

1 John O. Johnson
 2 Tax Counsel
 3 Board of Equalization, Appeals Division
 4 450 N Street, MIC:85
 5 PO Box 942879
 6 Sacramento CA 95814
 7 Tel: (916) 319-9118
 8 Fax: (916) 324-2618

9 Attorney for the Appeals Division

10 **BOARD OF EQUALIZATION**
 11 **STATE OF CALIFORNIA**

12 In the Matter of the Appeal of:) **HEARING SUMMARY**
 13)
 14) **CORPORATION FRANCHISE TAX APPEAL**
 15)
 16 **A.C.K. MASONRY CORPORATION¹**) Case No. 417778

<u>Tax Years Ending</u>	<u>Claim For Refund</u>
12/31/1993 – 12/31/2006 ²	\$21,931.92 ³

17 Representing the Parties:

18 For Appellant: Eric Divine, Tax Appeals Assistance Program⁴
 19 For Franchise Tax Board: Jane Perez, Tax Counsel

20 ¹ Appellant’s listed address with the Secretary of the State’s office is in Ventura County, California.

21 ² The breakdown of the amounts assessed for each year, including interest is provided in respondent’s reply brief, in the chart
 22 on page 3. For tax year ending 12/31/1993, respondent reports that no tax was due (See also Resp. Reply Br., exhibit E.) For
 23 each of the other years, an \$800 minimum franchise tax was assessed, as well as an estimated tax penalty in varying amounts
 24 and interest. A late filing penalty was imposed for all years except tax years ending 12/31/1993 and 12/31/2006, and an
 25 amnesty penalty was imposed for tax years ending 12/31/1994 through 12/31/2002.

26 ³ This amount represents the original claim amount accepted by Board Proceedings. Appellant has subsequently agreed to
 27 concede the minimum franchise tax and estimated tax penalty amounts, represented as questions (1) and (3). (App. Add’l
 28 Br., p. 3.) The remaining amount on appeal is \$4,781.71 plus interest, and is comprised of \$2,400.00 in late filing penalties
 and \$2,381.71 in post-amnesty penalties. (Resp. Reply Br., p. 3.; App. Add’l Br., p. 1, fn. 3.)

⁴ Mr. Divine is a student participating in the Tax Appeals Assistance Program (TAAP). Another student participating in
 TAAP, Habib Hanna, filed a brief on behalf of appellant in this appeal. Appellant’s appeal letter and reply brief were
 submitted by Bruce J. Kellner, who is the brother of Cleo F. Kellner (who, in turn, is listed as appellant’s president on file
 with the Secretary of the State). (Resp. Reply Br., exhibit A, p. 1.)

- 1 QUESTIONS: (1) Whether appellant has shown that the minimum franchise tax for taxable years
2 ending 12/31/1994 through 12/31/2006 should be refunded.
- 3 (2) Whether appellant has shown that the late filing penalties imposed for taxable
4 years ending 12/31/1994 through 12/31/2005 should be abated.
- 5 (3) Whether appellant has shown that the estimated tax penalties imposed for taxable
6 years ending 12/31/1994 through 12/31/2006 should be abated.
- 7 (4) Whether respondent properly determined not to abate interest for each of the
8 taxable years listed above under Revenue and Taxation Code (R&TC) section
9 19104, subdivision (a), or section 19112.
- 10 (5) Whether the Board has jurisdiction over the post-amnesty penalty imposed for
11 taxable years ending 12/31/1994 through 12/31/2002.

12 HEARING SUMMARY

13 Background

14 According to the California Secretary of State records, appellant, a former California
15 corporation, filed its articles of incorporation on June 16, 1975 and officially dissolved on December 26,
16 2006. (Resp. Reply Br., exhibit A.) Appellant lists Cleo Kellner as the president, and his wife, Virginia
17 Kellner, as secretary of the corporation. (App. Appeal Letter, exhibits.) Respondent states that, due to
18 its data retention policy, it does not have records of appellant's returns for tax years prior to 1993.
19 However, respondent states that appellant apparently filed its corporate franchise tax returns up through
20 1992, but not for years subsequent. (Resp. Reply Br., p. 2.) On December 10, 1996, respondent sent a
21 notice to appellant regarding past due corporate tax returns, and appellant responded on December 15,
22 1996, stating that he was working with a certified public accountant (CPA) on getting the returns filed.
23 (Resp. Reply Br., p. 2 & exhibits B, C.) Respondent indicates that it received no follow-up contact from
24 appellant, and sent several more notices to appellant through 1999 requesting past due corporate tax
25 returns.⁵ (Resp. Reply Br., p. 2 & exhibit B.)

26 Respondent suspended appellant on February 1, 2000, because appellant did not file
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28 ⁵ Appellant does not express any contentions with regard to respondent's representation of the facts, and indicates that "[t]he facts stated appear to be correct in general." (App. Reply Br., p. 1.)

