

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:)
RED VISION SYSTEMS, INC.) OTA Case No. 18124068
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)

OPINION

Representing the Parties:

For Appellant: Patrick T. Connolly, Director of Tax
Stan Tarbell, Vice President of Tax

For Respondent: Leoangelo C. Cristobal, Tax Counsel
Maria Brosterhous, Tax Counsel IV

C. AKIN, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, Red Vision Systems, Inc. (appellant) appeals an action by respondent Franchise Tax Board (FTB) denying appellant’s claim for refund of \$9,725.56¹ for the short tax year ending September 20, 2016.

Office of Tax Appeals (OTA) Administrative Law Judges Cheryl L. Akin, Elliott “Scott” Ewing,² and Richard Tay held an electronic oral hearing for this matter on April 26, 2022. After the conclusion of the hearing, OTA requested the parties provide additional briefing. At the close of the additional briefing period, the record was closed, and this matter was submitted for an opinion.

¹ This amount consists of a late payment penalty of \$7,925.06 and an underpayment of estimated tax penalty (estimated tax penalty) of \$4.14, plus applicable interest. FTB issued a refund claim denial in the amount of \$9,667.37, but appellant’s refund claim was filed before it paid the penalties and interest on December 29, 2017 (\$9,667.36), and January 25, 2018 (\$58.20). As appellant was seeking a refund of all penalties and interest, the Office of Tax Appeals will treat the total of these two payments (i.e., \$9,725.56) as the amount at issue in this appeal. Appellant does not present any evidence or argument with respect to the estimated tax penalty or interest on appeal, and this Opinion does not address these two items further.

² Judge John O. Johnson replaced Judge Ewing on the panel for staffing reasons. Judge Johnson has watched the recording of the hearing, read the hearing transcript, been fully briefed on the appeal, and has no additional questions for the parties.

ISSUE

Whether appellant has established that the late payment penalty should be waived or abated.

FACTUAL FINDINGS

1. Appellant was acquired by First American Financial Corporation (First American) in a stock sale on September 20, 2016.
2. On June 5, 2017, First American filed IRS Form 8023 to make a timely and valid Internal Revenue Code (IRC) section 338 election (338 election) to treat its stock purchase of appellant as an asset acquisition for income tax purposes.³
3. As a result of the 338 election, appellant, which was taxed as a C corporation for federal and California income tax purposes, was required to file short period federal and California income tax returns for the short tax year beginning on January 1, 2016, and ending on September 20, 2016.⁴
4. Appellant timely filed its California income tax return for the short tax year ending on September 20, 2016, within the automatic extension period on June 22, 2017, reporting tax due of \$122,724.⁵ The reported tax due was entirely attributable to the deemed sale of appellant's assets on September 20, 2016, as a result of First American's 338 election.⁶ Appellant mailed a check to FTB on July 5, 2017, which untimely satisfied the tax due as reported on its return for the short tax year ending on September 20, 2016.⁷
5. FTB subsequently assessed a late payment penalty.
6. Appellant paid the balance due and filed a claim for refund which FTB denied. This timely appeal followed.

³ An IRC section 338(g) election allows the acquiring corporation (here, First American) to make an election to treat the purchase of stock as a purchase of assets. The target corporation (here, appellant) does not participate in this election. The election results in the target corporation (here, appellant) reporting gain on the deemed sale of its assets.

⁴ Appellant's short tax year beginning on September 21, 2016, and ending on December 31, 2016 is not at issue in this appeal.

⁵ Appellant filed its federal income tax return on June 13, 2017.

⁶ Absent this election, appellant would have generated a taxable loss for the year, and only would have been required to pay the \$800 minimum tax, which appellant paid on December 15, 2016.

⁷ FTB received this payment and applied it to appellant's account effective July 12, 2017.

DISCUSSION

R&TC section 19132 imposes a late payment penalty when a taxpayer fails to pay the amount 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 (without regard to extensions of time for filing). (R&TC, § 19001.) The due date for appellant’s payment of tax for its short tax year ending September 20, 2016, was January 15, 2017, which is the 15th day of the fourth month after the taxable year ended. (See R&TC, § 18601.) Since appellant did not fully pay its tax until July 5, 2017, FTB properly imposed the late payment penalty.⁸

The late payment penalty may be abated if the taxpayer shows that the failure to make a timely payment of tax was due to reasonable cause and was not due to willful neglect. (R&TC, § 19132(a)(1).) When FTB imposes a penalty, the law presumes that the penalty was imposed correctly, and the taxpayer has the burden of proof to show that reasonable cause exists to support abatement of the penalty. (*Appeal of Xie*, 2018-OTA-076P.) To establish reasonable cause for the late payment of tax, a taxpayer must show that the failure to make a timely payment of the proper amount of tax occurred despite the exercise of ordinary business care and prudence. (*Appeal of Moren*, 2019-OTA-176P (*Moren*).) The taxpayer bears the burden of proving that an ordinarily intelligent and prudent businessperson would have acted similarly under the circumstances. (*Ibid.*) An asserted lack of documentation or difficulty in calculating a tax liability does not, by itself, constitute reasonable cause. (*Ibid.*)

