

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:)
M. NEUNER AND) OTA Case No. 220510453
C. NEUNER)
_____)

OPINION

Representing the Parties:

For Appellants: Joel Landson, Representative

For Respondent: Christopher M. Cook, Tax Counsel

E. LAM, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, M. Neuner (appellant-husband) and C. Neuner (collectively, appellants) appeal an action by respondent Franchise Tax Board (FTB) denying appellants’ claim for refund of \$11,385.90, and applicable interest for the 2020 tax year.

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

ISSUES

1. Whether appellants have demonstrated reasonable cause to abate the late payment penalty.
2. Whether appellants have established that interest should be abated.

FACTUAL FINDINGS

1. Appellant-husband is a member of PGP Investors, LLC, (PGP) a limited liability company taxed as a partnership.¹
2. On November 24, 2020, appellant-husband sent an email correspondence to his tax preparer about the anticipated sale of his membership interest in PGP. Appellant-

¹ Since PGP is classified as a partnership for federal and California income tax purposes, this Opinion uses the terms “membership interest” and “partnership interest” interchangeably.

husband's tax preparer indicated that he did not know appellant-husband's tax basis in PGP, had tried to get a tax basis for appellants, but never received a response, and attempted to reconstruct the tax basis to the best of his ability. Appellant-husband also indicated that he did not know his tax basis in PGP.

3. On December 18, 2020, appellant-husband sent an email to his tax preparer that he sold his membership interest in PGP for \$1,032,531.56.
4. On December 21, 2020, appellant-husband's tax preparer emailed appellant-husband, indicating that the tax preparer needed some more time to verify the tax basis for PGP.
5. Appellants did not have accurate information on appellant-husband's tax basis in PGP to accurately calculate their estimated tax liability. As a result, on January 14, 2021, appellants' tax preparer estimated appellant-husband's tax basis to be zero and appellants remitted an estimated tax payment of \$50,000 to FTB.
6. On May 11, 2021, appellant-husband received an email indicating that the PGP 2020 Schedule K-1 will not be available for several weeks.
7. On September 20, 2021, appellants received appellant-husband's PGP 2020 Schedule K-1, which reported a negative beginning capital account balance and a positive ending capital account balance.
8. On October 1, 2021, appellants timely filed their joint 2020 California Resident Income Tax Return. The 2020 tax return reported a \$151,812 tax balance due after applying appellant's January 14, 2021 estimated tax payment of \$50,000.
9. FTB accepted appellants' return as filed and assessed a late payment penalty of \$11,385.90 and \$1,801.97 of interest.
10. Appellants remitted the penalties and interest in full, and filed a claim for refund seeking abatement of both based on reasonable cause. FTB denied appellants' claim for refund.
11. This timely appeal followed.

DISCUSSION

Issue 1: Whether appellants have demonstrated reasonable cause to abate the late payment penalty.

R&TC section 19132 imposes a late payment penalty when taxpayers fail to pay the amount of tax 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 (determined without regard to any extension of time for filing the return). (R&TC, § 19001.) The late payment penalty may be abated if the taxpayers show that the failure to make timely payments of tax was due to reasonable cause and was not due to willful neglect. (R&TC, § 19132(a)(1).)

Here, appellants' tax payment was due on April 15, 2021 (see R&TC section 18566), which FTB postponed until May 17, 2021 due to COVID-19.² Appellants do not dispute that their payments were late or that FTB improperly calculated and imposed the late payment penalty. Additionally, FTB does not assert that appellants acted with willful neglect. Therefore, the only issue is whether appellants have demonstrated reasonable cause for their failure to timely pay their required taxes in full.

To establish reasonable cause for the late payment of tax, taxpayers must show that the failure to make timely payments of the proper amount of tax occurred despite the exercise of ordinary business care and prudence. (*Appeal of Friedman*, 2018-OTA-077P.) The taxpayers bear the burden of proving that an ordinarily intelligent and prudent businessperson would have acted similarly under the circumstances. (*Ibid.*) In a late payment of tax case, a strong, and often determinative, factor in finding reasonable cause is to examine whether taxpayers have access to sufficient information upon which to base a reasonable estimate of their tax liability. (*Appeal of Moren*, 2019-OTA-176P.) Furthermore, the taxpayers must show more than an asserted lack of documentation or difficulty in calculating the tax liability. (*Ibid.*) Reasonable cause based on insufficient information requires the taxpayers to demonstrate the efforts made to retrieve records from third parties or acquire the information necessary to determine the tax liability. (*Ibid.*)

On appeal, appellants contend that they lacked the information necessary to accurately calculate their gain and the resulting tax liability from appellant-husband's sale of his membership interest in PGP. Appellants specifically assert that at the time their 2020 tax payment was due, they were aware that appellant-husband has sold his membership interest in PGP to a third party for \$1,032,531.56, but did not know appellant-husband's adjusted basis in the partnership, and therefore estimated the adjusted basis to be zero. Appellants contend that they did not receive their 2020 PGP Schedule K-1 until September 20, 2021, and that prior to receiving this Schedule K-1, they were unaware that appellant-husband had a negative tax basis

² See <https://www.ftb.ca.gov/about-ftb/newsroom/news-releases/2021-03-state-tax-deadline-for-individuals-postponed-until-may-17-2021.html>.

beginning capital account balance in PGP. Appellants contend that this negative capital account balance caused the resulting gain tax to be higher than what was initially estimated.

