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7 **BOARD OF EQUALIZATION**
8 **STATE OF CALIFORNIA**
9

10 In the Matter of the Appeal of:) **HEARING SUMMARY**
11) **PERSONAL INCOME TAX APPEAL**
12 **ALFRED M. HUMPHRIES AND**) Case No. 598220
13 **JILL HUMPHRIES**)
14 _____)

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16 Year Claim for
2010 \$ 2,306.42
17 Refund

18 Representing the Parties:
19 For Appellants: Alfred M. Humphries
20 For Franchise Tax Board: Eric A. Yadao, Tax Counsel
21

22 QUESTION: Whether appellants have established reasonable cause to abate the mandatory
23 electronic payment penalty.

24 HEARING SUMMARY
25 Background

26 On September 30, 2008, Assembly Bill 1389 was signed, adding Revenue and Taxation
27 Code (R&TC) section 19011.5 to the Revenue and Taxation Code. R&TC section 19011.5 (the “e-pay
28 statute”) requires certain individuals to submit their payments electronically, beginning on or after

1 January 1, 2009, or be subject to a mandatory electronic payment penalty (e-pay penalty). Although
2 the e-pay statute had an effective date of January 1, 2009, respondent began imposing the e-pay
3 penalty effective January 1, 2011, to allow taxpayers and their representatives time to implement
4 processes to comply with the statute.

5 In November 2008, respondent began issuing courtesy letters to all taxpayers who made
6 payments which would require them to make all subsequent payments electronically under the e-pay
7 statute. According to respondent's records, respondent sent such a courtesy letter to appellants on
8 June 11, 2010, advising them of the e-pay statute and its requirements. The letter stated that appellants
9 should submit future payments electronically to avoid the mandatory electronic payment penalty under
10 R&TC section 19011.5. (Resp. Op. Br., p. 1, Exs. A & B.)

11 On January 12, 2011, respondent received appellants' estimate check for the 2010 tax
12 year in the amount of \$50,000. Appellants then timely filed their 2010 return. With their return,
13 appellants remitted payment of the balance of their self-assessed liability by written check dated
14 April 14, 2011, in the amount of \$230,623. On July 7, 2011, respondent imposed the e-pay penalty
15 because appellants' April 14, 2011 payment was not remitted electronically. (Resp. Op. Br., p. 2, Ex.
16 C & D.)

17 Appellants filed a claim for refund of the penalty on July 20, 2011, acknowledging the
18 requirement to pay electronically, but requested that the penalty be waived. Appellants asserted that a
19 waiver is appropriate because appellants' preparer, who is located in New York and unaware of the
20 rule, advised appellants to pay their liability by mailing a check. Appellants stated that there was a lot
21 going on at tax time, getting it all right, when appellants mailed their check as they have done for the
22 last 40 years. Appellants stated that they are good customers of California and would like a break to
23 have the penalty waived. Appellants state that \$2,307 is a crazy penalty for forgetting the rule.
24 Appellants noted that they paid their liability on time and there was no harm done. Upon review,
25 respondent denied appellants' claim for refund. This timely appeal followed. (Resp. Op. Br., p. 2, Ex.
26 E.)

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1 Contentions

2 Appellants' Contentions

3 Appellants contend that the one percent e-pay penalty is excessive. While appellants
4 acknowledge that this is the second time they've done this, and that the FTB forgave them once already,
5 appellants contend that they did not think about respondent's new rule during the tax time rush when
6 they remitted their payment by check. Appellants further contend that their out-of-state accountant sent
7 appellants their return with the same note to mail respondent a check by the due date. Appellants
8 contend they are large, reliable taxpayers that are unfairly hurt by this penalty. Appellants are willing to
9 either pay a \$230 penalty since they forgot about the e-pay rule or pay a penalty based on the prior
10 transgression which was smaller and more reasonable. Appellants assert that those who have to pay a
11 lot to California should not be treated differently than those who don't have to pay a lot to California.
12 Appellants state that the purpose of the penalty has been made clear and they guarantee they will never
13 forget again. (Appeal Letter.)

