable California statutory and regulatory authorities, as well as OTA's precedential Opinion in *Bindley*, she generated California source income. Specifically, appellant acknowledges or does not dispute that: as a nonresident, California can tax her income to the extent it is derived from sources within this state, and she is required to file a nonresident tax return if her gross income exceeds certain minimum thresholds (R&TC, §§ 17041(b) & (i)(1)(B), 17951(a), 18501); income from sources within and without California must be allocated and apportioned under rules and regulations prescribed by FTB (R&TC, § 17954); California Code of Regulations, title 18, (Regulation) section 17951-4(c)

[3] These returns are not in the record.

[4] Appellant originally argued that if she were found to have a California filing requirement, she was entitled to offset her California source income with business expenses related to her CPA practice. By accepting her filed 2013, 2014, and 2015 California tax returns, FTB has apparently allowed appellant to claim such expenses, and appellant concedes this issue is now moot.

[5] Since FTB issued an NOA for the 2013 tax year in 2017, and appellant requests interest abatement starting in 2018, it appears FTB's interest abatement concession relates only to the 2014 and 2015 tax years.

apportions a nonresident unitary sole proprietorship's business income, such as appellant's service income, under California's Uniform Division of Income for Tax Purposes Act (UDITPA), as codified in R&TC sections 25120 through 25141; and for tax years beginning on or after January 1, 2013, UDITPA requires most businesses to apportion their business income to California by multiplying that income by a single-sales factor, where the numerator is the taxpayer's total sales in California and the denominator is the taxpayer's total sales everywhere during the tax year (R&TC, §§ 25128.7, 25134).

Critically, appellant also acknowledges that beginning on or after January 1, 2013, the computation of the sales factor numerator for service receipts, such as here, was legislatively changed from sourcing such receipts to where the taxpayer performed the services to where the purchaser received the benefit of the services. (Compare R&TC, former § 25136 [income-producing activity/costs of performance] with R&TC, § 25136(a)(1) and Cal. Code Regs., tit. 18, § 25136-2(c) [market-based sourcing].) Essentially, this statutory amendment now requires nonresident unitary sole proprietorships, such as appellant, to file California nonresident tax returns if they derive service income from customers who receive the benefit of the nonresidents' services within California, even if such nonresidents do not have a physical presence in this state, whereas these same nonresidents did not have such a filing requirement before 2013 because their service income was sourced to the location where they performed their services. (*Bindley*, *supra* [nonresident unitary sole proprietorship properly taxed on service income derived from California payors under market-based sourcing rules, even though taxpayer had no physical presence in California].) Appellant thus does not dispute that her clients with a California payor address received the benefit of her services in this state under California's market-based sourcing provisions, and FTB correctly taxed her income on the statutory and regulatory grounds noted above, even though she had no physical presence in this state.

Rather, appellant asserts California's imposition of tax under circumstances here violates the due process and commerce clauses of the U.S. Constitution and is inconsistent with U.S. Supreme Court precedent. Since appellant did not perform any services in California, she contends her sole proprietorship did not have nexus in California and therefore she received no benefits or services from this state. However, OTA lacks jurisdiction to rule on the merits of this argument because it cannot decide whether a California statute (e.g., R&TC section 25136(a)(1)) is invalid or unenforceable under the U.S. or California Constitution, unless an appellate court

has already made such a determination. (Cal. Const., Art. III, § 3.5; Cal. Code Regs., tit. 18, § 30104(a); *Appeal of Acosta and Castro*, 2022-OTA-235P.) Appellant does not direct OTA to, nor is OTA aware of, any appellate court decision that has determined whether California can constitutionally impose an income tax on nonresident unitary sole proprietorships that lack a physical presence in this state but generate California source income. Accordingly, appellant has not established error in FTB's proposed assessments.[6]

Issue 2: Whether appellant has established reasonable cause to abate the late-filing penalties.

