

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:)
MEDICAL INSTRUMENT)
DEVELOPMENT LABORATORIES INC.)
)
)
)
)

OPINION

Representing the Parties:

For Appellant: Yung Ming Ling, CPA

For Respondent: Christopher T. Tuttle, Attorney

S. ELSOM, Hearing Officer: Pursuant to Revenue and Taxation Code (R&TC) section 19324, Medical Instrument Development Laboratories Inc. (appellant) appeals an action by the Franchise Tax Board (respondent) denying appellant’s claims for refund of \$104,085.08 for the short tax year beginning January 18, 2020, and ending March 31, 2020 (short tax year ending March 31, 2020), and \$3,778.70 for the fiscal year beginning April 1, 2021, and ending March 31, 2022 (2021 tax year).¹

Appellant waived the right to an oral hearing; therefore, the matter was submitted to the Office of Tax Appeals (OTA) on the written record pursuant to California Code of Regulations, title 18, section 30209(a).

ISSUES

1. Whether appellant has established reasonable cause for the abatement of the late filing penalty for the short tax year ending March 31, 2020.
2. Whether appellant has established a legal basis for the abatement of the estimated tax penalty for the 2021 tax year.
3. Whether appellant has established a legal basis for the abatement of interest for the short tax year ending March 31, 2020, and the 2021 tax year.

¹ Appellant’s claim for a refund for the short tax year ending March 31, 2020, includes the late filing penalty of \$64,551.50 plus interest of \$39,533.58. Appellant’s claim for refund for the 2021 tax year includes the estimated tax penalty of \$3,053.75 plus interest of \$724.95.

FACTUAL FINDINGS

Background and Tax Filings

1. Appellant is a C corporation which operated as a subsidiary of parent C corporation, Mid Labs LTD and Subsidiaries (Mid Labs). Mid Labs in turn operated as a holding company whose principal asset was the stock it owned in appellant.
2. On January 17, 2020, Mid Labs dissolved, distributing the entire stock of appellant to its shareholder(s), while appellant continued to operate.²
3. Despite its dissolution on January 17, 2020, Mid Labs filed a 2019 Form 100, California Corporation Franchise or Income Tax Return, (2019 Form 100) for the entire fiscal year beginning April 1, 2019, and ending March 31, 2020. On page 1 of the 2019 Form 100, Mid Labs reported that it had “merged/reorganized” effective March 31, 2020. Attached to the 2019 Form 100 was Schedule R-7, Election to File a Unitary Taxpayers’ Group Return, reporting self-assessed tax for Mid Labs and appellant of \$800 and \$755,120, respectively (\$755,920 total), payments of \$850,000, and an overpayment of \$94,080. Mid Labs elected to report the overpayment as an amount to be credited to the following year’s estimated tax.³
4. Appellant timely filed a 2020 Form 100 for the fiscal year beginning April 1, 2020, and ending March 31, 2021 (2020 tax year), reporting total tax of \$800, an overpayment from prior year allowed as a credit of \$94,080, total payments of \$94,080, and an overpayment of \$93,280. Appellant elected to report the overpayment as an amount to be credited to 2021 estimated tax.
5. Appellant timely filed a 2021 Form 100 for the fiscal year beginning April 1, 2021, and ending March 31, 2022 (2021 tax year), reporting total tax of \$398,572, overpayment from prior year allowed as a credit of \$93,280, total payments of \$478,280, and an overpayment of \$79,708. Appellant elected to report the overpayment as an amount to be credited to 2022 estimated tax.

² The record does not identify who the shareholder(s) of Mid Labs were at the time of its dissolution, but that information does not appear material to the issues on appeal and therefore is not discussed further herein.

