OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **METRO MORTGAGE GROUP, LLC**	)	OTA Case No. 230713826

OPINION

Representing the Parties:

For Appellant: Dorelle Peters, Managing Member

For Respondent: Alisa L. Pinarbasi, Attorney
Topher Tuttle, Attorney

N. RALSTON, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19331, Metro Mortgage Group, LLC (appellant) appeals an action by the Franchise Tax Board (respondent) denying appellant's claim for refund of $1,652.69 for the 2019 tax year.

Appellant elected to have this appeal determined pursuant to the procedures of the Small Case Program. Those procedures require the assignment of a single panel member. (Cal. Code Regs., tit. 18, § 30209.05.)

Office of Tax Appeals (OTA) Administrative Law Judge Natasha Ralston held an oral hearing for this matter in Sacramento, California on September 18, 2024. At the conclusion of the oral hearing, the record was closed and this matter was submitted on the oral hearing record pursuant to California Code of Regulations, title 18, (Regulation) section 30209(b).

ISSUES

1. Whether appellant owes the annual Limited Liability Company (LLC) tax.
2. Whether appellant has established a basis to abate the late filing penalty.
3. Whether appellant has established a basis to abate the demand penalty.
4. Whether appellant has established a basis to abate filing enforcement fee.

FACTUAL FINDINGS

1. Appellant is a Colorado LLC.
2. Appellant elected to be treated as an S corporation for federal purposes, but did not file a California return.
3. After receiving information that appellant had at least one employee in California during the 2019 tax year, respondent issued a Demand for Tax Return (Demand) to appellant. The Demand required appellant to respond to the Demand by filing a 2019 California return, providing evidence that it had already filed a 2019 return or explaining why it did not have a filing requirement.
4. Appellant responded by filing a Nonqualified Business Entity Questionnaire (Questionnaire). In the Questionnaire appellant stated that it did not have any sales or property in California, but did have one occasional part-time clerical employee in California who generated no business.
5. Based on this information, respondent determined that appellant had a filing requirement and issued a Determination of Filing Requirement on September 29, 2021, which required appellant to file a return by October 27, 2021.
6. FTB subsequently issued a Notice of Proposed Assessment (NPA) assessing tax of $800, a late filing penalty of $432, a demand penalty of $200 and a filing enforcement fee of $97. The NPA also assessed applicable interest.
7. Appellant subsequently paid the amount due and filed a claim for refund on June 3, 2022, alleging that appellant was not "actively engaging in any transaction for the purpose of financial or pecuniary gain or profit" in California and did not meet any of the thresholds set forth in R&TC section 23101(b) during the 2019 tax year such that it could be considered doing business. Appellant confirmed that it employed a California resident during the 2019 tax year, but argued that the employee was compensated $121, less than one percent of total payroll.
8. Appellant's claim for refund was deemed denied by respondent because respondent did not grant or issue a denial within 6 months of the claim. Appellant filed this timely appeal.

DISCUSSION

Issue 1: Whether appellant owes the annual LLC tax.

Respondent's determination of tax is presumed to be correct, and the taxpayer has the burden of proving otherwise. (*Appeal of Head and Feliciano,* 2020-OTA-127P.) Unsupported

assertions are not sufficient to satisfy that burden of proof. (*Appeal of Wright Capital Holdings, LLC,* 2019-OTA-219P.) Respondent's determination cannot successfully be rebutted when the taxpayer fails to provide credible, competent, and relevant evidence as to the issues in dispute. (*Ibid*.)

R&TC section 17941 provides that every LLC must pay the annual $800 LLC tax for the privilege of "doing business" in California, as defined in R&TC section 23101. (R&TC, §§ 17941(a), 23153(d).) R&TC section 23101, in turn, establishes two alternative ways a taxpayer is considered doing business in California. (*Appeal of GEF Operating, Inc.*, 2020-OTA-057P.) Respondent bases its proposed assessment in this case on R&TC section 23101(a), which provides that a taxpayer is doing business in California if it is "actively engaging in any transaction for the purpose of financial or pecuniary gain or profit."[1]

The word "actively" has been interpreted as the opposite of passively or inactively, and means the active participation in any transaction for the purpose of a financial or pecuniary gain or profit. (*Golden State Theatre & Realty Corp. v. Johnson* (1943) 21 Cal.2d 493, 496 [construing the predecessor to R&TC section 23101(a)].) The transaction does not need to result in an actual profit for purposes of R&TC section 23101(a), and the relevant inquiry is whether the activity or transaction was motivated by a financial or pecuniary gain or profit. (*Hise v. McColgan* (1944) 24 Cal.2d 147; *Appeal of Columbia Supply Co*. (60-SBE-012) 1960 WL 1391.)

Here, it is undisputed that appellant employed a California employee during the 2019 tax year. Based on these facts, respondent's determination that appellant was doing business in California during 2018 is reasonable. Therefore, it is presumed to be correct; appellant thus has the burden of proving error. *(Appeal of GEF Operating, Inc.*, *supra*.) Appellant has argued that its primary business is as a mortgage broker and that its California employee was a "limited engagement employee" and was not licensed to originate mortgages in California. Appellant further argues that the employee performed clerical duties, such as organizing electronic files, that can hardly be construed as contributing to the transactions for the purpose of financial gain or profit.

[1] The second way a taxpayer is considered doing business in California is if it satisfies certain bright-line nexus conditions or thresholds found in R&TC section 23101(b)(1) through (4), which is effective for tax years beginning on or after January 1, 2011. However, respondent concedes that appellant does not meet the payroll threshold under R&TC section 23101(b)(4), and it does not appear to us that appellant meets the remaining conditions under R&TC section 23101(b). Therefore, we do not consider these conditions or thresholds further.