Additionally, a waiver of the late payment penalty is available to taxpayers who make a late payment of tax because of “circumstances that would not exist but for” a 338 election. (Treas. Reg. § 1.338-10(b)(1).) 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, the taxpayer is entitled to a waiver of the late payment penalty. (Treas. Reg. § 1.338-10(b)(1).) “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.) Pursuant to IRC section 338(g), a 338 election is required to be made not later than the 15th day of the ninth month beginning after the month in which the acquisition date occurs. Since appellant was acquired on

⁸ With respect to the penalty calculation, FTB acknowledges it miscalculated the monthly portion of the penalty by using three months instead of six months. However, in its opening brief, FTB conceded the difference and stated it would not recalculate the penalty.

September 20, 2016, the last day for First American to make a 338 election was June 15, 2017, the 15th day of the ninth month after the acquisition.

Appellant acknowledges that it does not meet the requirements for the waiver provision in Treasury Regulation section 1.338-10(b) for California purposes, because it did not make its payment of California tax on or before June 15, 2017. Instead, appellant argues that the penalty should be abated for reasonable cause pursuant to R&TC section 19132. Appellant further asserts that the penalty waiver provision in Treasury Regulation section 1.338-10(b) is not applicable for California purposes and cannot be used to “interpret the reasonable cause provisions in [R&TC s]ection 19132,” because California has chosen not to conform to IRC section 6651 (the federal failure to file tax return or pay tax penalties), and instead enacted its own stand-alone language imposing a late payment penalty in R&TC section 19132, which “parallels” the federal penalty provision.

Contrary to appellant’s assertion, the penalty waiver provision contained in Treasury Regulation section 1.338-10(b) is applicable for California tax purposes because California conforms to IRC section 338. (See R&TC, § 24451.) Because California law incorporates the provisions of IRC section 338, California also applies the Treasury Regulations promulgated thereunder. (R&TC, § 17024.5(d); *Appeal of Daneshgar*, 2021-OTA-210P.) Additionally, 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.” (R&TC, § 19132(a)(1); IRC, § 6651(a)(2).) When material provisions of federal and state statutes are substantially identical, interpretation of the federal statute guides construction of the state statute. (*Appeal of Jones*, 2021-OTA-144P, fn. 2; *Appeal of Rougeau*, 2021-OTA-335P, fn. 1.)

Thus, the penalty waiver provision contained in Treasury Regulation section 1.338-10(b) is applicable for California purposes and OTA finds it be relevant to the question of whether there is reasonable cause for the abatement of the late payment penalty under R&TC section 19132. While appellant asserts, and OTA agrees, that a taxpayer can still show reasonable cause for the late payment of tax under R&TC section 19132 where the penalty waiver provision in Treasury Regulation section 1.338-10(b) is not met, OTA disagrees with appellant’s assertion that the penalty waiver provision in Treasury Regulation section 1.338-10(b) is not relevant to and should not be considered in this reasonable cause

analysis.⁹ As appellant notes, reasonable cause under R&TC section 19132 is a “facts and circumstances” analysis. Here, one of those relevant facts and circumstances is that appellant could have obtained a waiver of the California late payment penalty by paying its California tax by June 15, 2017, the last day for making a 338 election. OTA understands appellant’s arguments regarding the complexity of and due diligence required for making a 338 election, and the subsequent federal and state tax computations that must be done as a result of such an election;¹⁰ however, appellant had almost nine months (i.e., from the date of the sale on September 20, 2016, through June 15, 2017) to do both and avoid imposition of the late payment penalty under the Treasury Regulation penalty waiver provision. Where, as here, the law provides relief from the imposition of the late payment penalty if the taxpayer makes payment by a specific date (here, June 15, 2017) after the original payment due date (here, January 15, 2017), OTA believes that an ordinarily intelligent and prudent businessperson would have made a diligent effort to pay its tax by that specific date. Thus, OTA concludes that an ordinarily intelligent and prudent businessperson would have attempted to not only make the 338 election within the time period provided in IRC section 338(g), but also would have made a diligent effort to pay the California tax due by this date (i.e., by June 15, 2017), such that it would qualify for waiver of the penalty under Treasury Regulation section 1.338-10(b).