14 Respondent's Contentions

15 Respondent contends that it properly imposed the e-pay penalty rule because appellants'
16 total tax liability exceeded \$80,000 and appellants were required to pay by electronic means pursuant to
17 R&TC code section 19011.5. Respondent notes that R&TC section 19011.5 was enacted with an
18 effective date of January 1, 2009. Respondent states that it administratively deferred imposing the
19 penalty for two years to promote education and compliance. During the administrative deferral period,
20 respondent issued a number of Tax News articles to advise the practitioner community of the newly-
21 enacted statute requiring e-pay and of its delayed implementation date of January 1, 2011. Respondent
22 notes that various tax publications also communicated the effect of the statute, indicating that Tax News
23 Articles discussing mandatory e-pay were published in November 2008, May 2009, January 2010,
24 November 2010, and March 2011. Respondent states that it also issued courtesy letters to taxpayers
25 who could be affected by the e-pay requirements and notes that appellants were notified of the statute
26 and their e-pay requirement by the courtesy letter dated June 11, 2010. (Resp. Op. Br., pp. 2-3, Ex. F.)

27 Respondent notes that the e-pay penalty may be abated if the failure to make the payment
28 as required was for reasonable cause and was not the result of willful neglect. Respondent further notes

1 that, in the context of late filing penalties, reasonable cause is defined as such cause that would prompt
2 an ordinarily intelligent and prudent businessperson to have so acted under similar circumstances, citing
3 the *Appeal of Joseph W. and Elsie M. Cummings*, 60-SBE-040, decided by the Board on December 13,
4 1960.¹ Respondent further notes that federal regulations provide that the evidentiary grounds for a
5 finding of reasonable cause for the abatement of a penalty “include an honest misunderstanding of fact
6 or law that is reasonable in light of all of the facts and circumstances, including the experience,
7 knowledge, and education of the taxpayer” and whether the taxpayer exercised ordinary business care
8 and prudence and was nevertheless unable to comply, citing Federal Tax Regulations, 26 C.F.R. sections
9 1.6664-4(b) and 301.6651-1(c).

10 Respondent contends that appellants acknowledged that this is the second time they failed
11 to pay their liability electronically. Despite having notice of the penalty, appellants state that, in the tax
12 time rush, they just did not think of the new rule. Respondent contends that, while appellants’ failure to
13 pay their tax liability electronically may have been an oversight, the Board has held that being too busy
14 does not comport with the exercise of ordinary business care and prudence and such is an insufficient
15 reason to relieve a taxpayer of a statutory obligation, citing the Board’s decision in the *Appeal of Loew’s*
16 *San Francisco Hotel Corp.*, 73-SBE-050, decided on September 17, 1973. (Resp. Op. Br., pp. 3-4.)

17 Respondent notes that appellants may be inferring that they relied on their out-of-state
18 accountant, who prepared their return and directed appellants to mail a check. However, respondent
19 contends that reliance on an agent cannot function as a substitute for compliance with an unambiguous
20 statute, citing *United States v. Boyle* (1985) 469 U.S. 241. Respondent contends that the e-pay
21 requirement is unambiguous. In addition, respondent publicized the statute and penalty to the tax
22 practitioner community and appellants were notified of the statute in June 2010 and even acknowledge
23 their prior awareness. Accordingly, respondent contends that any reliance appellants attribute to their
24 accountant’s direction to mail a check is not reasonable cause to abate the e-pay penalty. (Resp. Op. Br.,
25 pp. 4-5.)

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28 ¹ Board of Equalization cases may be found on the Board’s website: www.boe.ca.gov.

1 Applicable Law

2 Burden of Proof

3 The FTB's determination is presumed correct and an appellant has the burden of proving
4 it to be wrong. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Michael E. Myers*,
5 2001-SBE-001, May 31, 2001.) In the absence of uncontradicted, credible, competent, and relevant
6 evidence showing an error in the FTB's determinations, respondent's proposed assessments must be
7 upheld. (*Appeal of Oscar D. and Agatha E. Seltzer*, 80-SBE-154, Nov. 18, 1980.)