³ Mid Labs elected on box 41 to apply overpayments to its “2020 estimated tax.” Because Mid Labs was a fiscal filer prior to its dissolution and incorrectly filed a 2019 Form 100 for the entire fiscal year beginning on April 1, 2019, and ending on March 31, 2020, despite its dissolution on January 17, 2020, the “2020 estimated tax” refers to estimated tax payments for the fiscal year beginning April 1, 2020, and ending March 31, 2021. However, Mid Labs ceased to exist following its dissolution on January 17, 2020, and it is unclear from the record why Mid Labs elected to apply its overpayments to a future tax year after it dissolved.

6. Respondent subsequently sent two separate Return Information Notices (RINs) to appellant for the 2020 and 2021 tax years stating that respondent had no record of appellant's reported overpayment credits and imposing the estimated tax penalty plus applicable interest, for each year.⁴
7. Appellant called respondent on January 25, 2023, to inquire about the overpayment credits, stating that appellant had filed under its parent corporation, Mid Labs, for the fiscal year beginning April 1, 2019, and ending March 31, 2020, and that Mid Labs had "merged out of existence" on January 17, 2020. Appellant requested respondent to transfer Mid Labs's overpayment credits to appellant. Respondent advised appellant that the "reorganization creates a short period filing requirement of 04/19/2019 to 01/17/2019 under [Mid Labs] and 01/18/2020 to 03/31/2020 for [appellant]."⁵
8. On April 13 2023, Mid Labs filed a 2019 Form 100X, Amended Corporation Franchise or Income Tax Return for the short year beginning April 1, 2019, and ending January 17, 2020, reporting total tax of \$497,714 (a \$258,206 decrease from the amount originally reported), an overpayment credit shown on original return of \$94,080, and a \$258,206 refund (\$352,286 total).
9. On April 13, 2023, appellant filed a 2019 Form 100 for the short year beginning January 18, 2020, and ending March 31, 2020, (the short tax year ending March 31, 2020), reporting total tax of \$258,206, an overpayment from prior year allowed as a credit of \$352,286, and an overpayment of \$94,080, which appellant elected to report as an amount to be credited to 2020 estimated tax.

Respondent's Imposition of Penalties and Interest for the Short Tax Year Ending
March 31, 2020

10. On August 9, 2023, respondent sent appellant a RIN for the short tax year ending March 31, 2020, correcting appellant's prior year overpayment credits from \$352,286 to \$0, and appellant's amount to be credited to 2020 estimated tax from \$94,080 to \$0. The RIN also imposed a late filing penalty of \$64,551.50, plus applicable interest, for a total balance due of \$362,291.08 (appellant's reported total tax of \$258,206, plus a late

⁴ Respondent issued RINs for the 2020 and 2021 tax years on December 22, 2023, and December 23, 2023, respectively. Appellant did not appeal the penalties and interest imposed by respondent for the 2020 tax year and it will not be discussed further in this Opinion.

⁵ The quoted events are as stated by respondent in its comment detail for appellant's account, which respondent provided with its opening brief.

filing penalty of \$64,551.50, plus interest of \$39,533.58). Appellant paid the balance due on the same day.

11. On August 28, 2023, appellant sent a letter to respondent to request a waiver of the late filing penalty and applicable interest, which respondent treated as a claim for refund.
12. On October 16, 2023, respondent sent appellant a letter denying the claim for refund.
13. This timely appeal followed.

Respondent's Imposition of Penalties and Interest for the 2021 Tax Year

14. On October 10, 2023, respondent issued a second RIN to appellant for the 2021 tax year, to update the calculations made in its prior RIN issued for the 2021 tax year.⁶ The RIN imposed a revised estimated tax penalty of \$3,778.70, plus applicable interest. Appellant paid the balance due.
15. On August 28, 2023, appellant sent a letter to respondent to request a waiver of the estimated tax penalty and applicable interest, which respondent treated as a claim for refund.
16. On October 16, 2023, respondent sent appellant a letter denying the claim for refund.
17. This timely appeal followed.

DISCUSSION

Issue 1: Whether appellant has established reasonable cause for the abatement of the late filing penalty for the short tax year ending March 31, 2020.

