

1 Sheriene A. Ridenour
Tax Counsel
2 Board of Equalization, Appeals Division
450 N Street, MIC: 85
3 PO Box 942879
Sacramento CA 95814
4 Tel: (916) 323-3108
5 Fax: (916) 324-2618

6 Attorney for the Appeals Division

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

10 In the Matter of the Appeal of:) **HEARING SUMMARY**
11) **PERSONAL INCOME TAX APPEAL**
12 **HAIG TACORIAN AND GILDA TACORIAN¹**) Case No. 621172

	<u>Year</u>	<u>Claim For Refund</u>
	2010	\$49,905.76

16 Representing the Parties:

17 For Appellants: Allen M. Ullman, CPA
18 For Franchise Tax Board: Marguerite E. Mosnier, Tax Counsel III

20 QUESTION: Whether appellants have established reasonable cause for an abatement of the late
21 payment penalty imposed under Revenue and Taxation Code (R&TC) section 19132
22 for the tax year 2010.

23 HEARING SUMMARY

24 Background

25 Appellants filed their 2010 California tax return on October 14, 2011. Appellants reported
26 federal adjusted gross income (AGI) of \$8,038,493, of which, \$6,641,729 was income received from
27

28 ¹ Appellants reside in Los Angeles County.

1 Tacori Enterprises, an S corporation that appellants are the sole shareholders. Appellants reported net
2 California adjustments (an addition) of \$119,249, less itemized deductions of \$11,365, resulting in
3 taxable income of \$8,146,377, and tax of \$773,399. After subtracting an “other state” tax credit of
4 \$16,627, and adding the mental health services tax of \$71,464, appellants reported a total tax of
5 \$828,236. Appellants reported withholding credits of \$204,414, stated a balance due of \$623,822, and
6 remitted a payment of \$623,822 with the return. The Franchise Tax Board (Respondent/FTB) accepted
7 the return as filed and imposed a late payment penalty of \$49,905.76, pursuant to R&TC section 19132.
8 (Resp. Opening Br., p. 1, exhibit A.)

9 On or about October 31, 2011, the FTB issued a notice informing appellants of the
10 imposition of the late payment penalty and of the accrued interest on the late-paid tax and penalty. In
11 November 2011, appellants made a payment of \$10,750. Thereafter, the FTB undertook collection
12 activity and charged appellants a \$16 lien fee and a \$154 collection cost recovery fee. Appellants
13 subsequently made payments of \$50,506.49 and \$117.72 on April 24, 2012 and May 15, 2012,
14 respectively, satisfying the remaining amount due. Afterward, appellants filed a claim for refund. The
15 FTB denied the claim for refund by letter dated June 8, 2012. Appellants then filed this timely appeal.
16 (Resp. Opening Br., p. 2, exhibit C.)

17 Contentions

18 Appellants’ Contentions

19 On appeal, appellants contend that they qualify to have the late payment penalty abated
20 based on reasonable cause. Appellants assert that their corporation’s total sales increased from
21 \$29,382,396 in 2009 to \$44,678,338 in 2010, and that this unexpected increase complicated appellants’
22 bookkeeping for the year. Appellants contend that, due to the high increase in total sales, it was
23 impossible for them to correctly estimate the corporation’s total sales for 2010 and the tax due, and
24 appellants wanted to have their books reviewed before making additional tax payments. Appellants state
25 that they have implemented a new software system to handle the increase in business; however, the new
26 software took time to setup. Appellants assert that this was the first time they made underpayments and
27 have taken the necessary steps to prevent future underpayments. Appellants contend that, due to the
28 unforeseeable circumstances and situations outside of their control, the assessed late payment penalty

1 should be abated based on reasonable cause. (Appeal Letter, p. 1, App. Reply Br., p. 3.)

