

ISSUES²

1. Whether appellants have substantiated sufficient basis in appellant H. Hojati's (Shareholder's) stock shares of ICC Collision Centers 1, Inc. (ICC 1) to allow additional pass-through losses beyond the amount allowed by FTB.
2. Whether appellants have substantiated other pass-through losses beyond the amount allowed by FTB.
3. Whether appellants have shown reasonable cause to abate the late-filing penalty.

FACTUAL FINDINGSBackground

1. For the 2017 tax year, Shareholder was the sole owner of four corporations taxed as S corporations: ICC Collision Centers, Inc. (ICC), ICC 1, ICC Collision Centers 6, Inc. (ICC 6), and Apex Management, Inc. (Apex). ICC conducted business solely outside of California and did not file a California corporate income tax return. ICC 1 was incorporated in 2009.
2. For the 2017 tax year, Shareholder was a 50 percent owner of two partnerships, Arizona State Commercial Properties, LLC (ASCP) and California State Commercial Properties, LLC (CSCP). Appellant E. Hojati was the other 50 percent owner of both partnerships. ASCP was not a California taxpayer.
3. On December 26, 2018, ICC 1 filed a California S Corporation Franchise or Income Tax Return for the 2017 tax year (2017 Form 100S). On the 2017 Form 100S, ICC 1 reported a net loss after state adjustments of \$2,286,521. On California Schedule K-1, Shareholder's Share of Income, Deductions, Credits, etc. (CA Schedule K-1), ICC 1 reported that Shareholder's pro rata share of ICC 1's ordinary business loss for California purposes was \$2,286,521.
4. On January 14, 2019, FTB received appellants' joint California Resident Income Tax Return for the 2017 tax year (2017 Return), which reported a total pass-through loss of \$4,453,349 for state purposes on line 17 of Schedule CA, California Adjustments –

² The parties agree that the itemized deduction limitation solely results from FTB's adjustments and is computational in nature. (See RT&C, § 17077; Internal Revenue Code (IRC), § 68.) The itemized deduction limitation will be discussed only if and to the extent FTB's adjustments are found to be in error.

Residents (Schedule CA).³ The 2017 Return also reported itemized deductions of \$52,192 on Schedule CA.

FTB's audit and appeal

5. FTB audited the 2017 Return. FTB requested documentation to support Shareholder's stock basis in ICC 1 and ICC 1's indebtedness to Shareholder (debt basis).
6. Appellants provided a 2017 stock basis schedule which used federal income amounts to report Shareholder's negative basis of \$1,119,866 in ICC 1 as of December 31, 2017. Appellants did not provide a debt basis schedule.
7. Based on CA Schedule K-1 information available to FTB, it generated a schedule of Shareholder's basis in ICC 1 from 2013 to 2017. FTB determined that Shareholder's beginning basis in ICC 1 for 2013 was \$5,000. FTB recomputed Shareholder's basis in ICC 1 to \$1,421,360 as of December 31, 2017. Accordingly, FTB determined that Shareholder's pass-through loss from ICC 1 was limited to \$1,421,360, disallowed losses of \$865,161 ($\$2,286,521 - 1,421,360 = \$865,161$),⁴ and proposed to increase appellants' taxable income by \$865,161.
8. Based on the CA Schedule K-1 information available to FTB, it recomputed appellants' total allowable California flow-through losses from all entities to \$4,268,324. As appellants reported total California losses of \$4,453,349 on the 2017 Return, FTB disallowed losses of \$185,024 ($\$4,453,349 - 4,268,325 = \$185,024$), and it proposed to increase appellants' taxable income by \$185,024.
9. FTB issued appellants a Notice of Proposed Assessment (NPA), which as relevant here, proposed to increase appellants' California taxable income by \$1,088,077 based on the disallowed flow-through losses and itemized deductions.⁵ The NPA also proposed to assess a late-filing penalty of \$24,740.

³ Line 17 reports income and adjustments from rental real estate, royalties, partnerships, S. corporations, trusts, etc. \$4,155,504 of the total pass-through loss was attributable to Shareholder and \$297,845 was attributable to appellant E. Hojati. Shareholder's pass-through loss included the \$2,286,521 flow-through loss from ICC 1.

⁴ The disallowed loss of was suspended to a future tax year when Shareholder had sufficient basis to claim the loss.