California imposes a penalty for failing to file a return on or before the due date, unless the taxpayer shows that the failure is due to reasonable cause and not due to willful neglect. (R&TC, § 19131.) The late filing penalty is calculated at 5 percent of the tax due for each month or fraction of each month the return is late, with a maximum penalty of 25 percent of the tax required to be shown on the tax return. (R&TC, § 19131(a).) The amount required to be shown on the return is reduced by the amount of timely payments made on or before the due date of the tax and credits against the tax which may be claimed on the return. (R&TC, § 19131(c).)

When respondent imposes a late filing penalty, it is presumed to have been correctly imposed, and the burden of proof is on the taxpayer to show that reasonable cause exists to abate the penalty. (*Appeal of Cremel and Koeppe*, 2021–OTA–222P.) To overcome the presumption of correctness, the taxpayer must provide credible and competent evidence

⁶ See factual finding 6 above for additional details regarding the prior RIN issued by respondent for the 2021 tax year.

supporting a claim of reasonable cause. (*Ibid.*) To establish reasonable cause, the taxpayer must show the failure to timely file a return occurred despite the exercise of “ordinary business care and prudence.” (*Ibid.*)

Appellant does not dispute that it filed the return for its short tax year ending March 31, 2020, late or that the late filing penalty was properly imposed or calculated,⁷ but instead provides reasonable cause type arguments for the abatement of it. Appellant states that it filed a combined return with Mid Labs and timely paid the corresponding tax due, and as a result, has demonstrated that it has attempted to comply with its filing and payment obligations. Specifically appellant asserts that it:

made every effort to comply with [its] tax and filing obligations. Additionally, [respondent] was in possession of the tax due with the returns. However, [respondent] is unable to transfer tax between related entities. This has resulted in the filing of amended returns and the underpayment of tax. Appellant further requests OTA to consider Mid Labs’s timely filing of returns and payment of tax in prior years.

Appellant specifically notes that: “[p]rior to the dissolution of [Mid Labs], [appellant] filed and paid all taxes in a timely manner.” Appellant further contends that it “has remained compliant with [its] filing and payment obligations,” and “[t]he only year which there was an issue [was] the year of dissolution in which tax could not be transferred.”

Appellant’s first argument rests on the assertion that Mid Labs’s timely filing of a combined return with appellant for the entire fiscal tax year beginning April 1, 2019, and ending March 31, 2020, and payment of tax produces the same equitable result as the filing of the two required short year returns and payment of tax: (1) a combined short year return for the short tax year beginning April 1, 2019, and ending January 17, 2020, and (2) a separate short year return for appellant only for the short tax year beginning January 18, 2020, and ending March 31, 2020. Assuming that appellant is correct that this produces the same equitable result, R&TC section 19131 does not include a provision for abatement of the late filing penalty on an equitable basis. The standard for relief is instead whether appellant established reasonable cause by demonstrating that its failure to timely file a return occurred despite the exercise of “ordinary business care and prudence.” (*Appeal of Cremel and Koepfel, supra.*)

The record here establishes that on January 17, 2020, Mid Labs distributed its stock in appellant to its shareholder(s) and dissolved. However, appellant does not explain the steps it

⁷ Appellant’s return for the short tax year ending March 31, 2020, due on July 15, 2020. (See R&TC. § 18601(a), (c).) However, appellant did not file its return for the short tax year ending March 31, 2020, until April 13, 2023.

took to determine its filing requirements in the year of Mid Labs's dissolution, and has not provided any information to support the reasons why it did not timely file a separate return for the short tax year beginning January 18, 2020, and ending March 31, 2020.⁸ Additionally, appellant does not explain why Mid Labs's 2019 Form 100 (covering the entire fiscal tax year beginning April 1, 2019, and ending March 31, 2020) reported that it had "merged/reorganized" rather than "dissolved" and an effective date for this merger or reorganization of March 31, 2020, rather than the correct date of January 17, 2020.

