

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:

K. FERMAGLICH AND
J. SANDERS

) OTA Case No. 220610661
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OPINION

Representing the Parties:

For Appellants: Hal J. Michels

For Respondent: Leoangelo C. Cristobal, Tax Counsel

T. STANLEY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, K. Fermaglich and J. Sanders (appellants) appeal an action by respondent Franchise Tax Board (FTB) denying appellants' claim for refund of \$10,096.25 for the 2019 taxable year.

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

ISSUE

Have appellants established reasonable cause to abate the late-filing penalty?

FACTUAL FINDINGS

1. Appellants reside in New Jersey. Prior to 2019, they reported no California source income.
2. In April 2019, appellant-husband became a partner (member) in United Talent Agency, LLC (UTA), which was registered to do business in the State of California in 2019.
3. Appellants learned on June 22, 2020, that 70 percent of appellant-husband's income from UTA would be taxable by California.

4. Appellant-husband received a schedule K-1 for the 2019 taxable year from UTA reporting California source income.¹
5. Appellants filed a 2019 California Nonresident or Part-Year Resident Income Tax Return on September 30, 2021. On California Form 5805 (Underpayment of Estimated Tax by Individuals and Fiduciaries) attached to the return, appellants calculated an underpayment of estimated tax penalty (estimated tax penalty) of \$2,820 and checked the box requesting a waiver of the penalty.
6. FTB issued to appellants a Notice of Tax Return Change that included a late-filing penalty of \$10,096.25. FTB did not assess an estimated tax penalty.
7. Appellants paid the late-filing penalty plus interest and filed a claim for refund of the penalty based on reasonable cause. FTB denied appellants' claim.
8. This timely appeal followed.

DISCUSSION

California imposes a penalty for failing to file a return on or before the due date, unless the taxpayer shows that the failure is due to reasonable cause and not due to willful neglect. (R&TC, § 19131.) The late-filing penalty is calculated at 5 percent of the tax due for each month, or fraction of each month, the return is late, with a maximum penalty of 25 percent of the tax due. (R&TC, § 19131(a).) When FTB imposes a penalty, it is presumed to have been imposed correctly. (*Appeal of Mauritzson*, 2021-OTA-198P.) A taxpayer may rebut this presumption by providing credible and competent evidence supporting abatement of the penalty for reasonable cause. (*Ibid.*)

To establish reasonable cause, the taxpayer must show that the failure to file a timely return occurred despite the exercise of ordinary business care and prudence, or that such cause existed as would prompt an ordinarily prudent businessperson to have so acted under similar circumstances. (*Appeal of Mauritzson, supra.*) 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*)). California follows

¹ FTB states that UTA filed its California tax return on September 15, 2020, and issued to appellants a schedule K-1 reporting their share of UTA's income, among other things. FTB submitted Exhibit K in support of the filing date. However, FTB redacted all information on Exhibit K, including the filing date. Appellants do not dispute that they received the schedule K-1 prior to the extended filing due date of October 15, 2020.

Boyle in 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.*)

Appellants contend that they did not receive any California source income prior to 2019. Appellants further assert that they did not learn that UTA income would be taxable by California until they were informed on June 22, 2020. Appellants also state that the COVID-19 pandemic “created significant delays of pertinent information needed for the preparation of [their] tax return.” Lastly, appellants argue that they have a good compliance history and acted in good faith by paying taxes on the UTA income to the State of New York and by making extension payments after they determined they would owe California tax.

FTB asserts that the penalty was properly imposed because appellants did not file their 2019 return until September 30, 2021. FTB contends that appellants have not established reasonable cause to abate the late-filing penalty because they had the information they needed to file their tax return prior to the filing due date.

There is no dispute that appellants filed a late return for 2019. Therefore, the penalty was properly imposed, and it is appellants’ burden to establish reasonable cause exists to abate the late-filing penalty. OTA agrees that appellants did not act with willful neglect. Thus, the only question is whether appellants acted as reasonably prudent businesspersons but were unable to file their 2019 California return on time.² The record on appeal reflects that appellants did not initially know they had California source income from UTA and paid taxes on the entire amount to the State of New York. However, appellants were admittedly informed of the fact that 70 percent of appellant-husband’s UTA income was taxable in California on June 22, 2020, which was nearly a month prior to the postponed original due date for appellants’ 2019 tax return of July 15, 2020.³ Appellants made an extension payment once they learned that they would owe California taxes but did not file their return. Appellants claim that they had difficulty, because of the COVID-19 pandemic, gathering the necessary documentation to prepare and file their return on time. However, appellants do not dispute FTB’s contention that they received a 2019

² FTB’s brief states that appellants claim they relied on their tax advisor in good faith. OTA’s record does not reflect that assertion on appeal. Even if appellants intended to assert reasonable reliance on a tax professional, OTA notes that pursuant to *Boyle, supra*, reliance on a tax adviser must involve reliance on substantive tax advice and not on simple clerical duties such as tax filing due dates.

³ In response to COVID-19, FTB postponed the due dates for returns, payments, and refund claims to July 15, 2020. (See <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>; FTB Notice 2020-02.)

schedule K-1 approximately one month before the postponed original filing deadline of July 15, 2020, and four months prior to the extended filing due date of October 15, 2020. The schedule K-1 shows the amounts of appellant-husband's share of the LLC's California source income and deductions. Appellants have not explained why they needed a full year after receiving their schedule K-1 to prepare and file their 2019 return. Reasonably prudent taxpayers would have recognized they had the information needed to file their return prior to the October 15, 2020 extended deadline. Thus, appellants have failed to establish reasonable cause to abate the late-filing penalty.

With respect to appellants' good faith in paying tax to the State of New York and making extension payments, OTA notes that the penalty at issue is not for late payment of tax but rather was imposed because appellants filed their return nearly one year after the extended filing deadline. Appellants also argue that this was the first time they were required to report and pay California taxes and that they have been compliant for all subsequent taxable years. Appellants' claim appears to be that their compliance warrants a first-time abatement of penalties. California did adopt a first-time abatement program for certain individual taxpayers for taxable years starting January 1, 2022. (R&TC, § 19132.5.) OTA has no authority to abate penalties assessed prior to that date, as here, on the basis of a taxpayer's good compliance history.


Appellants also assert that FTB relieved them of the estimated tax penalty for the same reasons appellants are claiming they had reasonable cause to file their return late. Appellants calculated but did not self-report an estimated tax penalty of \$2,820. Instead, appellants checked the box requesting a waiver of the penalty on Form 5805 which was attached to their return. OTA has no evidence in its record whether the waiver was automatic or reviewed by an employee of FTB. Appellants are correct that FTB did not impose the estimated tax penalty; however, it does not appear to be based solely on a finding of reasonable cause as appellants assert because there is no general reasonable cause exception to the estimated tax penalty. (*Appeal of Johnson*, 2018-OTA-199P.)

HOLDING

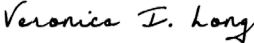
Appellants have not established reasonable cause to abate the late-filing penalty.


DISPOSITION

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

DocuSigned by:

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Teresa A. Stanley
Administrative Law Judge

We concur:

DocuSigned by:

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Veronica I. Long
Administrative Law Judge

DocuSigned by:

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Richard Tay
Administrative Law Judge

Date Issued: 3/16/2023