⁵ There is a \$1 difference between FTB's determination of the adjustment at audit and on the NPA. The difference does not affect the outcome of this appeal. FTB also proposed to include a mental health services tax based on the income adjustments. Appellants have not made any specific argument regarding that adjustment, and therefore, the Opinion does not discuss it further. FTB subsequently discovered some math errors at protest and appeal but does not seek to increase its adjustment.

10. Appellants timely protested the NPA.
11. On November 28, 2022, FTB issued appellants a Notice of Action affirming the NPA.
12. This timely appeal followed. On appeal, appellants provide, for the 2017 tax year, a federal Schedule K-1 for ASCP, CA Schedule K-1s for CSCP, a 2017 California worksheet for Schedule E, Rents, royalties, partnerships, estates, etc. (Schedule E), and a federal supporting statement for Schedule E.⁶ On appeal, FTB provides, for the 2017 tax year, federal Schedule K-1s for ICC, ICC 1, ICC 6, Apex, and ASCP; CA Schedule K-1s for ICC 1, ICC 6, Apex, CSCP; and federal Schedule E.

DISCUSSION

Issue 1: Whether appellants have substantiated sufficient basis in Shareholder's stock shares of ICC 1 to allow additional pass-through losses beyond the amount allowed by FTB.

FTB's determination of tax is presumed to be correct, and taxpayers have the burden of proving otherwise. (*Appeal of Nag and Rudd*, 2023-OTA-150P.) Unsupported assertions are not sufficient to satisfy taxpayers' burden of proof. (*Ibid.*) In the absence of credible, competent, and relevant evidence showing that FTB's determination is incorrect, it must be upheld. (*Ibid.*) Taxpayers' failure to produce evidence that is within their control gives rise to a presumption that such evidence, if provided, would be unfavorable to the taxpayers' case. (*Appeals of Kwon, et al.*, 2021-OTA-296P.)

It is well settled that establishing basis is a factual matter. (*Vaira v. Commissioner* (3rd Cir. 1971) 444 F.2d 770, 775; see *Oates v. Commissioner* (8th. Cir. 1963) 316 F.2d 56, 58-59; *Burnet v. Houston* (1931) 283 U.S. 223, 227.) The burden of proof is generally on appellants as to all issues of fact and requires proof by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(a), (b).) To meet this evidentiary standard, a party must establish by documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (*Appeal of Belcher*, 2021-OTA-284P.)

California has adopted federal tax law regarding the treatment of S corporations and their shareholders, except as otherwise provided under the R&TC. (R&TC, § 17087.5; see also *The 2009 Metropoulos Family Trust, et al. v. Franchise Tax Bd.* (2022) 79 Cal.App.5th 245, 268.) For both federal and California tax purposes, the S corporation's income and losses are passed through on a pro rata basis to the corporation's shareholders, who must report them on

⁶ On appeal, appellants also submit an unsigned 2017 Form 100S for ICC 1, which they assert is an amended return which was timely filed. The unsigned 2017 Form 100S adjusts Schedule L, balance sheet, to move \$1,230,364 from line 15, accounts payable, to line 22, paid-in or capital surplus. This reclassification purports to increase appellants' basis by \$1,230,364.

their individual returns. (Internal Revenue Code (IRC), §§ 1363(b) & 1366; R&TC, §§ 17087.5, 23800; *Appeal of Johnson*, 2022-OTA-166P.) An S corporation uses CA Schedule K-1 to report the shareholder's pro rata share of the S corporation's income, deductions, credits, etc., and the shareholder uses the information from the CA Schedule K-1 to file his or her return and is liable for the income tax on his or her pro rata share of the S corporation's income. (*Appeal of Johnson*, *supra*.)

In general, a shareholder's basis is increased by his or her pro rata share of the pass-through items of income and decreased by his or her pro rata share of the pass-through of items of loss and deductions, nondeductible expenses and distributions. (IRC, § 1367.) A shareholder's basis may not be decreased below zero. (IRC, § 1367(a)(2).) The aggregate amount of losses and deductions that the shareholder may utilize in each taxable year is limited to the amount of the shareholder's basis. (IRC, § 1366(d)(1).) However, where decreases to basis exceed the amount which reduces the shareholder's basis to zero, such excess may reduce the shareholder's debt basis. (IRC, § 1367(b)(2)(A).) If the pass-through losses exceed the shareholder's basis due to the basis limitation, then the exceeding losses are generally suspended and carried forward until there is sufficient basis to allow the shareholder use of those losses. (IRC, § 1366(d)(2)(A).)