OTA finds the fact that appellant employed a California employee during the 2019 tax year is sufficient to find that appellant was engaged in business for the purposes of R&TC section 23101(a).) While the employee may not have directly engaged in the profit-making activity of the LLC (i.e. brokering mortgages), OTA finds that hiring an employee is a profit-motivated transaction as it contributed to appellant's business and appellant has not provided evidence to show that the employee was hired for any reason other than to further appellant's business. Therefore, respondent properly determined that appellant was subject to the $800 LLC tax, and appellant has failed to carry its burden of showing it was not doing business in California.

Issue 2: Whether appellant has established a basis to abate the late filing penalty.

R&TC section 19172.5 imposes a per-shareholder late filing penalty on an S corporation 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. When FTB imposes a penalty, the law presumes that the penalty was imposed correctly, and the burden of proof is on the taxpayer to show that reasonable cause exists to support abating the penalty. (*Appeal of Xie*, 2018-OTA-076P.) Reasonable cause requires a showing that the taxpayer acted as an ordinarily intelligent and prudent businessperson would have acted under similar circumstances. (*Appeal of Quality Tax & Financial Services, Inc.*, 2018-OTA-130P.) The due date to file Form 100S is on or before the 15th day of the third month following the close of the S corporation's taxable year. (R&TC, § 18601(d)(1).) For the 2019 tax year, respondent postponed the due date for filing Form 100S to July 15, 2020, in response to the COVID-19 pandemic.[2] The penalty is not measured by the tax amount due, but is instead imposed based on the number of shareholders and lateness of the return. The amount of the per-shareholder late filing penalty is calculated as $18 multiplied by the number of persons who were shareholders in the S corporation during any part of the taxable year multiplied by the number of months (or fraction thereof) the return is late, but not to exceed 12 months. (R&TC, § 19172.5(a), (b).)

Here, appellant's 2018 tax return was due on March 15, 2019, and appellant has not filed a return. Appellant has not alleged error in the imposition or calculation of the penalty but rather, argues that it did not have a filing requirement. Here, appellant's assertion that it was unaware of its California filing requirements because it believed that did not conduct any business in California during the 2019 tax years does not demonstrate that appellant acted as

[2] See https://www.ftb.ca.gov/about-ftb/newsroom/news-releases/2020-3-state-postpones-tax-deadlinesuntil-july-15-due-to-the-covid-19-pandemic.html.

an ordinary intelligent and prudent businessperson. Even if appellant was unaware of a filing requirement, ignorance of the law is not an excuse for failing to file a timely return. (*Appeal of GEF Operating, Inc.*, *supra*.)

Issue 3: Whether appellant has established a basis to abate the demand penalty.

R&TC section 19133 provides that if a taxpayer fails to make and file a return upon notice and demand by respondent, then respondent may impose a demand penalty unless the taxpayer's failure is due to reasonable cause. The requirements for imposing the demand penalty for the 2018 tax year were satisfied here; the issue is whether there is reasonable cause to abate the demand penalty. The burden of proving reasonable cause for failing to file upon demand is on the taxpayer. (*Appeal of GEF Operating, Inc*., *supra*.) To establish reasonable cause, a taxpayer must show that the failure to timely respond to a demand occurred despite the exercise of ordinary business care. (*Ibid*.) The taxpayer's reason for failing to respond to a demand must be such that an ordinarily intelligent and prudent businessperson would have acted similarly under the circumstances. (*Ibid*.)

Respondent informed appellant in the Demand that appellant was required to file a return for the 2019 tax year and may be subject to the demand penalty if respondent did not receive a return from appellant within the prescribed period in the Demand. Appellant responded to the Demand by filing the Questionnaire with respondent and argued that it did not have a California filing requirement. OTA finds that appellant reasonably believed that it did not have a California filing requirement and therefore, it was reasonable for appellant to respond to respondent's Demand by filing the Questionnaire. Although respondent subsequently issued a Determination of Filing Requirement, OTA finds that an ordinarily intelligent and prudent businessperson would have reasonably believed that filing the Questionnaire was a sufficient response to respondent's Demand. Thus, appellant has established reasonable cause for abatement of the demand penalty.

Issue 4: Whether appellant has established a basis to abate filing enforcement fee.

Respondent shall impose a filing enforcement fee if a taxpayer fails or refuses to file a required tax return within 25 days after respondent mails a formal legal demand to file the tax return. (R&TC, § 19254(a)(2).) Once the fee is properly imposed, the statute provides no grounds, including reasonable cause, upon which the fee may be abated. (R&TC, § 19254; see *Appeal of Shanahan*, 2024-OTA-039P.) Therefore, OTA's inquiry is limited to whether respondent complied with the statutory notice requirements for imposing the filing enforcement fee. Here, respondent issued appellant a Demand for the 2019 tax year, notifying appellant that

it would impose a filing enforcement fee if appellant had a filing requirement and failed to file a tax return by the due date stated in the Demand. Respondent properly imposed the fee after appellant, who has a 2019 tax return filing requirement, did not file a tax return. Since the fee was properly imposed, there is no authority for the abatement of this fee; therefore, OTA cannot abate the filing enforcement fee.

HOLDINGS

1. Appellant owes the annual LLC tax.
2. Appellant has not established a basis to abate the late filing penalty.
3. Appellant has established a basis to abate the demand penalty.
4. Appellant has not established a basis to abate filing enforcement fee.

DISPOSITION

The demand penalty is abated, and respondent's action is otherwise sustained.

Signed by:
Natasha Ralston
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Natasha Ralston
Administrative Law Judge

Date Issued: 12/13/2024