Appellant also subsequently informed respondent that Mid Labs had "merged out of existence." Thus, it is unclear whether appellant misunderstood whether Mid Labs had dissolved or merged, was uncertain of the filing requirements caused by the dissolution of a parent company, or was simply unaware of its own separate filing requirement after Mid Lab's dissolved and ceased to exist on January 17, 2020. Regardless of the reason, ignorance of the law does not establish reasonable cause for appellant's failure to comply with statutory requirements, and appellant has not demonstrated that it exercised ordinary business care and prudence in attempting to timely file its required return for the short tax year ending March 31, 2020. (*Appeal of Cremel and Koepfel, supra.*)

With respect to appellant's second argument, appellant refers to Mid Labs's timely filing and payment history prior to its dissolution as support for the finding of reasonable cause for appellant's own failure to timely file. Unlike the IRS, California has not enacted legislation or otherwise instituted a means for the abatement of late filing penalties based solely on prior good filing and/or payment history for the tax year at issue here (i.e., the short tax year ending March 31, 2020) or for corporate taxpayers.⁹ Instead, for the tax year at issue, California law provides that the late filing penalty shall apply unless reasonable cause is shown. (R&TC, § 19131(a).) Nevertheless, a good filing and payment history, both with California and the IRS, might lend credibility to assertions that an attempt to file timely was made in some circumstances. (*Appeal of Xie, 2018-OTA-076P.*) However, the record in this appeal does not establish that appellant attempted to timely file a short year return for the short tax year ending March 31, 2020, or was even aware of its filing requirement prior to being informed of it by respondent approximately two years after the deadline had passed. Additionally, as an entity

⁸ See R&TC section 24634(a)(2) requiring the filing of a short period return "when the taxpayer is in existence during only part of what would otherwise be its taxable year."

⁹ R&TC section 19132.5, effective for tax years beginning on or after January 1, 2022, allows individual taxpayers to request a one-time abatement of a timeliness penalty. As appellant is a corporation and the year at issue in this appeal is 2020, this provision is not applicable.

separate from appellant, Mid Labs's filing history does not apply to the determination of reasonable cause for appellant. Once respondent has imposed the late filing penalty, California law provides limited relief based upon reasonable cause. For the reasons stated above, appellant has not provided credible or competent evidence to establish reasonable cause.

Overpayment Credits

Appellant argues that Mid Labs's transfer of overpayment credits to appellant complies with California Code of Regulations, title 18, sections 23663-1 through 23663-6, stating, "the term 'eligible credit' shall mean any credit earned by a taxpayer in a taxable year beginning on or after July 1, 2008." Appellant further notes, "The term does not exclude the credit for a carryover of an overpayment of tax." Appellant further argues that "[t]he request to transfer payments have not required the citation of any law to perform the transfer only the acknowledgement that the transferor will not claim the tax payment," and "[t]his is especially true where the transferor is acquired or becomes part of a new group." Although appellant does not explain how Mid Labs's timely payment of tax establishes reasonable cause for appellant's untimely filing of its return for the short tax year ending March 31, 2020, if accepted, appellant's reported overpayment credits from Mid Labs would substantially reduce or eliminate the late filing penalty. (See R&TC, § 19131(c).)

Respondent argues appellant is confusing "tax credits" which may be assigned to another member of a combined reporting group pursuant to R&TC section 23663, and "overpayment credits" as contemplated by the claim for refund statutes beginning with R&TC section 19301, which are not assignable pursuant to R&TC section 23633. Respondent asserts that this is made clear by a plain reading of R&TC section 23036(c) through (e). Respondent further argues that Mid Labs may only transfer its overpayments as a credit to its shareholder(s), who is/are Mid Labs's successor in interest. (R&TC, § 19302.)