2 Appellants assert that they have established reasonable cause for an abatement, which is
3 further evidenced by the federal abatement of the penalty. Appellants contend that they provided the IRS
4 with the same explanation regarding their late payment of federal taxes for 2010. The IRS, which
5 imposed a \$61,197.24 late payment penalty against appellants on November 14, 2011, for their late
6 payment of 2010 taxes, abated the penalty on February 6, 2012. Appellants assert that the only reason
7 the IRS will abate late payment penalties is for reasonable cause. Appellants point to Internal Revenue
8 Code (IRC) section 6651(a)(2), which states that, when a taxpayer fails to pay the amount shown as tax
9 on any return by the date prescribed for the payment of such tax, a late payment penalty will be imposed
10 “unless it is shown that such failure is due to reasonable cause and not due to willful neglect”.

11 Appellants contend that the FTB is postulating that the IRS’s abatement was for a reason other than
12 reasonable cause merely because appellants’ Individual Master File (IMF) failed to show “PRC-62”.²
13 Appellants claim that the FTB’s reference to the IRS’ Internal Revenue Manual (IRS Manual) in support
14 of its contention that the IRS may abate penalties for reasons other than reasonable cause is misplaced
15 because the IRS Manual is for policy statements and is not law. Appellants contend that the FTB is
16 assuming that the IRS relied on the portion of the IRS Manual that suits the FTB’s purpose, and that the
17 only basis for the FTB’s assumption is the omission of “PRC-62” on appellants’ IMF. (App. Reply Br.,
18 pp.1-3, App. Additional Br., p. 1.)

19 Respondent’s Contentions

20 The FTB contends that it properly imposed the late payment penalty and appellants failed
21 to demonstrate reasonable cause. The FTB asserts that, while appellants filed their 2010 income tax
22 return on extension, an extension of time to file a return is not an extension of the time to pay the tax
23 required to be paid on or before the original due date of the return. The FTB contends that appellants
24 have the burden of establishing reasonable cause, which means they must show that the failure to timely
25 pay the proper amount of tax occurred despite the exercise of ordinary business care and prudence. The
26 FTB claims that a taxpayer’s difficulty in determining income does not negate the taxpayer’s requirement
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28 ² “PRC” is an acronym for Penalty Reason Code.

1 to pay tax based on a reasonably accurate estimation of the tax liability, and a failure to pay the amount
2 shown on the return by the payment due date, because of a lack of necessary information, does not
3 constitute reasonable cause. The FTB contends that appellants have not explained how the increases in
4 sales between 2009 and 2010 complicated appellants' bookkeeping such that they could not accurately
5 estimate corporate income. The FTB asserts that appellants have also not explained how the time
6 required to set up the new software contributed to the failure to have paid the tax shown on the return by
7 the April 15, 2011 due date. The FTB notes that, while Tacori Enterprises had a significant increase in
8 sales during the appeal year, appellants did not make estimate payments based on the corporate income
9 that would flow through to them as the sole shareholders of the corporation. The FTB claims that the
10 only timely payments appellants made were the withholding payments from Tacori Enterprises based on
11 wages paid to appellants. (Resp. Opening Br., pp. 2-4.)

12 With regard to the IRS's abatement of the federal late payment penalty, the FTB contends
13 that it does not appear from appellants' IMF that the abatement was due to a showing of reasonable
14 cause. The FTB argues that, although appellants' IMF for 2010 notes that the federal late payment
15 penalty was abated, there is no code showing that the reason for the abatement was for reasonable cause.
16 The FTB explains that, generally, if the IRS abates the late payment penalty based on reasonable cause,
17 there would be a "62" in the field next to "PRC" adjacent to Transaction Code 271 on the IMF. The FTB
18 contends that the imposition and abatement of the late payment penalty at the federal level is governed
19 both by IRC section 6651(a)(2) and the IRS Manual. The FTB claims that, while the Internal Revenue
20 Code requires that the IRS impose a late payment penalty unless it is shown that the late payment was
21 due to reasonable cause and not willful neglect, the IRS Manual provides for an abatement of penalties
22 for reasons other than reasonable cause. The FTB claims that a taxpayer may be relieved of a late
23 payment penalty imposed by the IRS if no other penalty has been imposed in the three prior years. The
24 FTB points to the IRS Manual section 20.1.1.3.6.1 regarding the First Time Abate (FTA) option which
25 authorizes the first time abatement of the late payment penalty based on the taxpayer's good filing
26 history. The FTB contends that a penalty abatement pursuant to FTA is not based on a finding of
27 reasonable cause and that the "PRC-62" code is not used in those circumstances. Consequently, the FTB
28 asserts that, because appellants' IMF indicates that the federal late payment penalty was abated, but the

