



Here, appellant solely contends that the Opinion is contrary to law. “[T]he ‘contrary to law’ standard of review shall involve a review of the Opinion for consistency with the law.” (Cal. Code Regs., tit. 18, § 30604(b).) To find that the Opinion is contrary to law, OTA must determine whether the Opinion is unsupported by any substantial evidence. (*Appeals of Swat-Fame, Inc., et al.*, 2020-OTA-045P.) This requires a review of the Opinion to indulge in all legitimate and reasonable inferences to uphold it. (*Ibid.*) The relevant question is not over the quality or nature of the reasoning behind the Opinion, but whether the Opinion can or cannot be valid according to the law. (*Ibid.*) In its review, OTA considers the evidence in the light most favorable to the prevailing party (here, FTB). (*Ibid.*)

### Background

Appellant was acquired by another corporation in a stock sale on September 20, 2016, and on June 5, 2017, the acquiring corporation made a timely Internal Revenue Code (IRC) section 338 (338 election) to treat its stock purchase of appellant as an asset acquisition for income tax purposes.<sup>1</sup> As a result of the 338 election, appellant was required to file short period federal and California returns for the tax year beginning on January 1, 2016, and ending on September 20, 2016 (the date of the sale). Appellant timely filed its California return for this short tax year within the automatic extension period on June 22, 2017, reporting tax due. This tax due was entirely attributable to the deemed sale of appellant’s assets on September 20, 2016, resulting from the acquiring corporation’s 338 election. Appellant did not pay the California tax due until July 5, 2017, and FTB imposed a late payment penalty.

Pursuant to IRC section 338(g)(1), a 338 election is required to be made by the 15th day of the ninth month beginning after the month of the acquisition. Here, the deadline to make the 338 election was June 15, 2017, the 15th day of the ninth month following the acquisition on September 20, 2016. Because this election may be made up to nine months after the sale occurs, this can result in a situation where the target corporation’s short period return (and related tax payment) resulting from the 338 election is due many months before the election is even made. As a result, the IRS provides potential relief from the late payment and late filing penalties in

---

<sup>1</sup> An IRC section 338(g) election allows the acquiring corporation to make an election to treat the purchase of stock as a purchase of assets. The target corporation (here, appellant) does not participate in the decision to make this election. The election results in the target corporation (here, appellant) reporting gain on the deemed sale of its assets. California conforms to IRC section 338 pursuant to R&TC section 24451.

Treasury Regulation section 1.338-10(b)(1), where a 338 election is made and certain other conditions are satisfied.

Treasury Regulation section 1.338-10(b)(1) allows a penalty to be waived if the penalty is “excusable upon a showing of reasonable cause” and a taxpayer takes “corrective action” on or before the last day for making a 338 election. “Corrective action” includes paying the tax due on or before the last day for making a 338 election. (Treas. Reg. § 1.338-10(b)(4), Example 1.) Appellant did not meet the requirements for waiver of its California late payment penalty under Treas. Reg. section 1.338-10(b) because it did not pay its California tax by June 15, 2017, the last day for making the 338 election. On appeal, appellant acknowledged that it does not meet the requirements for the waiver provision in Treasury Regulation section 1.338-10(b) for California purposes, but argued that the late payment penalty should, nevertheless, be abated for reasonable cause pursuant to R&TC section 19132.

#### Discussion<sup>2</sup>

In its petition, appellant asserts that the “Opinion erred in concluding that California law conforms to [f]ederal Treasury Regulation [s]ection 1.338-10 with respect to R&TC [s]ection 19132[.]” Appellant notes that California does not directly conform to IRC section 6651, the federal late payment penalty provision, and instead enacted its own penalty waiver rule in R&TC section 19132, and contends that “[s]ince California law does not conform to IRC [s]ection 6651, Treasury Regulation [s]ection 1.338-10(b) is inapplicable to California law to the extent that regulation speaks to IRC [s]ection 6651.” Appellant further asserts, “Specifically, Treasury Regulation [s]ection 1.338-10(b)’s corrective action prong is inapplicable to California law because it speaks to relief of late payment penalties under IRC [s]ection 6651 (to which California law does not conform).”

However, appellant raised this same argument in its underlying appeal, which OTA thoroughly considered and rejected as unpersuasive in the Opinion. The Opinion expressly noted appellant’s argument that the penalty waiver provision in Treasury Regulation is not applicable for California purposes and cannot be used to interpret the reasonable cause provisions in R&TC section 19132. In response, the Opinion concluded that “[c]ontrary to appellant’s assertion, the penalty waiver provisions contained in Treasury Regulation section 1.338-10(b) is applicable for

---

<sup>2</sup> Because appellant does not dispute any of the factual findings in the Opinion, the sole question in this petition is one of law.

California tax purposes because California conforms to IRC section 338,” citing to R&TC section 24451 and *Appeal of Daneshgar*, 2021-OTA-210P.<sup>3</sup> The Opinion further noted that because California law incorporates the provisions of IRC section 338, California also applies the Treasury Regulations promulgated thereunder. (See R&TC, § 23051.5(d).)

The Opinion then addressed appellant’s argument that Treasury Regulation section 1.338-10(b) cannot be used to interpret the reasonable cause provisions in R&TC section 19132 because California enacted its own stand-alone late payment penalty in R&TC section 19132, which “parallels,” rather than directly conforming (i.e., conforming by reference) to, IRC section 6651, noting that both “the federal late payment penalty in IRC section 6651, and the California late payment penalty in R&TC section 19132, may be abated where the taxpayer shows that ‘the failure is due to reasonable cause and not due to willful neglect.’” (See R&TC, § 19132(a)(1), IRC, § 6651(a)(2).) The Opinion then noted that when material provisions of federal and state statutes are substantially identical, interpretation of the federal statute guides construction of the state statute, citing to *Appeal of Jones*, 2021-OTA-144P, fn. 2 and *Appeal of Rougeau*, 2021-OTA-335P, fn. 1.