R&TC section 19131 imposes a penalty for the failure to file a return on or before the due date, unless it is shown that the late filing is due to reasonable cause and not due to willful neglect. Here, it is undisputed FTB properly imposed and computed the late-filing penalties. Because FTB does not assert willful neglect, the only issue is whether appellant has demonstrated reasonable cause for the late filing of her 2013, 2014, and 2015 tax returns.

To establish reasonable cause, the taxpayer must show that the failure to file timely tax returns 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 late-filing penalty imposed by FTB is presumed to be correct, and the burden of proof is on the taxpayer to establish that reasonable cause exists to support an abatement of the penalty. (*Appeal of Xie*, 2018-OTA-076P.)

Appellant argues she has established reasonable cause because she was a Washington resident and had no reason to be aware of the California law change to market-based sourcing in 2013. Indeed, appellant argues she did not know of the existence of the law change until 2017, when FTB sent her a Request for the 2013 tax year. However, it is well settled that ignorance of the law does not excuse the failure to file a timely return. (*Appeal of GEF Operating, Inc.*, *supra*.) Generally, the most important factor in determining whether reasonable cause exists is the extent of the taxpayer's effort to assess the taxpayer's proper tax liability. (See *Appeal of Moren*, 2019-OTA-176P [involving the late-payment penalty, which contains similar issues to the late-filing penalty].) By her own admission, appellant, a CPA, took no action to ascertain or

[6] Appellant does not assert Regulation section 17951-5(a)(3) applies here, and therefore OTA will not discuss this further.

understand California's market-based sourcing law change until she was contacted by FTB in 2017, even though she generated hundreds of thousands of dollars of income from California payors for each tax year at issue, as shown on Forms 1099 that she prepared.[7]

Appellant also asserts the Request for the 2013 tax year only provided an example of a nonresident receiving payments for services performed in California to illustrate when a filing requirement exists and never mentioned what to do when a nonresident derives service income from California sources without a physical presence in this state. However, taxpayers are required to follow the law, such as statutes, regulations, and judicial decisions, and not information publications published by a tax agency. (*Appeal of Dandridge*, 2019-OTA-458P.)

Appellant further asserts OTA's interpretation of the market-based sourcing rules was not clear as to whether she was required to file a tax return because *Appeal of Larsen*, 2018-OTA-073 (*Larsen*) (a nonprecedential Opinion) and *Bindley* (a precedential Opinion), reached different conclusions based on similar facts. However, *Larsen* was issued in 2018 and *Bindley* in 2019, well after appellant's 2013, 2014, and 2015 tax returns became due, and the relevant overarching inquiry for reasonable cause purposes here is whether appellant took any steps to determine whether she had a filing obligation when her returns became due, which she did not do. Accordingly, appellant has not established reasonable cause to abate the late-filing penalties.

Issue 3: Whether appellant has established a basis to abate interest for the 2014 and 2015 tax years.

Interest must be assessed from the date a tax payment is due through the date that it is paid. (R&TC, § 19101.) Imposition of interest is mandatory; it is not a penalty, but it is compensation for appellant's use of money after it should have been paid to the state. (*Appeal of Moy*, 2019-OTA-057P.) As relevant here, FTB may abate interest to the extent it is attributable in whole or in part to any unreasonable error or delay by an officer or employee of FTB (acting in his or her official capacity) in performing a ministerial or managerial act. (R&TC,

[7] Appellant cites the IRS's Internal Revenue Manual (IRM) to support her reasonable cause arguments for, among other things, the proposition that ignorance of the law may justify a finding of reasonable cause where there were recent changes in tax forms or law that a taxpayer could not reasonably be expected to know. However, the IRM is not binding authority before OTA. (*Appeal of Xie*, *supra*.) Although appellant cites federal case law and several Treasury Regulation sections, which may serve as the IRS's basis for statements in the IRM, OTA need not discuss the applicability of these authorities because, as a factual matter, she has not shown she took any steps to ascertain whether she had a filing obligation when her returns became due or even prior to FTB contacting her about such obligation.

