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7 **BOARD OF EQUALIZATION**

8 **STATE OF CALIFORNIA**

9  
10 In the Matter of the Appeal<sup>1</sup> of: ) **HEARING SUMMARY**  
11 ) **FRANCHISE INCOME TAX APPEAL**  
12 **CITATION DEVELOPMENT COMPANY<sup>2</sup>** ) Case No. 567630

13  
14 Year Claim for  
15 2003 Refund  
16 \$39,145.75

16 Representing the Parties:

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18 For Appellant: Steve McNulty, C.P.A.

19 For Franchise Tax Board: Nancy E. Parker, Tax Counsel III

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21 **QUESTION:** Whether appellant demonstrated reasonable cause to abate the late filing penalty.

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26 <sup>1</sup> The Board hearing was originally scheduled for October 26, 2011, but due to a scheduling conflict, appellant requested the hearing be rescheduled. The hearing was rescheduled to the January/February 2012 Culver City Board meeting.

27 <sup>2</sup> According to the Nevada Secretary of State records, as of November 16, 2011, appellant's corporate status is revoked.  
28 Respondent states that it is unclear whether revocation affects a Nevada corporation's capacity or standing to sue or be sued. However, because of the uncertainty of the Nevada law, respondent is treating this appeal as though appellant has proper capacity and standing, but reserves the right to object to appellant's capacity and standing to maintain a lawsuit for purposes of future litigation. (Resp. Op. Br., p. 1.)

1 HEARING SUMMARY

2 Facts

3 Appellant filed its 2003 tax return for the tax year ending (TYE) December 31, 2003, on  
4 March 12, 2007. In its return, appellant indicated that it began business, or income was derived from  
5 California, beginning on December 19, 1994. Appellant also submitted Internal Revenue Service (IRS)  
6 Form 4549, Income Tax Examination Changes, dated February 9, 2007. The IRS Form 4549 reported  
7 appellant had other income of negative \$51,410, interest income of \$184, a net operating loss of  
8 \$78,308, and Schedule D income of \$1,822,530 from the sale of property. The IRS changes indicated a  
9 total adjustment to income of \$1,692,996 for the TYE December 2003. Based on those changes, the IRS  
10 determined that appellant owed an additional \$575,619.00 in federal tax and \$118,519.03 of interest. On  
11 behalf of appellant, Jan Currey, the president and director of appellant, agreed to the immediate  
12 assessment of this federal tax. (Resp. Op. Br., pp. 1-2; Ex. B.)

13 In its 2003 California Form 100X, appellant reported a pass-through entity Schedule D-1  
14 income of \$1,822,529 from the sale of business property. Appellant's Schedule D-1 indicated that the  
15 pass-through income was reported on a Schedule K-1, although appellant did not submit a Schedule K-1  
16 with its return. Appellant's return indicated other income of negative \$51,411, for a total income of  
17 \$1,771,301. These amounts were generally consistent with the amounts reported in the IRS Form 4549.  
18 Appellant accordingly self-assessed tax of \$156,583 and interest of \$7,937, for a total amount due of  
19 \$164,520 which was submitted by Ms. Currey. The check indicated payment was from the personal  
20 account of Ms. Currey, of Malibu, California, and was signed by appellant's representative, Steve  
21 McNulty. (Resp. Op. Br., p. 2; Ex. B.)

22 Respondent accepted the return as filed. However, because the return was filed late,  
23 respondent imposed a late filing penalty of \$39,145.75, pursuant to Revenue and Taxation Code  
24 (R&TC) section 19131, subdivision (a). In addition, respondent imposed an estimated tax penalty of  
25 \$4,822.87 under R&TC section 19136 because appellant did not make any quarterly estimated tax  
26 payments. In addition, interest of \$41,097.53 accrued as of June 20, 2008. Respondent billed appellant  
27 for the remaining balance due. When appellant failed to pay the balance due or respond to the notices,  
28 respondent began collection activity and imposed a collection cost recovery fee of \$352 and a lien fee of

1 \$15 on appellant's account. During its collection activity, respondent attempted to contact Ms. Currey  
2 and Mr. McNulty as officers and agents of the corporation. (Resp. Op. Br., pp. 2-3.)

3           On January 28, 2009, Mr. McNulty responded to respondent's contact by telephone.  
4 According to respondent's records, Mr. McNulty explained that appellant is a small corporation that is  
5 no longer doing business. He explained that appellant filed a 2003 return because it was the right thing  
6 to do. Mr. McNulty acknowledged receipt of the billing notices but stated that appellant is out of  
7 business and had no funds to pay them. He also explained that Ms. Currey's deceased husband had a  
8 partnership with two other individuals. An attorney advised them to incorporate in Nevada and they  
9 sold the partnership's assets. He also stated that Ms. Currey did not know that the partnership  
10 maintained a 10 percent interest in an apartment building, the sale of which was the source of appellant's  
11 income in 2003. Mr. McNulty indicated that Ms. Currey received the proceeds of the partnership sale of  
12 property. (Resp. Op. Br., p. 3; Ex. C.)