1 California tax returns. (Resp. Reply Br., exhibit A, p. 2.) Respondent states that appellant did not file
2 the required Annual Statement of Officers with the Secretary of State (SOS), and that the SOS
3 suspended the corporation on February 18, 1998. (*Id.*) Respondent took no further collection actions
4 after suspending appellant on February 1, 2000, except for an Amnesty Notice sent in 2005. (Resp.
5 Reply Br., p. 2 & exhibit B, p. 1.)

6 On September 14, 2006, Bruce Kellner, brother of appellant's president Cleo Kellner,
7 began contact with respondent. (Resp. Reply Br., exhibit D.) Respondent's records show that Bruce
8 Kellner called their offices on that day, reporting that Cleo Kellner had been suffering from cancer
9 (leukemia) for 15 years and finally passed away in March of 2006, and that he was attempting to revive
10 the corporation so that the life insurance policy, which named the company as the beneficiary, could be
11 paid. Respondent's notes state that Bruce Kellner considered the corporation non-operational, with its
12 physical location and bank account being closed.⁶ (*Id.*)

13 Respondent indicates that it assisted Bruce Kellner in reviving the corporation to good
14 standing. (Resp. Reply Br., p. 2.) The record shows that appellant needed to file corporate tax returns
15 from 1993 through 2006 and make payments totaling \$21,931.92 for the minimum franchise tax,
16 penalties, and interest for each year. (Resp. Reply Br., p. 2 & exhibits E-R)⁷ Bruce Kellner, under a
17 power of attorney, filed these returns and made the payments for appellant on November 2, 2006. (*Id.*)
18 A subsequent recalculation by respondent resulted in an additional \$548.40 being due, which Bruce
19 Kellner paid on November 15, 2006.⁸ In a letter dated October 30, 2006, Bruce Kellner requested
20 whatever assistance was available to waive fees, penalties, and interest where possible due to his
21 brother's illness. (App. Appeal Letter, exhibits.) Mr. Kellner then sent a letter to respondent on January
22 28, 2007, making a formal claim for refund, again based on the circumstances surrounding the
23 corporation and its president's prolonged and fatal condition. (*Id.*) When respondent did not respond to
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26 ⁶ This conversation took place three months prior to the official dissolution of the corporation with the Secretary of State.

27 ⁷ The breakdown of the amount due for each year according to the returns is expressed in respondent's reply brief, exhibit E.
28 The individual corporate tax returns are found in respondent's reply brief, exhibits F through R.

⁸ A complete breakdown of the total amounts paid, including the additional \$548.40, and how they were allocated is provided
in a chart by respondent. (Resp. Reply Br., p. 3.)

1 the claim for refund, it was deemed denied and this timely appeal followed.

2 Contentions

3 Appellant concedes the minimum franchise tax and estimated tax penalties issues, but
4 contends that it is entitled to abatement of the interest, late filing penalties, and post-amnesty penalties.
5 (App. Add'l Br., p. 3.) Appellant contends that the Board can apply R&TC section 19112 to waive the
6 interest in this appeal due to the financial disability caused by the severe illness of appellant's president.
7 In this connection, appellant argues that R&TC section 19112 is "a subset of the larger interest
8 abatement statute covered by R&TC sections 19101 – 19120" and that R&TC section 19104 therefore
9 provides the Board with authority to "abate interest imposed under the provisions of that section." (App.
10 Add'l Br., p. 5.) Appellant also contends that there is reasonable cause for the late filing of the
11 corporate tax returns, and that the post-amnesty penalty is unconstitutional. (*Id.*)

12 Respondent asserts that abatement of interest is not proper in this appeal because it did
13 not cause an error or delay by a ministerial or managerial act, and that a significant aspect of the delay is
14 attributable to appellant. (Resp. Reply Br., pp. 6-8.) Respondent also contends that R&TC section
15 19112 does not apply here because appellant is not an individual or fiduciary. (Resp. Add'l Br., p. 1.)
16 Respondent contends that appellant's reasons for the late filing of its corporate tax returns do not meet
17 the requirements to establish reasonable cause. Namely, respondent contends that an illness may count,
18 but not if it merely causes the taxpayer to sacrifice the timeliness of one aspect of the taxpayer's affairs
19 to pursue other aspects. Appellant must show that the illness completely prevented the taxpayer from
20 timely filing a return. In this instance, this also includes why the corporation was not dissolved when it
21 apparently ceased operating and why the other officers and agents did not tend to the corporate
22 requirements. (Resp. Reply Br., p. 5.) Respondent contends that the post-amnesty penalty can only be
23 challenged on the limited grounds that the amount paid to satisfy the penalty was not computed properly
24 by the FTB. (Resp. Reply Br., pp. 8-9.)

25 Applicable Law

26 Since appellant has stated that it is prepared to accept the minimum franchise tax (Rev. &
27 Tax. Code, § 25153) and estimated tax penalties (Rev. & Tax. Code, § 19136) assessed against the
28 corporation (see App. Add'l Br., p. 3.), only the interest, late filing penalties, and post-amnesty penalties

1 will be discussed below.