R&TC section 23051.5(d) provides that when applying the IRC, the regulations promulgated by the IRS shall be applicable as regulations under California’s Corporation Tax Law (CTL) to the extent that they do not conflict with the CTL or with the regulations issued by FTB. Treasury Regulation section 1.338-10(b) interprets and clarifies IRC section 338. In summary, California conforms to IRC section 338 (see R&TC, § 24451), both the federal late payment penalty and California late payment penalty may be abated where the failure to make a timely payment of tax is “due to reasonable cause and not willful neglect,” and Treasury Regulation section 1.338-10(b) does not conflict with the R&TC or the regulations issued by FTB. Therefore, the Opinion correctly concluded that Treasury Regulation section 1.338-10(b)

---

<sup>3</sup> OTA notes that California’s application of Treasury Regulation section 1.338-10(b) is usually beneficial to taxpayers since it provides for waiver of the late payment penalty in certain circumstances without an express showing of reasonable cause by the taxpayer when the tax payment is made late (i.e., many months after the payment deadline in R&TC section 19001), but before the last day for making the 338 election.

“is applicable for California purposes” and “relevant to the question of whether there is reasonable cause for the abatement of the late payment penalty under R&TC section 19132.”<sup>4</sup>

Next appellant argues that the “Opinion erred in the application of the due diligence period provided under IRC [s]ection 338.” This is essentially a continuation of appellant’s argument that Treasury Regulation section 1.338-10(b) is inapplicable for purposes of the California late payment penalty imposed pursuant to R&TC section 19132. Because appellant argues that the penalty waiver provision in Treasury Regulation section 1.338-10(b) is inapplicable, appellant contends that “by enacting IRC [s]ection 338, Congress concluded that [the 338 election period] is the period of time necessary for taxpayers to exercise ordinary business care and reasonable prudence to determine whether to make an IRC [s]ection 338 election,” and additional time is then needed after the 338 election period provided in IRC section 338(g) to “give the taxpayer sufficient time to make the election, prepare the federal and California tax returns, and pay the California tax resulting from making the IRC [s]ection 338 election.”

OTA expressly considered and rejected this argument in the Opinion, noting that Treasury Regulation section 1.338-10(b) “effectively puts taxpayers on notice that they should both make the 338 election and attempt to calculate and pay the resulting taxes within the 338 election period in IRC section 338(g).”<sup>5</sup> Because OTA has concluded that Treasury Regulation section 1.338-10(b) “is applicable for California purposes” and “relevant to the question of whether there is reasonable cause for the abatement of the late payment penalty under R&TC section 19132,” OTA’s conclusions here are reasonable, consistent with the applicable law, and supported by substantial evidence. As such, appellant has failed to establish that the Opinion is contrary to law. (See *Appeals of Swat-Fame, Inc., et al., supra.*)

Finally, the Opinion expressly agreed with appellant that a taxpayer can still show reasonable cause for the late payment of tax under R&TC section 19132, where, as here, the penalty waiver provision in Treasury Regulation section 1.338-10(b) is not met. The Opinion

---

<sup>4</sup> Treasury Regulation section 1.338-10(b)(1)(i) permits waiver of penalties arising because of circumstances that would not exist but for the 338 election, if under the relevant statute, the penalty is “excusable upon a showing of reasonable cause.” Both the federal late payment penalty under IRC section 6651 and the California late payment penalty under R&TC section 19132 meet this requirement as both are imposed “unless the failure is due to reasonable cause and not willful neglect.”


<sup>5</sup> See footnote 12 on page 6 of the Opinion.

then considered whether appellant had established reasonable cause here even though it did not meet the waiver provision. The Opinion expressly noted that by June 8, 2017, at the latest, appellant had computed its California tax liability for the short tax year at issue but did not pay that tax liability until almost a month later on July 5, 2017. The Opinion noted that appellant failed to establish reasonable cause for the almost one-month delay in paying its California tax due after computing the amount of that tax. As noted in the Opinion, “an acceptable reason for failure to pay taxes will excuse such failure only so long as the reasons remain valid” and “a taxpayer’s failure to timely remit the balance due on a tax liability caused by an oversight, does not, by itself, constitute reasonable cause.” (See *Appeal of Triple Crown Baseball LLC*, 2019-OTA-25P; *Appeal of Friedman*, 2018-OTA-077P.) Thus, even if appellant were correct that Treasury Regulation section 1.338-10(b) is inapplicable and should not have been considered by OTA, the Opinion expressly found that appellant failed to establish reasonable cause existed for the entire period of its late payment (i.e., from January 15, 2017, the due date for the payment of appellant’s taxes, to July 5, 2017, the date the taxes were paid).<sup>6</sup> Abatement of the late payment penalty is not permitted on this basis alone.


---


<sup>6</sup> As noted in the Opinion, OTA requested additional briefing from the parties as to whether OTA could grant a partial abatement of the late payment penalty, where a taxpayer established reasonable cause for only part of the time the tax payment was late. The parties agreed that OTA cannot grant a partial abatement of the late payment penalty here. Thus, appellant must establish reasonable cause for the entire period for which its payment was late.

In short, appellant’s petition largely restates the same arguments it made in the underlying appeal, and OTA continues to find those arguments unpersuasive. Consequently, OTA denies appellant’s petition.

DocuSigned by:  
  
Cheryl L. Akin  
Administrative Law Judge

We concur:

DocuSigned by:  
  
Suzanne B. Brown  
Administrative Law Judge

DocuSigned by:  
  
Michael F. Geary  
Administrative Law Judge

Date Issued: 10/2/2023