§ 19104(a)(1).) The error or delay can be considered only if no significant aspect is attributable to the taxpayer, and only if the error or delay occurred after FTB contacted the taxpayer in writing about the underlying deficiency. (R&TC, § 19104(b)(1).)

OTA has jurisdiction to determine whether a failure by FTB to abate interest was an abuse of discretion and may order an abatement in such cases. (R&TC, § 19104(b)(2)(B).) To show an abuse of discretion, a taxpayer must establish that, in refusing to abate interest, FTB exercised its discretion arbitrarily, capriciously, or without sound basis in fact or law. (*Appeal of Gorin*, 2020-OTA-018P.) Interest abatement provisions are not intended to be routinely used to avoid the payment of interest, and thus abatement should be ordered only where failure to abate interest would be widely perceived as grossly unfair. (*Ibid*.)

Appellant asserts she is entitled to an abatement of interest for three periods after receiving FTB's 2014 and 2015 NPAs in 2017: January 2018, through November 2019; January 2020, through July 2020; and September 2020, through March 2021. For the first period, January 2018, through November 2019, FTB issued (1) a position letter to appellant in December 2017, (2) a letter to appellant informing her that FTB assigned her protests for the 2014 and 2015 tax years (apparently filed in October 2017, and November 2017, respectively) to FTB staff in March 2018, and (3) an initial contact letter (ICL) and an information document request (IDR) in November 2019. As noted above, FTB concedes there was a delay in issuing the ICL and IDR to appellant after assigning appellant's case, and FTB will abate interest from July 6, 2018, through November 20, 2019. However, appellant has not established FTB committed any other error or delay in performing a ministerial or managerial act during this period.

From January 2020, through July 2020, appellant concedes she received an extension to respond to FTB's IDR and provided her response on January 15, 2020. FTB asserts that six months was a reasonable amount of time for it to review appellant's IDR response (received in February 2020) and contact appellant in July 2020, to schedule a protest hearing because of its workload constraints. Appellant argues there was an unreasonable delay during this period for FTB to review her IDR response and contact her to schedule a protest hearing. However, the mere passage of time does not establish error or delay in performing a ministerial or managerial act and FTB's failure to work on a case due to other priorities is not a ministerial act. (See, e.g., *Ibrahim v. Commissioner*, T.C. Memo. 2011-215.)

Lastly, from September 2020, through March 2021, FTB asserts that six months was a reasonable amount of time due to workload constraints for it to conduct a protest hearing in September 2020, review appellant's protest, draft a determination letter that was sent in February 2021, and issue the NOAs for the 2014 and 2015 tax years in March 2021. Appellant argues that FTB should have issued the NOAs sooner because FTB already addressed appellant's same arguments from an earlier protest for the 2013 tax year. However, again, the mere passage of time does not establish error or delay in performing a ministerial or managerial act and FTB's failure to work on a case due to other priorities is not a ministerial act. (See, e.g., *Ibrahim v. Commissioner*, *supra*.)

HOLDINGS

1. Appellant has not established error in FTB's proposed assessments.
2. Appellant has not established reasonable cause to abate the late-filing penalties.
3. Appellant has not established a basis to abate interest for the 2014 and 2015 tax years.

DISPOSITION

Subject to its concessions, as noted above in factual findings number 6, to reduce the proposed assessments of tax and late-filing penalties for the 2013, 2014, and 2015 tax years, as well as to abate interest from July 6, 2018, through November 20, 2019, relating to the 2014 and 2015 tax years, FTB's actions are otherwise sustained in full.

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Kenneth Gast
Administrative Law Judge

We concur:

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Ovsep Akopchikyan
Administrative Law Judge

DocuSigned by:
Josh Aldrich
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Josh Aldrich
Administrative Law Judge

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