Appellants contest FTB's determination that Shareholder's initial basis in ICC 1 was only \$5,000 for 2013. Shareholder testified that: all six pass-through entities relevant to this appeal were related to the body shop business;⁷ the business originated with one body shop; the business expanded into multiple body shops; and eventually, each body shop was separately incorporated. ICC 1 was one such body shop. Shareholder further testified that: when ICC 1 was separately incorporated, equipment was transferred to ICC 1 from another location; ICC 1 had depreciable assets including a frame machine and a paint booth; and when ICC 1 was separately incorporated, about \$1 million of assets were transferred to ICC 1. Appellants assert that the transferred assets should have also been included in Shareholder's basis. However, Shareholder admits that "I never took inventory of the assets."

Appellants provide no evidence to support their assertions. Appellants do not provide copies of ICC 1's returns or Shareholder's Schedule K-1's for the 2010 through 2013 tax years. Appellants provide no contracts, agreements, or other evidence establishing Shareholder's additional stock basis or debt basis in ICC 1. Appellants have the burden to establish basis by

⁷ Shareholder testified that Apex was the management company for all the body shops, and that ASCP and CSCP owned the real estate in Arizona and California, respectively, where the body shops were located. ICC, ICC 1, and ICC 6 were the auto body shops.

documentation or other evidence, and in the absence of evidence showing that FTB's determination is incorrect, it must be upheld. (*Vaira v. Commissioner, supra*, 444 F.2d at 775; Cal. Code Regs., tit. 18, § 30219(a), (b); *Appeal of Belcher, supra*; *Appeal of Nag and Rudd, supra*.) Moreover, evidence of additional shareholder basis is within appellants' control, and the failure to provide such evidence gives rise to a presumption that, if provided, it would be unfavorable to their case. (*Appeals of Kwon, supra*.)

Furthermore, for the 2017 tax year, ICC 1 reported capital stock of \$5,000 on Schedule L, Balance Sheet (Schedule L) of the 2017 Form 100S. OTA notes that while ICC 1 reported inventories, depletable assets, and other assets on Schedule L, it reported zero paid-in or capital surplus, and zero loans from shareholders.⁸ Based on the record before OTA, appellants have not established that Shareholder had a basis in ICC 1 exceeding \$5,000.

Appellants also contest FTB's determination that as of December 31, 2017, Shareholder's basis in ICC 1 was \$1,421,360. Shareholder testified that in 2017, ICC 1 changed paint contractors, and, as part of the new paint contract, ICC 1 and its related entities were liable for a \$1.5 million "prebate" or rebate (paint deposit).⁹ During the hearing, appellants asserted that the paint deposit resulted in a net increase in liabilities of \$1,230,364, and ICC 1's 2017 Form 100S shows an increase of \$1,230,364 in accounts payable.¹⁰ Appellants assert that approximately \$1 million was paid back to the former paint contractor as a result of the new paint contract, and the excess paint deposit was used to fund the loss ICC 1 claimed on the 2017 Form 100S.

Appellant H. Hojati testified that he owned 100 percent of ICC 1; the paint deposit was wired to the company only; and concerning the paint deposit in excess of the liability to the former paint company, "we put everything into [ICC 1]." Appellant testified that "as far as I'm concerned I owed" the paint deposit because "ICC 1 was my company" and "I don't like to owe anybody money," and because the new paint contractor insisted that he be personally liable.

⁸ As discussed below, while appellant's unsigned 2017 Form 100S reallocated \$1,230,364 to line 22, paid-in capital or capital surplus, appellants assert that this amount is attributable to a change in paint contractors in 2017. Thus, the unsigned 2017 Form 100S is not relevant to Shareholder's 2013 beginning basis in ICC 1.

⁹ Appellants explained that the paint deposit was a deposit paid by the paint contractor, which was earned over the life of the contract and refunded or discounted at the end of the contract if sufficient volumes of paint were purchased from the paint contractor during the contract. However, if insufficient volumes of paint were purchased from during the contract, ICC 1 and its related entities were obligated to pay the deposit back to the paint contractor when the contract term expired.

