OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **WAREHOUSE SYSTEMS, INC.**	OTA Case No. 220510410

OPINION

Representing the Parties:

For Appellant: William A. Lau, CPA

For Respondent: Alisa L. Pinarbasi, Tax Counsel

K. GAST, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, Warehouse Systems, Inc. (appellant) appeals an action by respondent Franchise Tax Board (FTB) denying appellant's claim for refund totaling $16,881.69 in penalties and interest for the 2018 tax year.[1]

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

ISSUES

1. Whether appellant is entitled to abatement of the late-filing penalty.
2. Whether appellant is entitled to abatement of the per-shareholder late-filing penalty.
3. Whether appellant is entitled to abatement of the estimated tax penalty.
4. Whether appellant is entitled to abatement of interest.

[1] This amount consists of a late-filing penalty of $11,068.50 imposed under R&TC section 19131, a per-shareholder late-filing penalty of $216.00 imposed under R&TC section 19172.5, an estimated tax penalty of $1,236.76 imposed under R&TC section 19142, and (what appears to be) partial interest of $4,360.43. Although FTB's Notice of Action denying appellant's refund claim and appellant's appeal letter to the Office of Tax Appeals (OTA) both list the disputed amount as $12,521.26 (i.e., the sum of just the three penalties), appellant's refund claim requested a refund of $16,881.69, and its arguments in its appeal letter suggest it wishes to also request partial abatement of the interest imposed by FTB. Therefore, OTA will treat the difference between these two disputed amounts ($16,881.69 - $12,521.26, or $4,360.43) as FTB's deemed denial, under R&TC section 19331, of appellant's request for a refund of partial interest.

FACTUAL FINDINGS

1. In 2018, appellant was based in Illinois, taxed as an S corporation for federal and California income tax purposes, and had one shareholder.
2. FTB received information from the California Department of Tax and Fee Administration indicating appellant derived over $11 million of California sales during 2018. Based on this information, on October 20, 2020, FTB issued to appellant a Demand for Tax Return for the 2018 tax year. One month later, on November 30, 2020, appellant untimely filed its 2018 California S Corporation Franchise or Income Tax Return, which was due March 15, 2019, and made untimely tax payments.
3. FTB then imposed the three penalties noted above, plus applicable interest, which appellant ultimately paid. Appellant filed a claim for refund, requesting abatement of the penalties (and presumably partial abatement of interest) on reasonable cause grounds.
4. FTB denied the refund claim and this timely appeal followed.

DISCUSSION

Issue 1: Whether appellant is entitled to abatement of the late-filing penalty.

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 penalty. Because FTB does not assert willful neglect, the only issue is whether appellant has demonstrated reasonable cause for the late filing of its 2018 tax return.

To establish reasonable cause, the taxpayer must show that the failure to file a timely tax return 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.)

As background, appellant asserts it historically used a prior CPA firm to prepare its income tax returns but, in August 2018, that firm was acquired by Mr. Lau, appellant's current CPA and representative in this appeal. Although Mr. Lau employed a CPA from the acquired

firm to prepare draft income tax returns for 2018, the CPA resigned from Mr. Lau's firm, without providing to Mr. Lau all relevant tax information pertaining to appellant. According to appellant, its previous CPA only provided Mr. Lau with prior year state income tax returns for Illinois but not any other states, including California. Appellant asserts it provided all necessary documentation to Mr. Lau to prepare its 2018 tax returns, including state-by-state revenues. But Mr. Lau, presumably at the time appellant's 2018 California return became due, did not know appellant for the first time derived certain revenue (specifically, installation service revenue) from California in 2018, which, unlike in 2017, would have required appellant to pay an income tax for that tax year.[2] Appellant further assets the previous CPA, prior to resignation, did not provide any kind of information to Mr. Lau that would indicate a 2018 California filing obligation might exist.

The crux of appellant's contention is it exercised ordinary business care and prudence because it relied on Mr. Lau—who has over 40 years of experience preparing returns, including California returns—to timely file its 2018 California tax return. Appellant asserts that within a month of learning from FTB a 2018 California tax filing obligation existed, it promptly had Mr. Lau prepare the return and it paid the taxes due.

