

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:)
ECS FEDERAL HOLDING CO.) OTA Case No. 20015737
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OPINION

Representing the Parties:

For Appellant: Mario J. DeLuca, CPA, JD, LLM

For Respondent: David Muradyan, Tax Counsel III

V. LONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, ECS Federal Holding Co. (appellant) appeals an action by respondent Franchise Tax Board (FTB) denying appellant’s claim for refund of \$6,619.00, plus applicable interest for the short taxable year ending April 3, 2018.

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

ISSUE

Whether appellant has demonstrated reasonable cause to abate the late filing penalties.

FACTUAL FINDINGS

1. Appellant is an S corporation with California operations and income during the short taxable year ending April 3, 2018. Appellant dissolved and closed its books on April 3, 2018, necessitating a short period return for the taxable year ending on the same date.¹

¹ A short period return will be required for any taxpayer that is in existence during only part of what would otherwise be its taxable year. (R&TC, § 24634(a)(2).)

2. Appellant engaged the services of a professional accounting firm to prepare and file its 2018 tax return. Appellant's short period return was filed on April 12, 2019.
3. FTB issued past due and collection notices to appellant assessing late filing penalties pursuant to R&TC sections 19131 and 19172.5 totaling \$6,619.00.²
4. Appellant paid the balance due and filed a claim for refund for the penalties and associated interest. FTB denied appellant's claim for refund and this timely appeal follows.

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.) California also imposes a per-shareholder late filing penalty on an S corporation 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. (R&TC, § 19172.5(a).) When FTB imposes a penalty, the law presumes that the penalty was imposed correctly, and the burden of proof is on the taxpayer to establish otherwise. (*Appeal of Xie*, 2018-OTA-076P; *Appeal of Quality Tax & Financial Services, Inc.* 2018-OTA-130P.) 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. (*Appeal of Xie, supra.*) 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 ordinary intelligent and prudent businessperson to have so acted under similar circumstances. (*Appeal of GEF Operating, Inc.*, 2020-OTA-057P.)

It is well established that each taxpayer has a personal, non-delegable obligation to ensure the timely filing of a tax return, and thus, reliance on an agent to perform this act does not constitute reasonable cause to abate a late filing penalty. (*U.S. v. Boyle* (1985) 469 U.S. 241, 251-252 (*Boyle*); *Appeal of Quality Tax & Financial Services, Inc., supra.*) In *Boyle*, the executor of an estate relied upon an attorney to timely file an estate tax return. However, due to a clerical error, the attorney did not timely file the return. The U.S. Supreme Court held that: The time has come for a rule with as "bright" a line as can be drawn consistent with

² A late filing penalty of \$6,295.00 was imposed pursuant to R&TC section 19131 and a per-shareholder late filing penalty of \$324.00 was imposed pursuant to R&TC section 19172.5. FTB also imposed an underpayment of estimated tax penalty (estimated tax penalty) of \$7.98; however, appellant does not present any argument or evidence with respect to the estimated tax penalty on appeal, and this penalty will not be addressed further in this Opinion.

the statute and implementing regulations. Deadlines are inherently arbitrary; fixed dates, however, are often essential to accomplish necessary results. The Government has millions of taxpayers to monitor, and our system of self-assessment in the initial calculation of a tax simply cannot work on any basis other than one of strict filing standards. Any less rigid standard would risk encouraging a lax attitude toward filing dates Congress has placed the burden of prompt filing on the executor, not on some agent or employee of the executor. The duty is fixed and clear; Congress intended to place upon the taxpayer an obligation to ascertain the statutory deadline and then to meet that deadline, except in a very narrow range of situations. (*Boyle, supra* at pp. 248-250.)

The fact that a tax preparer was expected to attend to a matter does not relieve a taxpayer of the duty to comply with the statute, and an agent's failure to file a tax return cannot constitute reasonable cause for the taxpayer. (*Id.* at p. 252; *Henry v. U.S.*, (N.D. Fla. 1999) 73 F.Supp.2d 1303; *McMahan v. Commissioner* (1997) 114 F.3d 366; *Denenburg v. U. S.*, (5th Cir. 1991) 920 F.2d 301; *Estate of Fleming v. Commissioner* (7th Cir. 1992) 974 F.2d 894.) Office of Tax Appeals (OTA) has consistently applied the above rule, set forth in *Boyle* and supported in subsequent caselaw, to income tax returns required to be filed with FTB. (See, e.g., *Appeal of Fisher*, 2022-OTA-337P; *Appeal of Quality Tax & Financial Services, Inc.*, *supra*; *Appeal of Auburn Old Town Gallery, LLC*, 2019-OTA-319P; *Appeal of Summit Hosting LLC*, 2021-OTA-216P.)

Appellant's short period return was due on or before July 15, 2018.³ Appellant asserts that it acted reasonably and in good faith by engaging and relying upon a return preparer to timely file its returns.⁴ As support, appellant asserts that the filing delay did not result in a delay in the assessment or collection of tax because an S corporation is a pass-through entity and appellant's shareholders timely filed individual returns reporting their respective shares of the flow-through income from appellant. However, timely filing of individual returns and the timely payment of tax by appellant's shareholders does not negate appellant's own filing obligation. Additionally, though S corporation shareholders must report their shares of S corporation items of income and loss on their individual returns, the R&TC also imposes an income tax at a rate of 1.5 percent on S corporation income at the entity level. (R&TC, § 23802.)

³ Here, that would be July 15, 2018. However, because July 15, 2018, was a Sunday, appellant's return would have been treated as timely if filed on or before Monday, July 16, 2018.

⁴ Appellant does not contest the imposition or calculation of the late filing penalty and only argues that the penalties should be abated based on reasonable cause.

While OTA is sympathetic to appellant's situation, longstanding precedent on this issue compels OTA to conclude that appellant has not established reasonable cause for the late filing of its California return. As explained above, the fact that appellant relied on a tax preparer to file its return does not relieve appellant of responsibility to ensure the return is timely filed. The late filing penalty will not be abated merely by showing that the taxpayer relied upon a return preparer who filed the return late; the issue is instead whether the taxpayer reasonably relied on the advice of the return preparer concerning a question of law, such as whether it is unnecessary to file a return. (*Boyle, supra* at p. 250-251; *McMahan v. Commissioner, supra*; *Estate of Fleming v. Commissioner, supra*.) No such question of law was present in this case.

The exercise of ordinary business care and prudence required appellant to do more than merely delegate the tasks necessary to timely file the return. (*Appeal of Fisher, supra*.) It also required appellant to verify the return had been successfully filed, and when it had not been, to take appropriate corrective action. (*Appeal of Quality Tax & Financial Services, Inc., supra*.) The record does not show appellant took such action, but instead chose to rely solely upon the return preparer.

For the reasons explained above, OTA finds that appellant has not shown that there is reasonable cause to abate the late filing penalties.

HOLDINGS

Appellant has not demonstrated reasonable cause to abate the late filing penalties.

DISPOSITION

FTB’s action denying the claim for refund is sustained.

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Veronica I. Long
Administrative Law Judge

We concur:

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Keith T. Long
Administrative Law Judge

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Cheryl L. Akin
Administrative Law Judge

Date Issued: 1/27/2023