¹⁰ During the hearing, appellants explained that "ICC 1 was one of at least three operating companies that were in the body shop business at the time, and some of th[e paint deposit] was passed on to the other members of the group, who are also part of the contract."

Based on the foregoing, appellants assert that the paint deposit increased shareholder basis by \$1,230,364. Moreover, in post-hearing briefing, appellants submit an unsigned 2017 Form 100S for ICC 1 which reclassifies \$1,230,364 of accounts payable as paid-in or capital surplus.

A shareholder who borrows money in an arm's length transaction and then loans the funds to the S corporation, is entitled to an increase in basis. (*Oren v. Commissioner*, T.C. Memo 2002, aff'd (8th Cir. 2004) 357 F.3d 854, 857.) However, a shareholder's guarantee of a corporate loan or pledge of personally owned property, without more, is not an economic outlay and is insufficient to create basis in the S corporation. (*Hargis v. Commissioner* T.C. Memo 2016-232, aff'd (8th Cir. 2018) 893 F.3d 540, 543 (*Hargis*); see Treas. Reg. § 1.1366-2(a)(2)(ii).) Basis is only created when the shareholder is actually called on to make good upon the guaranty or the loan is called to satisfy the corporation's debt. (*Hargis, supra*, 893 F.3d at p. 543.)

However, appellants provide no contracts, agreements, promissory notes, or other evidence establishing Shareholder's additional stock basis or debt basis in ICC 1. Appellants have not substantiated whether Shareholder, ICC 1, and/or other entities in the body shop business were jointly liable for the paint deposit as co-signors, borrowers, or otherwise, or whether Shareholder and/or other entities were guarantors of the paint deposit. Even if OTA considers the unsigned 2017 Form 100S, the tax return itself is not evidence that the statements contained therein are true and correct. (See *Seaboard Commercial Corp. v. Commissioner* (1957) 28 T.C. 1034, 1051.)

As described above, appellants have the burden to establish basis, and in the absence of evidence showing that FTB's determination is correct, it must be upheld. (*Vaira v. Commissioner, supra*, 444 F.2d at p. 775; Cal. Code Regs., tit. 18, § 30219(a), (b); *Appeal of Belcher, supra*; *Appeal of Nag and Rudd, supra*.) As mentioned previously, evidence of additional shareholder basis is within appellants' control, and the failure to provide such evidence gives rise to a presumption that, if provided, it would be unfavorable to their case. (*Appeals of Kwon, supra*.) Based on the record before OTA, appellants have not established that Shareholder had an additional basis in ICC 1 of \$1,230,364.

Issue 2: Whether appellants have substantiated other pass-through losses beyond the amount allowed by FTB.

Partnership losses

Appellants' CA Schedule K-1s and federal Schedule K-1s reported total net flow-through partnership losses from CSCP and ASCP of \$594,891.¹¹ However, on the 2017 California worksheet for Schedule E, appellants reported total net flow-through partnership losses of \$595,691, an \$800 difference. At audit, FTB erroneously added only Shareholder's pro rata share of ASCP's flow-through gains and mischaracterized them as losses. Therefore, FTB determined that appellants were entitled to total net flow-through partnership losses of \$666,043.¹²

In post-hearing briefing, FTB concedes that it made an error and determines that the partnership net flow-through losses should total \$594,891. However, appellants maintain that the partnership net flow-through losses should total \$595,691 based on the tax return, and that FTB's numbers are wrong. Appellants fail to provide any evidence. The tax return itself is not evidence that the statements contained therein are true and correct. (*Seaboard Commercial Corp. v. Commissioner, supra*, 28 T.C. at p. 1051.) Moreover, unsupported assertions are insufficient to satisfy taxpayers' burden of proof. (*Appeal of Mauritzson*, 2021-OTA-198P.) Therefore, OTA finds that total net flow-through partnership losses should be \$594,891, and no additional partnership losses are allowable.