However, the failure to timely file a tax return due to an oversight or mistake, by itself, does not constitute reasonable cause. (*Appeal of Auburn Old Town Gallery, LLC*, 2019-OTA-319P; see *Appeal of Moren*, 2019-OTA-176P [lack of documentation or difficulty in calculating a tax liability does not, by itself, constitute reasonable cause].) Similarly, it is well settled that a taxpayer's reliance on an agent, such as an accountant, to file a return by the due date is not reasonable cause because a taxpayer has a personal, non-delegable obligation to meet statutory deadlines. (*Appeal of Quality Tax & Financial Services, Inc.*, 2018-OTA-130P, citing *U.S. v Boyle* (1985) 469 U.S. 241, 252.) Under the facts here, an ordinarily intelligent and prudent businessperson would have inquired with its tax preparer prior to the due date of the return

[2] Public Law (P.L.) 86-272, which is a federal statute, essentially prohibits a state from imposing an income tax on income derived within its borders from interstate commerce if the only business activity in that state consists of solicitation of orders for sales of tangible personal property. (15 U.S.C. §§ 381-384.) Appellant appears to concede its installation service revenue in California disqualified it from protection under P.L. 86-272 for the 2018 tax year. In addition, even if OTA were to assume, without concluding, that appellant only derived revenue from sales of tangible personal property to California customers and was thus protected from an income tax under P.L. 86-272 for its prior 2017 tax year, it still may have been subject to the $800 minimum franchise tax and would have had a California filing requirement. (See R&TC, §§ 23101, 23802(c), 23153, 18601(d); Cal. Code Regs., tit. 18, § 23101(a).)

whether a California tax obligation existed, especially when a taxpayer, such as appellant, knew it derived a significant amount of sales from this state (i.e., over 90 percent of appellant's gross receipts in 2018 were from California customers). Indeed, appellant admits it supplied 2018 California sales information to its prior CPA and did the same for Mr. Lau, but does not explain why it did not inquire with Mr. Lau why a 2018 California tax return was not prepared by his firm in 2019, despite the fact that nearly all of its 2018 sales were from California sources, as reported on its untimely filed 2018 California tax return.

Appellant also argues it relied on Mr. Lau's substantive tax advice, which, if true, can establish reasonable cause under certain circumstances.[3] But, critically, it has not established as a threshold matter that prior to the due date of its return, it consulted with Mr. Lau on a substantive tax issue, such as whether it was doing business in California to prompt a California filing obligation. (*Appeal of GEF Operating, Inc.*, *supra*.) Appellant urges that Mr. Lau's preparation of its 2018 Illinois corporate tax return, which reported all income on such return, "and the corresponding decision not to prepare a California return is the functional equivalent of providing substantive tax advice." However, the mere fact that Mr. Lau prepared appellant's Illinois return does not show he considered whether appellant was doing business in California and consequently had a California filing requirement. (*Ibid*. [taxpayer did not provide any specific information to establish it consulted with a qualified tax professional and relied on advice that it had no California tax filing requirement].) Rather, it appears appellant's CPA simply made, in its own admission, an "error" by not timely preparing appellant's 2018 California tax return. (*Ibid*. [even if a taxpayer is unaware of a filing requirement, ignorance of the law does not excuse compliance with statutory requirements].)

Appellant further contends in February 2019, Mr. Lau's office was flooded when a pipe broke, which made it difficult to prepare appellant's 2018 return. However, this explanation appears to be inconsistent with appellant's contention that the late filing was due, in part, to an oversight or mistake. In any event, appellant—or Mr. Lau, its CPA—has not shown it knew of a California filing requirement in February 2019, and the flooding event directly prevented

[3] Specifically, reasonable cause may exist if a taxpayer reasonably relies on a tax professional for substantive tax advice as to whether a tax liability exists and the following conditions are met: (1) the person relied on by the taxpayer is a tax professional with competency in the subject tax law; and (2) the tax professional's advice is based on the taxpayer's full disclosure of the relevant facts and documents. (*Appeal of Summit Hosting LLC*, 2021-OTA-216P, citing *U.S. v. Boyle*, *supra*.)