13           According to respondent's records, Mr. McNulty telephoned the FTB on March 18, 2009,  
14 requesting information regarding how the balance due was calculated and for payoff information. Mr.  
15 McNulty requested an abatement of penalties but did not express a reason for abatement. Mr. McNulty  
16 indicated that the real property sold by the partnership in 2003 was located in Los Angeles County.  
17 (Resp. Op. Br., p. 3; Ex. D.)

18           On March 27, 2009, appellant satisfied the remaining balance due of \$81,415.33 with a  
19 personal check from Ms. Currey. On April 17, 2009, respondent determined that appellant overpaid its  
20 liability by \$33.34 and mailed a refund of that amount to appellant. (Resp. Op. Br., p. 3; Ex.E.)

21           By letter dated December 4, 2009, appellant filed a claim for refund of \$39,145.75, the  
22 amount of the late filing penalty, and also requested interest abatement related to the late filing penalty  
23 on the basis that it is a Nevada corporation and only filed the 2003 return, after the IRS determined  
24 appellant received flow-through income during the federal audit of RCS Development, on February 20,  
25 2007. Respondent denied the claim for refund on the basis that appellant had a responsibility to file its  
26 own return which is due the year the disbursement is received, not upon audit by the IRS. (Resp. Op.  
27 Br., p. 3; Ex. F.)

28           This timely appeal then followed.

1           Contentions

2                   Appellant

3           Appellant requests that the late filing penalty, and the associated interest, be abated  
4 because appellant filed a return as soon as the California-source activity was generated in the  
5 corporation. Appellant states that Ms. Currey was forced to pay penalties and interest on behalf of  
6 appellant for the tax year 2003. Appellant indicates that the following facts and circumstances support  
7 an abatement of the penalty: Appellant was incorporated in Nevada on December 19, 1994. It was a  
8 shell corporation, owned no property, and transacted no business in California. As such, California  
9 returns were not required. In 2000, appellant replaced Sam Currey as a partner in RCS Development  
10 Company, a California partnership. Appellant states that RCS Development Company generated no  
11 income, so appellant had no reportable income from California. Appellant further states that the IRS  
12 audited RCS Development Company for the 2003 tax year and issued an adjustment to income that  
13 flowed through to appellant as a partner of RCS Development Company. Appellant notes that the audit  
14 report was dated February 20, 2007. Appellant also states that it filed a return and paid \$164,520 to the  
15 FTB on March 8, 2007. Accordingly, appellant requests an abatement of the late filing penalty. (App.  
16 Op. Br., pp. 1-2.)

17                   Respondent

18           Respondent contends that R&TC section 18601 provides that every taxpayer subject to  
19 the corporation tax law is required to file a return on the fifteenth day of the third month after the close  
20 of its tax year. Respondent contends appellant failed to file its 2003 return by the March 15, 2004 due  
21 date. Respondent further contends it did not receive appellant's 2003 return until March 12, 2007, well  
22 after the due date of the return. Respondent notes that the late filing penalty is computed at five percent  
23 of the tax due, after allowing for timely payments, for every month that the return is late, up to a  
24 maximum of twenty-five percent. Respondent notes that as appellant did not make any timely  
25 payments, the penalty was calculated on the total amount of tax due.<sup>3</sup> Accordingly, respondent contends  
26 it properly imposed the late filing penalty, unless appellant can show reasonable cause for the late filing  
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<sup>3</sup> \$156,583 total tax liability x 25 percent late filing penalty = \$39,145.75.

1 of the return. (Resp. Op. Br., p. 4.)

2 Respondent contends appellant failed to demonstrate reasonable cause for an abatement  
3 of the late filing penalty. With respect to appellant's contention that the IRS created flow-through  
4 income by virtue of the IRS audit, respondent initially notes that appellant has not explained what it  
5 means by "create income". Respondent contends that appellant failed to provide any legal or factual  
6 basis for its assertion, such as the federal authority for the IRS to "create income" or provide copies of  
7 appellant's federal return and the federal and state partnership returns for RCS Development Company.  
8 Respondent notes that appellant provided a copy of its agreement to the federal assessment and  
9 appellant's state return is based on those same facts. Based on appellant's statements and agreed upon  
10 federal assessment, respondent asserts that appellant had California-source income in 2003 for which it  
11 owed California corporate income tax pursuant to R&TC sections 23501 and 23040. (Resp. Op. Br.,  
12 p. 4.)