8 Mandatory Electronic Payment Penalty

9 R&TC section 19011.5, subdivision (a), requires individuals to remit all future
10 payments electronically if they make an estimated tax or extension payment in excess of \$20,000
11 beginning on or after January 1, 2009, or if they file an original return with a tax liability over \$80,000
12 for a taxable year beginning on or after January 1, 2009. R&TC section 19011.5, subdivision (c),
13 provides that individuals who do not comply with the electronic payment requirement shall pay a
14 penalty of one percent of the amount paid, unless it is shown that the failure to make the payment as
15 required was for reasonable cause and was not the result of willful neglect.

16 Although R&TC section 19011.5 does not define "reasonable cause", the Board has
17 addressed what is considered "reasonable cause" within the context of the late filing penalty.² To
18 establish reasonable cause for penalty abatement, taxpayers "must show that the failure to file timely
19 returns occurred despite the exercise of ordinary business care and prudence, or that cause existed as
20 would prompt an ordinary intelligent and prudent businessman to have so acted under similar
21 circumstances." (*Appeal of Howard G. and Mary Tons*, 79-SBE-027, Jan. 9, 1979.) The taxpayers bear
22 the burden of proving reasonable cause to excuse the penalty. (*Appeal of Winston R. Schwyhart*, 75-
23 SBE-035, Apr. 22, 1975.)

24 In *United States v. Boyle, supra*, the United States Supreme Court held that the duty to

26 ² As the issue of whether a taxpayer has demonstrated reasonable cause for the failure to make an electronic payment asks the
27 same questions and weighs the same evidence as the inquiry of whether reasonable cause exists for the failure to timely file a
28 tax return, judicial interpretations involving the inquiry of whether reasonable cause exists for the failure to timely file a tax
return are persuasive authority for determining whether reasonable cause exists for the failure to make an electronic payment.
(*See Appeal of Philip C. and Anne Berolzheimer*, 86-SBE-172, Nov. 19, 1986.)

1 file a tax return by a statutory deadline could not be delegated to an agent, such as an accountant or
2 attorney. In contrast, the court stated that a taxpayer's reliance on an accountant or an attorney for
3 advice on a substantive matter of tax law, such as whether a liability exists, is reasonable since most
4 taxpayers are not competent to discern error in the advice. (*Id.* at p. 251.)

5 Constitutional Issues

6 The Board is precluded from determining the constitutional validity of California statutes,
7 and has an established policy of declining to consider such issues. (Cal. Const., art III, § 3.5; *Appeal of*
8 *Aimor Corp.*, 83-SBE-221, Oct. 26, 1983.)

9 STAFF COMMENTS

10 Appellants contend that there is reasonable cause for their failure to comply with the
11 mandatory e-pay requirement because they relied on their accountant who advised them to pay their tax
12 liability by check, despite receiving a notice from respondent that they were required to electronically
13 pay their taxes. Appellants contend that, during the rush of tax time, they simply forgot about the
14 mandatory e-pay requirement. As appellants state that they knew about the e-pay requirement and
15 acknowledge that the FTB already forgave the e-pay penalty once, it appears to staff that appellants have
16 not demonstrated that their failure to e-pay was due to reasonable cause and not willful neglect pursuant
17 to R&TC section 19011.5, subdivision (c).³ Staff does not believe that an ordinarily intelligent and
18 prudent business person, after receiving notice that he or she is subject to mandatory e-pay and has
19 already run afoul of the requirement once, would simply forget about the e-pay requirement and rely on
20 their out-of-state accountant's advice to mail a check.

21 With regard to appellants' concern that they are being treated differently under the statute
22 and that the e-pay penalty is excessive, such issues are best addressed by the Legislature, or by a court
23 ruling, as the Board is not in a position to declare a statute unconstitutional. If either party has any
24 additional evidence to present, they should provide such evidence to the Board Proceedings Division at
25 least 14 days prior to the oral hearing pursuant to California Code of Regulations, title 18, section

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27 ³ Staff notes that there is no record of respondent waiving the e-pay penalty for appellants' January 12, 2011 payment of
28 \$50,000. Respondent should be prepared to discuss, and provide evidence of, whether the FTB waived the e-pay penalty for
appellants' \$50,000 payment.

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28 ⁴ Evidence exhibits should be sent to: Claudia Madrigal, Appeals Analyst, Board Proceedings Division, State Board of Equalization, P.O. Box 942879 MIC:80, Sacramento, California, 94279-0080.