Appellant primarily focuses its arguments on its actions following First American’s 338 election on June 5, 2017, noting this election was made timely and that it filed its federal tax return only eight days later on June 13, 2017, filed its California tax return only nine days after that on June 22, 2017, and then paid its California tax only 13 days later on July 5, 2017. However, this analysis does not address the period of time from the date of the sale on September 20, 2016, through First American’s 338 election on June 5, 2017. For this earlier time period, appellant describes in detail the efforts it undertook in deciding whether to make the

⁹ Appellant specifically asserts, “California has not legislated under [R&TC] section 19132 that reasonable cause can only be found to exist within the time period set out in Treasury Regulation section 1.338-10(b).” OTA agrees that reasonable cause can potentially be established under R&TC section 19132 even where the tax is paid after the penalty waiver period provided in the Treasury Regulation.

¹⁰ Appellant notes that it had filing requirements in 25 states for this tax year.

338 election by the June 15, 2017 election deadline; however, it does not specifically describe what efforts it made to also calculate and pay its California taxes by this same date.

For example, First American details the due diligence steps it undertook to assess whether it was prudent to make the 338 election, including the preparation of a 338 election model, researching and identifying the states that permit 338 elections, reviewing appellant's prior year return workpapers to evaluate its net operating losses and credit carryovers, and assessing the risks inherent in making a 338 election. Appellant also explains that it had limited resources after the acquisition by First American as many of its tax personnel were no longer employed by appellant, and notes that it had to obtain a purchase price allocation analysis from a third-party valuation firm.¹¹ However, given that appellant was owned by First American during this time period, appellant does not explain why it could not have worked on calculating its federal and California tax liabilities resulting from the 338 election, while First American was still doing some of its due diligence in determining whether to make that election. Appellant is essentially silent as to what efforts it specifically made to calculate and pay its California tax during this almost nine-month time period. Appellant does not expressly assert that it attempted to compute and pay its California tax liability within the penalty waiver period, and that despite exercising ordinary business care and prudence, it was nevertheless prevented from making such payment by June 15, 2017.¹²

Appellant asserts reasonable cause exists to excuse its late payment of tax because appellant's tax was dependent on First American's 338 election, and appellant made its payment shortly after First American made that election. Appellant points out that it could not pay its tax by the original payment deadline of January 15, 2017, because as of that date, First American had not yet decided that it would make the 338 election. OTA understands this argument;

¹¹ Appellant provides drafts of this valuation dated February 23, 2017, and March 23, 2017.

¹² Appellant instead asserts that the eight and a half months provided in IRC section 338(g) for a taxpayer to make a 338 election is the time Congress determined was necessary for a taxpayer to do its due diligence in determining whether to make the 338 election, and that it should, therefore, be allowed a reasonable amount of time after this date (here, June 15, 2017) to then compute and pay its California taxes. However, OTA believes 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). Thus, while OTA concludes that a taxpayer can still establish reasonable cause for the late payment of tax where the tax is paid after the penalty waiver period, OTA believes that reasonable cause in such circumstances requires the taxpayer to show that it exercised ordinary business care and prudence in attempting to calculate and pay the tax within the penalty waiver period, but was unable to do so.

however, “an acceptable reason for failure to pay taxes will excuse such failure only so long as the reasons remain valid.” (*Appeal of Triple Crown Baseball LLC*, 2019-OTA-25P.)¹³

Here, appellant had all the information and documents necessary to calculate its tax due prior to the June 15, 2017 penalty waiver deadline. Appellant provided a schedule dated June 8, 2017 (one week before the penalty waiver deadline), which showed a calculation of the California income tax due of \$122,724, the exact amount appellant reported as due on its California tax return. In fact, appellant mailed a check payment in this exact amount to FTB nearly one month later on July 5, 2017. Appellant has not provided a good reason for the delay in mailing a check, after it had computed its California tax liability by June 8, 2017. Although it may have been inconvenient for appellant to pay its California tax liability before filing its California tax return, appellant had the requisite information which indicates reasonable cause did not exist after this date. (See *Appeal of Cerwin-Vega Int’l* (78-SBE-070) 1978 WL 3543.) Appellant asserts that there was an internal process required for it to submit the California tax return and payment and that there was a “minor administrative delay further exacerbated by the Fourth of July [holiday],” in its processing of the California tax payment. However, appellant does not adequately explain why after computing its California tax liability by June 8, 2017, one week was insufficient for its internal process such that the tax payment could not be timely made within the penalty waiver period. In fact, there is no evidence in the record demonstrating appellant was “unable [to make a tax payment] within the prescribed time.” (*U.S. v. Boyle* (1985) 469 U.S. 241, 246.) As stated above, appellant bears the burden in showing reasonable cause existed, and unsupported assertions are not sufficient for appellant to carry that burden. (*Moren, supra.*) To the extent appellant’s failure to make a timely payment of its California tax liability was due to a “minor administrative delay,” OTA notes that 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. (*Appeal of Friedman*, 2018-OTA-077P.)