1 “PRC” field is blank, as opposed to showing “PRC-62”, there is no evidence that the IRS abated the late
2 payment penalty based on a finding of reasonable cause. The FTB contends that it properly determined
3 that appellants have not independently established reasonable cause for an abatement of the late payment
4 penalty. (Resp. Opening Br., p. 4, Resp. Reply Br., pp. 1-2.)

5 Applicable Law

6 R&TC section 19132, subdivision (a)(1)(A), imposes a late payment penalty when a
7 taxpayer fails to pay the amount shown on the return by the date prescribed for the payment of that tax.
8 Generally, the date prescribed for the payment of the tax is the due date of the return (without regard to
9 extensions of time for filing). (Rev. & Tax. Code, § 19001.) The late payment penalty does not apply
10 when the failure to pay is due to reasonable cause and is not due to willful neglect. The taxpayer bears
11 the burden of proving “reasonable cause” which means they must show that their failure to pay the tax in
12 a timely manner occurred despite the exercise of ordinary business care and prudence. (*Appeal of M.B.*
13 *and G.M. Scott*, 82-SBE-249, Oct. 14, 1982.)

14 In previous appeals, we determined that a taxpayer’s discovery of reportable income after
15 the original due date (*Appeal of Elixir Industries*, 83-SBE-248, Dec. 14, 1983), a taxpayer’s difficulty in
16 obtaining necessary information (*Appeal of J.B. and P.R. Campbell*, 85-SBE-112, Oct. 9, 1985), the
17 complexity and problems in accumulating the information necessary to complete a return (*Appeal of*
18 *Incom International, Inc.*, 82-SBE-053, Mar. 31, 1982), a taxpayer’s difficulty in resolving accounting
19 problems (*Appeal of Cerwin-Vega International*, 78-SBE-070, Aug. 15, 1978), a taxpayer’s difficulty in
20 determining income with exactitude (*Appeal of Roger W. Sleight*, 83-SBE-244, Oct. 26, 1983; *Appeal of*
21 *Avco Financial Services, Inc.*, 79-SBE-084, May 9, 1979), a taxpayer’s unresolved business matters
22 (*Appeal of Bild Industries, Inc.*, 82-SBE-212, Sept. 21, 1982), or the failure of the taxpayer’s accountant
23 to properly account for income (*Appeal of M.B. and G.M. Scott, supra*) did not constitute reasonable
24 cause for abating penalties.

25 STAFF COMMENTS

26 Should such information exist, appellants should be prepared to show evidence that the
27 federal abatement of the penalty was due to a showing of reasonable cause. Appellants may want to
28 provide a letter from the IRS stating that the penalty was abated due to a showing of reasonable cause.

1 Additionally, appellants should be prepared to show that the failure to pay the tax in a timely manner
2 occurred despite the exercise of ordinary business care and prudence. Staff notes that the Board's
3 previous holdings indicate the importance of preparing and filing a timely tax return and timely paying
4 the tax due, even in the face of business difficulties or difficulties in obtaining necessary information.

5 Pursuant to California Code of Regulations, title 18, section 5523.6, if either party has any
6 additional evidence to present, they should provide the evidence to the Board Proceedings Division at
7 least 14 days prior to the oral hearing.³

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³ 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.