S corporation losses

As described above, the 2017 Return reported a total pass-through loss of \$4,453,349 for state purposes on line 17 of Schedule CA and on the 2017 California worksheet for Schedule E. Excluding claimed net partnership losses of \$595,691 and claimed pass-through S corporation loss from ICC 1 of \$2,286,521, addressed above, appellants' other claimed net S corporation losses total \$1,571,137 ($\$4,453,349 - 595,691 - \$2,286,521 = \$1,571,137$). In post-hearing briefing, FTB provides Shareholder's CA Schedule K-1s for Apex and ICC 6, which

¹¹ Shareholder's CA Schedule K-1 for CSCP and Shareholder's federal Schedule K-1 for ASCP totaled a net flow-through loss of \$297,446 ($-\$321,163 + 23,717 = -\$297,446$). Appellant E. Hojati's CA Schedule K-1 for CSCP and ASCP totaled a net flow-through loss of \$297,445. ($-\$321,163 + 23,718 = -\$297,445$). The total net flow-through loss was therefore \$594,891.

¹² FTB calculated appellants' loss as \$666,043, which equals the sum of \$642,326, representing appellants' flow-through loss from CSCP (\$321,163 attributable to shareholder, and \$321,153 attributable to E. Hojati), and \$23,717, representing Shareholder's flow-through income from ASCP (incorrectly added as a loss).

report total California flow-through losses of \$884,509.¹³ Shareholder's federal Schedule K-1 for ICC reports a flow-through loss of \$431,251, which FTB accepted for California purposes, for a total net other S corporation loss of \$1,315,760 ($\$884,509 + \$431,251 = \$1,315,760$).

Consistent with Shareholder's CA Schedule K-1 and federal Schedule K-1 reporting for the other S corporations, FTB decreased appellants' allowable loss for the other S corporations by \$255,377 ($\$1,571,137 - \$1,315,760 = \$255,377$).

In post-hearing briefing, appellants maintain that the total S corporation losses should be \$3,832,658 as reported on the 2017 California worksheet for Schedule E. Adjusting appellants' figure to exclude claimed ICC 1 losses of \$2,286,521, and to include the IRC section 179 deduction allowable under California law,¹⁴ appellants claim entitlement to total other net S corporation losses of \$1,571,137 ($\$3,832,658 - \$2,286,521 + 25,000 = \$1,571,137$). Appellants assert that they did not receive the CA Schedule K-1s and federal Schedule K-1s and do not know the source of FTB's adjustments; that FTB's numbers are wrong; and that the S corporation losses should reflect the amounts listed in appellants' federal return. However, FTB's adjustments are based upon the California Schedule K-1s issued to appellants, and for entities that operated solely outside of California, FTB used appellants' federal Schedule K-1s. As above, appellants fail to provide any evidence to support that their figure is correct. The tax return itself is not evidence that the statements contained therein are true and correct. (*Seaboard Commercial Corp. v. Commissioner, supra*, 28 T.C. at p. 1051.) Moreover, unsupported assertions are insufficient to satisfy taxpayers' burden of proof. (*Appeal of Mauritzson, supra*.) Therefore, OTA finds that the total other net S corporation losses should be \$1,315,760, and no additional S corporation losses are allowable.

Based on the foregoing, appellants substantiated no additional flow-through losses beyond the amount determined by FTB.¹⁵

¹³ Apex reported California flow-through losses of \$318,617. ICC 6 reported California flow-through losses of \$565,892. $\$318,617 + 565,892 = \$884,509$.

¹⁴ In post-hearing briefing, appellants dispute FTB's "disallowance of appellant's section 179 deduction without explanation of support." However, *appellants* – and not FTB – reported a section 179 adjustment on the 2017 Return, as reflected on the 2017 California worksheet for Schedule E [reporting a \$130,196 section 179 deduction for federal purposes, but only \$25,000 for California purposes]. The adjustment is explained because California limits the deduction for section 179 property to \$25,000. (R&TC, § 24356(b)(2).)

¹⁵ FTB states in post-hearing briefing that, to the extent that the disallowed loss should be increased based on the revised flow-through partnership losses of \$594,891, FTB does not seek to increase the additional tax due from the amount stated on the Notice of Action dated November 28, 2022.

Issue 3: Whether appellants have shown reasonable cause to abate the late-filing penalty.