Mr. Lau from timely filing the 2018 California return, especially since the 2018 federal and Illinois tax returns were timely filed in 2019.

Lastly, appellant assures that steps have been implemented to prevent reoccurrence of the oversight, and this was the first time it failed to timely file its California tax return. However, for the 2018 tax year, there is no California legal authority that allows for abatement of the late-filing penalty based solely on good filing history. (See *Appeal of Xie*, *supra*; but see R&TC, § 19132.5 [for tax years beginning on or after January 1, 2022, an individual taxpayer shall receive, under certain conditions, a one-time abatement of the late-filing penalty].) Accordingly, appellant has not established reasonable cause to abate the late-filing penalty.

Issue 2: Whether appellant is entitled to abatement of the per-shareholder late-filing penalty.

R&TC section 19172.5 imposes a per-shareholder late-filing penalty on an S corporation for failing to file a return on or before the due date, unless it is shown that the late filing is due to reasonable cause. As with the late-filing penalty, it is undisputed FTB properly imposed and computed this penalty and the only issue is whether appellant has demonstrated reasonable cause for its late filing. The taxpayer bears the burden of proving reasonable cause exists, which requires a showing that it acted as an ordinarily intelligent and prudent businessperson would have acted under similar circumstances. (*Appeal of Quality Tax & Financial Services, Inc.*, *supra*.)

Appellant presents the same arguments here as it does for the late-filing penalty. However, for reasons expressed above, appellant has not established reasonable cause to abate the per-shareholder late-filing penalty.

Issue 3: Whether appellant is entitled to abatement of the estimated tax penalty.

A corporation that underpays its estimated tax is liable for an addition to tax (i.e., a penalty) equal to a specified rate of interest applied to the amount of the underpayment. (R&TC, §§ 19142, 19144.) Relief from the estimated tax penalty is not available upon a showing of reasonable cause, although a few limited statutory exceptions to the penalty exist.[4] (*Appeal of Weaver Equipment Co.* (80-SBE-048) 1980 WL 4976; R&TC, §§ 19147, 19148.)

[4] For example, several exceptions to imposition of the penalty are found in R&TC sections 19142(b), 19147, and 19148, but appellant does not allege, and the evidence does not show, that any of those apply to the facts here.

Here, again, there is no dispute FTB properly imposed and computed this penalty. Rather, appellant requests abatement based on reasonable cause. However, since no general reasonable cause exception exists, and appellant does not argue or provide evidence that the limited statutory exceptions to the penalty apply, there is no basis for abatement.

Issue 4: Whether appellant is entitled to abatement of interest.

If any amount of tax is not paid by the due date, interest is required to be imposed from the due date until the date the taxes are paid. (R&TC, § 19101(a).) Interest is not a penalty but is compensation for the taxpayer's use of money that should have been paid to the state. (*Appeal of Balch*, 2018-OTA-159P.) Imposition of interest is mandatory, and it can only be abated in certain limited situations when authorized by law. (R&TC, § 19101(a); *Appeal of Balch*, *supra*.)

There is no reasonable cause exception to the imposition of interest. (*Appeal of Moy*, 2019-OTA-057P.) Rather, to obtain relief from interest, appellant must qualify under R&TC section 19104 or 21012. Under R&TC section 19104, FTB is authorized to abate interest if there has been an unreasonable error or delay in the performance of a ministerial or managerial act by an employee of FTB. Appellant does not assert FTB committed such errors or delays. R&TC section 21012 is also not relevant here because FTB did not provide appellant with any written advice. Accordingly, appellant is not entitled to interest abatement.

HOLDINGS

1. Appellant is not entitled to abatement of the late-filing penalty.
2. Appellant is not entitled to abatement of the per-shareholder late-filing penalty.
3. Appellant is not entitled to abatement of the estimated tax penalty.
4. Appellant is not entitled to abatement of interest.

DISPOSITION

FTB's action denying appellant's refund claim is sustained.

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Kenneth Gast
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Kenneth Gast
Administrative Law Judge

We concur:

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Ovsep Akopchikyan
Administrative Law Judge

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Andrew J. Kwee
Administrative Law Judge

Date Issued: 7/11/2023