13 Respondent further contends that Ms. Currey, appellant's president and director, should  
14 have known of appellant's business activities and tax return filing requirements. Respondent contends  
15 that Ms. Currey had enough information to make the determination that appellant had a California tax  
16 liability. Respondent contends that ignorance of the law is not an excuse for failing to file a timely  
17 return, citing the Board's decision in the *Appeal of J. Morris and Leila G. Forbes*, 67-SBE-042, decided  
18 on August 7, 1967. Respondent asserts that each taxpayer has a personal, non-delegable duty to file a  
19 return by the due date, citing the Board's decision in the *Appeal of Thomas K. and Gail G. Boehme*, 85-  
20 SBE-134, decided on November 6, 1985. Respondent contends that the primary duty to file timely  
21 returns and to timely pay the tax lies with the taxpayer and cannot be delegated or excused by the failure  
22 of third parties, citing *United States v. Boyle* (1985) 469 U.S. 241. (Resp. Op. Br., p. 5.)

### 23 Applicable Law

24 R&TC section 18601 requires every taxpayer subject to the corporation tax law to file a  
25 return on the fifteenth day of the third month after the close of its tax year. R&TC section 19131  
26 provides that respondent shall impose a late filing penalty when a taxpayer fails to file a tax return on or  
27 before its due date unless the taxpayer establishes that the late filing was due to reasonable cause and  
28 was not due to willful neglect. The penalty is computed at five percent of the tax due, after allowing for

1 timely payments, for every month that the return is late, up to a maximum of 25 percent. (Rev. & Tax.  
2 Code, § 19131.)

3           When respondent imposes the late filing penalty, the law presumes that the penalty was  
4 imposed correctly. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of David A. and Barbara L.*  
5 *Beadling*, 77-SBE-021, Feb. 3, 1977.) To establish reasonable cause, the taxpayer bears the burden of  
6 proving that an ordinarily-intelligent and prudent businessperson would have acted similarly under the  
7 circumstances. (*Appeal of M.B. and G.M. Scott*, 82-SBE-249, Oct. 14, 1982.) Ignorance of the filing  
8 requirement does not excuse the late filing penalty. (*Appeal of Diebold, Incorporated*, 83-SBE-002,  
9 Jan. 3, 1983.) A taxpayer's misunderstanding of the law does not constitute reasonable cause. (*Id.*) The  
10 mere uninformed and unsupported belief of a taxpayer, no matter how sincere that belief may be that he  
11 is not required to file a tax return is insufficient to constitute reasonable cause for his failure so to file.  
12 (*Appeal of J. Morris and Leila G. Forbes, supra*, citing *Robert A. Henningsen* 26 T.C. 528.) The burden  
13 of prompt filing is a fixed and clear duty on the taxpayer, not on some agent or employee of the  
14 taxpayer. (*Appeal of Thomas K. and Gail G. Boehme*, 85-SBE-134, Nov. 6, 1985, citing *United States*  
15 *v. Boyle, supra.*)

#### 16 STAFF COMMENTS

17           It appears to the Appeals Division staff that appellant was a partner in RCS Development  
18 Company. It further appears that RCS Development Company sold property in Los Angeles County in  
19 2003 and, as a result of that sale, appellant received flow-through income in 2003. Appellant contends  
20 that it was unaware of its California filing obligation until the IRS audited RCS Development Company.  
21 Appellant contends it filed its 2003 return as soon as it was aware of the filing obligation and therefore  
22 should be excused for its late filing. However, ignorance of a filing requirement does not excuse the late  
23 filing penalty. (*Appeal of Diebold, Incorporated, supra.*) At the oral hearing, appellant may wish to  
24 provide additional detail of the circumstances surrounding its relationship with RCS Development  
25 Company prior to the sale of property in 2003. Appellant should also be prepared to address how it  
26 could have been unaware of a filing requirement when the income was based on a sale of property in  
27 California and appellant's president received the funds. Appellant should be prepared to discuss  
28 whether an ordinarily-intelligent and prudent businessperson would have acted similarly under the

1 circumstances. Pursuant to California Code of Regulations, title 18, section 5523.6, if appellant wishes  
2 to provide additional evidence supporting its appeal, it should be submitted if possible to the Board and  
3 respondent at least 14 days prior to the hearing date.<sup>4</sup>

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<sup>4</sup> Exhibits should be submitted to: Claudia Madrigal, Board Proceedings Division, Board of Equalization. P. O. Box 942879 MIC: 80, Sacramento, CA 94279-0080