Absent an extension, individual taxpayers who file on a calendar year basis are generally required to file their income tax returns by April 15 of the following year. (R&TC, § 18566.) While FTB allows an automatic six-month extension to file the return from the April 15 due date, the extension is conditioned solely upon filing a return within the automatic extension period. (Cal. Code Regs., tit. 18, § 18567.) If the return is not filed within six months of the due date, no extension is allowed. (*Ibid.*)

FTB imposes a late-filing penalty on a taxpayer who fails to file a return by either the due date or the extended due date unless it is shown that the failure was due to reasonable cause and not willful neglect. (R&TC, § 19131(a).) The late-filing penalty is calculated at five percent of the tax for each month or fraction thereof that the return is late, with a maximum penalty of 25 percent of the tax. (*Ibid.*) When FTB imposes a late-filing penalty, the law presumes that it has been correctly imposed. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Xie*, 2018-OTA-076P.)

Appellants dispute the imposition and calculation of the late-filing penalty. The burden of proof is generally on appellants as to all issues of fact and requires proof by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 18567.) To meet this evidentiary standard, a party must establish by documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (*Appeal of Belcher, supra.*) Unsupported assertions are insufficient to satisfy taxpayers' burden of proof. (*Appeal of Mauritzson, supra.*)

Concerning the imposition of the penalty, Shareholder testified that the 2017 Return was timely filed electronically. If taxpayers file a return before the statutory filing deadline and the return is received late, taxpayers must offer evidence that the return was timely filed, such as a registered or certified mail receipt. (Gov. Code, § 11003; IRC, § 7502; R&TC, § 21027; *Appeal of Fisher*, 2022-OTA-337P.) Taxpayers assume "the risk that the postmark will bear a date on or before the last date . . . prescribed for filing the [return]," and have the burden of proving the date of the postmark or that the return was timely mailed. (Treas. Reg. § 301.7502-1(c)(1)(iii).) R&TC section 21027 provides that Treasury Regulation section 301.7502-1, as revised on January 10, 2001, shall be applicable to FTB filings.¹⁶

¹⁶ Effective January 1, 2002, California amended R&TC section 21027 to add subdivisions (a)(2) and (b) to conform with specific provisions in IRC section 7502 regarding "designated delivery service" and "electronic filing." Aside from those specific provisions, R&TC section 21027 does not conform to IRC section 7502 in its entirety. (See R&TC, § 21027, as amended by Stats. 2001, ch. 543 (SB 1185), § 20, West's Cal. Legis. Service.)

However, appellants fail to satisfy their burden of proving that the 2017 Return was timely filed because they provide no evidence, such as a registered or certified mailing receipt, or an electronic filing confirmation. Unsupported assertions are insufficient to satisfy taxpayers' burden of proof. (*Appeal of Mauritzson, supra.*) On appeal, FTB provides a copy of the 2017 Return, filed by mail, and apparently signed by appellants with a signature date of December 28, 2018, and showing a received date of January 14, 2019. Shareholder affirmed that the 2017 Return bears his signature, and testified that "I didn't look at the dates" when he signed the return because he trusted his tax preparer, and commented that "if the date is wrong, then I guess it's wrong." Based on the record before OTA, the 2017 Return was filed on January 14, 2019.

Appellants assert in the alternative that the 2017 Return was "less than three months late" but FTB erroneously calculated a 25 percent penalty. However, because the 2017 Return was filed on January 14, 2019, after the six-month extended due date of October 15, 2018, had passed, no extension is allowed. (See Cal. Code Regs., tit. 18, § 18567.) Therefore, the 2017 Return was filed more than eight months after the due date of April 15, 2018. Thus, FTB correctly calculated and imposed the maximum penalty of 25 percent. (See R&TC, § 19131(a).)

Appellants also assert that reasonable cause exists for their failure to file a timely return. When FTB imposes a late-filing penalty, the law presumes that the penalty was properly imposed, and the burden of proof is on the taxpayer to show reasonable cause for the late filing of the return. (*Appeal of Cremel and Koepfel*, 2021-OTA-222P.) To establish reasonable cause, taxpayers must provide credible and competent evidence establishing that the failure to timely file the return occurred despite the exercise of ordinary business care and prudence. (*Ibid.*)

Appellants assert that even if the returns were untimely filed, they had reasonable cause for the late filing. Shareholder testified that appellants' tax preparer always filed returns on extension and told Shareholder that the tax returns were filed on time, and that appellants have a good history of tax compliance. Therefore, appellants conclude that they had no reason to doubt that the 2017 Return was timely filed.