¹³ OTA requested the parties provide additional briefing on 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, while OTA understands that First American had not yet made its 338 election by the January 15, 2017 original payment due date, in order to be entitled to an abatement of the late payment penalty, appellant must establish that reasonable cause for its late payment existed for the entire period running from the original due date of appellant’s tax on January 15, 2017, through the date the tax was actually paid on July 5, 2017.

The dissent relies on *Moren* to find reasonable cause for the four-week period of time appellant took to pay its California tax (mailed to FTB on July 5, 2017), after First American made its 338 election on June 5, 2015; however, the facts in *Moren* are distinguishable. In *Moren*, the taxpayer was unaware that the distribution from the estate would be taxable until after the payment deadline, when he received the Schedule K-1 from the estate in late August 2016. After receiving that Schedule K-1, the taxpayer questioned the estate's determination that the distribution was taxable and requested clarification from the estate (including the underlying documentation), but ultimately received no response. During the six-week period between the receipt of the Schedule K-1 and payment of tax, the taxpayer was both seeking clarification from the estate and computing his California tax liability. Here, after First American made its 338 election on June 5, 2017, the evidence shows that appellant had computed its California tax liability three days later by June 8, 2017. Appellant has not explained why after computing its tax by June 8, 2017, it took almost four weeks to then mail its payment to FTB. Unlike *Moren*, there was nothing left for appellant to do after it had computed its tax liability by June 8, 2017, other than remit its payment to FTB. Also, unlike *Moren*, appellant here had the information it needed to compute its tax even before First American made its 338 election on June 5, 2017, and knew that tax would be due if such an election were made.¹⁴ While the taxpayer in *Moren* did not know what portion, if any, of the distribution from the estate would be taxable, and could not begin his tax computation until the Schedule K-1 was received, the same is not true here. Consequently, appellant has not shown that reasonable cause existed from the day its tax payment was due until the day payment was made. As a result, the late payment penalty cannot be abated.

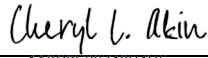
¹⁴ Appellant could have done its tax computations resulting from the 338 election while First American was still performing its due diligence in deciding whether or not to make that election and appellant and First American had almost nine months to do so.

HOLDING


Appellant has not shown that the late payment penalty should be waived or abated.

DISPOSITION

FTB's action is sustained.

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Cheryl L. Akin
Administrative Law Judge

I concur:

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John O. Johnson
Administrative Law Judge

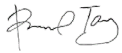
R. TAY, Dissenting:

I respectfully dissent from the majority's denial of the refund of the late payment penalty because I find appellant has met its burden to show reasonable cause. There is little disagreement on the facts; however, I find appellant's actions from the original payment due date through the actual date of payment to reflect ordinary business care and prudence, and thus, would have granted the refund. (*Appeal of Moren*, 2019-OTA-176P (*Moren*)). Appellant's tax payment was dependent on whether First American Financial Corporation (First American) would make an election under Internal Revenue Code section 338 (the 338 election), which it did on June 5, 2017.¹

After First American decided to make the 338 election, appellant calculated an estimate of its California tax on or around June 8, 2017, and subsequently, prepared its California return, finalized its tax liability and made its California income tax payment on July 5, 2017. Given the complexity of the 338 election, the corresponding California adjustments, and the other state returns appellant needed to prepare and file, I find the four-week period of time to process and submit the income tax return and tax payment consistent with ordinary business care and prudence. (See *Moren, supra*.) In *Moren*, the Office of Tax Appeals (OTA) found that approximately six weeks for "the process of preparing [the taxpayer's] return, determining his tax liability, and submitting both" to the Franchise Tax Board was "a reasonable time period."

¹ Appellant asserts it would have reported an overall loss if First American did not make the 338 election. Thus, presumably, any effort in accurately estimating its tax would have resulted in two vastly different amounts.

The taxpayer in *Moren* received a Schedule K-1 on or before August 21, 2016, and then, proceeded to prepare and file his return, and pay the tax due on October 15, 2016.² OTA did not conclude this delay defeated the taxpayer’s reasonable cause argument. Similarly, in this appeal, I find appellant’s time to prepare the California return, finalize the tax liability and submit its tax payment (approximately four weeks) to be “a reasonable time period.” Accordingly, I dissent.

DocuSigned by:

Richard Tay
Administrative Law Judge

Date Issued: 3/23/2023

² The taxpayer in *Moren* also sought clarification of the information on the Schedule K-1, which delayed the return preparation process slightly, but for purposes of this appeal, not significantly. The *Moren* Opinion states that it took the taxpayer “a matter of weeks” to complete the process of preparing the return and paying the tax due. The facts show it took approximately six weeks after the taxpayer sought clarification and decided to file the return based on the information on the Schedule K-1.