OTA agrees with respondent that there is a distinction between "tax credits" which may be assigned pursuant to R&TC section 23663 and a "credit" on a taxpayer's tax account for a particular year created by the overpayment of tax for that tax year (respondent refers to this as an "overpayment credit"). R&TC section 23663(a)(1) states that for each taxable year beginning on or after July 1, 2008, "any credit allowed to a taxpayer under this chapter" that is an eligible credit may be assigned by that taxpayer to any eligible assignee. "[T]his chapter" as referenced in R&TC section 23633(a)(1) refers to Chapter 3.5, "Tax Credits" of Part 11 (Corporation Tax Law). It includes R&TC sections 23601 through 23698.1, which allows certain credits such as the research and development credit, new employee credit, and the California competes credit.

(See e.g., R&TC, §§ 23609, 23626, 23689.) An “overpayment credit” or a “credit” created in one tax year as a result of an overpayment of tax for that year, is not one of the “tax credits” allowed pursuant to R&TC sections 23601 through 23698.1. Thus, it is not assignable pursuant to R&TC section 23663 as appellant contends.

Additionally, appellant’s argument that the transfer of payments between related entities is permitted upon request to respondent and is “especially true in cases in which a company is acquired and becomes part of a new group” is not applicable to the facts of appellant’s transaction. The record in this appeal demonstrates that Mid Labs was not acquired and did not become part of a controlled group, but instead distributed appellant’s stock to its shareholder(s) and dissolved on January 17, 2020. As a result, OTA finds that Mid Labs’s 2019 Form 100X (amended return) correctly reported the overpayment of \$258,206 as a claim for refund. (R&TC, § 19302.) For the reasons stated above, the refund claimed by Mid Labs is not eligible to be transferred to appellant, a separate and distinct taxpayer following Mid Labs dissolution on January 17, 2020, as an overpayment credit for use in future tax years.

Issue 2: Whether appellant has established a legal basis for the abatement of the estimated tax penalty for the 2021 tax year.

A corporation that underpays its estimated tax is liable for an addition to tax, which is treated and often referred to as 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 limited statutory exceptions to the penalty exist.¹⁰ (R&TC, §§ 19142(b), 19147, 19148; *Appeal of Weaver Equipment Co.* (80-SBE-048) 1980 WL 4976.)

Appellant makes similar arguments for the abatement of the estimated tax penalty as those discussed above for the late payment penalty. For the reasons discussed above, Mid Labs’s reported overpayment credit is not eligible for transfer to appellant and is thus not considered a payment for the purpose of determining the estimated tax penalty.

¹⁰ The exceptions found in R&TC sections 19147 and 19148 are based upon the amount of installment payments of tax made by the taxpayer in the year which they are due. Appellant did not make any tax payments in 2021 tax year, and as a result, these exceptions are not applicable. R&TC section 19142(b)(1) provides an exception to the estimated tax penalty to the extent that the underpayment was created or increased by any provision of law that is chaptered during and operative for the taxable year of the underpayment. This provision is not applicable for the year at issue in this appeal.

Issue 3: Whether appellant has established a legal basis for the abatement of interest for the short tax year ending March 31, 2020 and the 2021 tax year.


If any amount of the 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 which 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. To obtain relief from interest, appellant must qualify under R&TC section 19104, or 21012. Appellant does not argue these exceptions, and based upon the evidence in this appeal, none of the exceptions apply.

HOLDINGS

1. Appellant has not established reasonable cause for the abatement of the late filing penalty for the short tax year ending March 31, 2020.
2. Appellant has not established a legal basis for the abatement of the estimated tax penalty for the 2021 tax year.
3. Appellant has not established a legal basis for the abatement of interest for the short tax year ending March 31, 2020, and the 2021 tax year.


DISPOSITION

Respondent’s action denying appellants’ claims for refund is sustained.

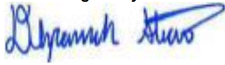
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 Seth Elsom
 Hearing Officer

We concur:

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 John O. Johnson
 Administrative Law Judge

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 _____ For
 Cheryl L. Akin
 Administrative Law Judge

Date Issued: 6/25/2025