It is well established that each taxpayer has a personal, non-delegable obligation to ensure the timely filing of a tax return, and thus, reliance on an agent to perform this act does not constitute reasonable cause to abate a late filing penalty. (*United States v. Boyle* (1985) 469 U.S. 241, 250 (*Boyle*); *Appeal of Fisher, supra.*) The U.S. Supreme Court has held that "reasonable cause" is established when a taxpayer shows reasonable reliance on the advice of an accountant or attorney that it was unnecessary to file a return, even when such advice turned

out to have been mistaken. (*Boyle, supra*, 469 U.S. at p. 250.) California follows *Boyle* in that taxpayers' reliance on a tax advisor must involve substantive tax advice and not on simple clerical duties. (*Appeal of Mauritzson, supra*.)

Thus, *Boyle* is clear that appellants' reliance on their tax preparer to timely file the tax return is not reasonable cause. (See *Boyle, supra*, 469 U.S. at p. 252.) Appellants' reliance on their tax preparer was not based on substantive tax advice, but instead was based on simple clerical duties. (See *Appeal of Mauritzson, supra*.) Moreover, appellants signed the 2017 Return dated December 28, 2018. Therefore, OTA finds that appellants knew or should have known that the 2017 Return would be filed after the extended due date of October 15, 2018.

Furthermore, California does not allow abatement of the late-filing penalty based solely on a good history of timely filing California returns.¹⁷ Thus, no relief is available based on a good history of tax compliance.

Appellants also assert that they are entitled to rely on "historically successful filing procedures" citing *Willis v. Commissioner*, 736 F.2d 134 (4th Cir. 1984) (*Willis*) because they "followed an established procedure, reviewed the return, authorized the filing and [were] told that the filing had been implemented." However, the *Willis* decision predates and directly conflicts with the decision in *Boyle*. (See *Valen Mfg. Co. v. U.S.* (6th Cir. 1996) 90 F.3d 1190, 1193.) *Boyle* effectively overturns *Willis*. (*Plato v. Commissioner* T.C. Memo. 2018-7.)¹⁸ Moreover, appellants provide no explanation of the "established procedure" and provide no evidence to show that despite the exercise of ordinary business care and prudence, the 2017 Return was untimely filed. (See *Appeal of Cremel and Koepfel, supra*.) Unsupported assertions are insufficient to satisfy taxpayers' burden of proof. (*Appeal of Mauritzson, supra*.) Thus, OTA has no basis to find that appellants established reasonable cause for the late filing of the 2017 Return.

¹⁷ R&TC section 19132.5, effective for tax years beginning on or after January 1, 2022, gives FTB the authority to provide taxpayers with a one-time abatement of timeliness penalties. However, the one-time abatement is inapplicable to the 2017 tax year. (R&TC, § 19132.5(f)(1).)

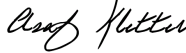
¹⁸ *Willis* is a fourth circuit case and California is not bound to follow it as precedent. OTA precedent holds that an agent's failure to file an income tax return cannot constitute reasonable cause for the taxpayer. (See *Appeal of Fisher, supra*; see also *Conklin Bros. of Santa Rosa, Inc. v. U.S.* (9th Cir. 1993) 986 F.2d 315, 317-318 [applying *Boyle* to distinguish taxpayers' reliance on an agent, which cannot avoid statutory tax obligations, from taxpayers' inability to timely comply with tax obligations due to circumstances beyond their control, which may establish reasonable cause for late filing].)

HOLDINGS


1. Appellants have not substantiated sufficient basis in Shareholder’s stock shares of ICC 1 to allow additional pass-through losses beyond the amount allowed by FTB.
2. Appellants have not substantiated other pass-through losses beyond the amount allowed by FTB.
3. Appellants have not shown reasonable cause to abate the late-filing penalty.

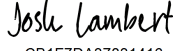
DISPOSITION

FTB’s actions are sustained.

DocuSigned by:

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 Asaf Kletter
 Administrative Law Judge

We concur:

Signed by:

 C04CD423E3264FD...
 Seth Elsom
 Hearing Officer

Signed by:

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 Josh Lambert
 Administrative Law Judge

Date Issued: 5/13/2025