The computation of a gain or loss realized by a partner selling a partnership interest is the amount realized, less the partner's adjusted basis in the partnership. (See IRC, §§ 741, 1001.)³ As relevant to this appeal, the amount realized includes the amount of money received and, generally, the seller's liabilities that is discharged as a result of the sale or disposition. (Treas. Reg. § 1.1001-2(a).) A partner's negative tax basis capital account, generally, reflects the partner's liability to the partnership or other partners in the partnership. As a result, when a partner sells his or her partnership interest with a negative tax basis capital account, but does not restore that tax basis capital account back from the deficit, then the selling partner's liability is discharged and assumed by the buyer, resulting in an additional amount realized. (See *ibid.*)

A partner's adjusted basis is, generally, with certain exceptions, equal to the sum of his tax basis capital account and his share of partnership liabilities. (See McKee et al., *Federal Taxation of Partnerships & Partners* (WG&L, 4th ed. 2007 & Supp. 2023-1), 6.04 *The Relationship Between a Partner's Basis and Capital Account*.) It is well established that the law places the responsibility of determining a partner's adjusted basis on the partner, not on the partnership. (Treas. Reg. § 1.705-1(a)(1).) A partner's adjusted basis is determined without regard to his "inside basis" or "any amount shown in the partnership books as the partner's 'capital', 'equity', or similar account." (*Ibid.*) Therefore, the mathematical computation of a partner's adjusted basis essentially requires a partner to maintain records of his or her "outside basis," including "the effect of liabilities in determining the amount of contributions made by a partner to a partnership or the amount of distributions made by a partnership to a partner." (Treas. Reg. § 1.705-1(a)(6).)

In the present appeal, appellants have not shown that the failure to make timely payments of the proper amount of tax occurred despite the exercise of ordinary business care and prudence. Appellants assert that "it was impossible for [them] to get information to re-create the tax basis for the extension payment to be made timely" and that they discussed with "the controller of [PGP] and the information [appellants] received in December 2020 indicated that the tax basis

³ "California incorporates [IRC] sections 701-761 relating to partners and partnerships with certain exceptions. (R&TC, § 17851.) When applying the IRC, California also incorporates Treasury Regulations to the extent that they do not conflict with regulations promulgated by FTB. (R&TC, § 17024.5(d).)" (*Appeal of Rios*, 2021-OTA-341P.) In addition, under R&TC section 18031, California generally conforms to Subchapter O of the IRC, which includes rules on the determination of gain or loss under IRC section 1001.

was zero.” However, unsupported assertions are insufficient to establish reasonable cause. (*Appeal of Moren, supra.*) Here, the burden is on appellant-husband to have all the necessary information available for him to calculate his gain on the sale of his membership interest. (See Treas. Reg. § 1.705-1(a)(1).) However, appellants have not clearly explained what specific components were missing and needed to calculate appellant-husband’s adjusted basis or tax basis capital account for purposes of determining the gain from the sale of appellant-husband’s membership interest. Also, there is no evidence in the record that appellants made any efforts to retrieve the missing information or records from PGP.⁴ (See *Appeal of Moren, supra.*) Instead, the evidence in the record only shows that appellant-husband and his tax preparer estimated appellant-husband’s adjusted basis in PGP without further evidence of their efforts made to obtain the missing information necessary to compute appellant-husband’s adjusted basis or tax basis capital account in PGP prior to the tax payment deadline. When appellants were informed of the delay in receiving appellant-husband’s K-1 from PGP, appellants should have taken steps in attempt to acquire the necessary information to compute appellant-husband’s adjusted basis or tax basis capital account in PGP prior to the tax payment deadline. Therefore, FTB properly denied appellants’ claim for refund of the late payment penalty because appellants did not satisfy their burden of proof that the failure to make timely payments of the proper amount of tax occurred despite the exercise of ordinary business care and prudence.

Issue 2: Whether appellants have established that interest should be abated.

R&TC section 19101 provides that taxes are due and payable as of the original due date of the taxpayers’ return (without regard to extension). If tax is not paid by the original due date or if FTB assesses additional tax and that assessment becomes due and payable, the taxpayers are charged interest on the resulting balance due, compounded daily. (R&TC, § 19101.) Interest is not a penalty but is compensation for a taxpayers’ use of money after it should have been paid to the state. (*Appeal of GEF Operating, Inc.*, 202-OTA-057P.) There is no reasonable cause exception to the imposition of interest, and interest is mandatory except where abatement is authorized under the law. (*Appeal of Moy*, 2019-OTA-057P.) Generally, to obtain relief from interest, taxpayers must qualify under one of the following three R&TC sections: 19104, 19112,

⁴ For example, evidence in the record does not show that appellants made efforts to retrieve certain information with regards to any specific missing information for the computation of appellant-husband’s adjusted basis or tax basis capital account from the tax matters partner of PGP.

or 21012. (*Ibid.*) OTA has no authority to review FTB’s action under R&TC section 19112. (*Ibid.*) Here, appellants do not allege, and nothing in the record suggests, that there is any basis for interest abatement under R&TC sections 19104 and 21012. Therefore, appellants have not established that interest should be abated.

HOLDINGS

1. Appellants have not demonstrated reasonable cause to abate the late payment.
2. Appellants have not established that interest should be abated.

DISPOSITION

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

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Eddy Y.H. Lam
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Eddy Y.H. Lam
Administrative Law Judge

We concur:

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Cheryl L. Akin
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Cheryl L. Akin
Administrative Law Judge

DocuSigned by:

Richard Tay
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Richard Tay
Administrative Law Judge

Date Issued: 4/28/2023