2 Abatement of Interest

3 The assessment of interest is mandatory on unpaid tax, including the minimum franchise
4 tax. (*Appeal of Amy M. Yamachi*, 77-SBE-095, June 28, 1977; *Appeal of Audrey C. Jaegle*, 76-SBE-
5 070, June 22, 1976.) Interest is also mandatory with respect to the imposition of a failure to file penalty,
6 a failure to pay penalty, or an accuracy-related penalty pursuant to R&TC sections 19131, 19132, and
7 19164, respectively. (Rev. & Tax. Code, § 19101, subd. (c)(2)(B).) Interest shall not apply, however,
8 to any failure to pay an estimated tax penalty imposed under R&TC section 19025 or 19136. (Rev. &
9 Tax. Code, § 19101, subd. (d).) This Board has held interest is not a penalty, but is simply
10 compensation for a taxpayer's use of money after the due date of the tax. (*Appeal of Audrey C. Jaegle*,
11 *supra.*) There is no reasonable cause exception to the imposition of interest. (*Appeal of Audrey C.*
12 *Jaegle, supra.*)

13 Respondent may abate interest accrued on a deficiency when the taxpayer identifies an
14 unreasonable error or delay which (1) occurred after respondent contacted the taxpayer in writing about
15 the particular deficiency or overpayment underlying the disputed interest; (2) is not significantly
16 attributable to the taxpayer; and (3) is attributable to a ministerial or managerial⁹ act performed by

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20 ⁹ In the *Appeal of Michael and Sonia Kishner* (99-SBE-007), decided September 29, 1999, this Board adopted the language
21 from Treasury Regulation section 301.6404-2 (b)(2), which defines a "ministerial act" as:

22 A procedural or mechanical act that does not involve the exercise of judgment or discretion, and that occurs
23 during the processing of a taxpayer's case after all prerequisites to the act, such as conferences and review
24 by supervisors, have taken place. A decision concerning the proper application of federal law (or other
25 federal or state law) is not a ministerial act.

26 For acts performed in tax years beginning on or after January 1, 1998, respondent may also abate interest for "managerial
27 acts" as well. (Rev. Tax. Code, § 19104(c)(1)(C)(iii).) In *Appeal of Michael and Sonia Kishner*, the Board noted that
28 Treasury Regulation section 301.6404-2 (b)(1) defines a "managerial" act as:

[A]n administrative act that occurs during the processing of a taxpayer's case involving the temporary or
permanent loss of records or the exercise of judgment or discretion relating to management of personnel. A
decision concerning the proper application of federal tax law (or other federal or state law) is not a
managerial act. Further, a general administrative decision, such as the IRS's decision on how to organize
the processing of tax returns or its delay in implementing an improved computer system, is not a
managerial act for which interest can be abated

1 respondent.¹⁰ (*Appeal of Michael and Sonia Kishner*, 99-SBE-007, Sept. 29, 1999; see also Rev. & Tax.
2 Code, § 19104, subds. (a)(1) & (b)(1).) An error or delay will only be taken into account if it occurred
3 after the FTB contacted the taxpayer in writing with respect to the deficiency from which the interest
4 accrued. (Rev. & Tax. Code, § 19104, subd. (b)(1).) Respondent's determination not to abate interest is
5 presumed correct, and the burden is on appellant to prove error. (*Appeal of Michael E. Myers*, 2001-
6 SBE-001, May 31, 2001.) Subdivision (b)(2)(B) of R&TC section 19104 states that the Board shall
7 have jurisdiction to determine whether respondent's failure to abate interest "under this section" was an
8 abuse of discretion and to order an abatement of interest if it determines that such an abuse occurred.
9 (*Appeal of Ernest J. Teichert*, 99-SBE-006, Sept. 29, 1999.) In order to show an abuse of discretion,
10 appellant must establish that the FTB exercised its discretion arbitrarily, capriciously, or without sound
11 basis in fact or law by refusing to abate interest. (See *Woodral v. Commissioner* (1999) 112 T.C. 19,
12 23.)

13 R&TC section 19112 provides as follows:

14 Interest may be waived for any period for which the Franchise Tax Board determines that
15 an individual or fiduciary demonstrates inability to pay that interest solely because of
16 extreme financial hardship caused by significant disability or other catastrophic
17 circumstance. Any waiver under this section shall be withdrawn retroactively if made
18 because of fraud, malfeasance, misrepresentation, or omission of any material fact.

19 Unlike R&TC section 19104, R&TC section 19112 does not include within its terms a provision for the
20 review of respondent's determinations.

21 Late Filing Penalties

22 Under R&TC section 18601, a corporation's tax return is due on the 15th day of the
23 corporation's third month following the close of its taxable year. A taxpayer may extend time for filing
24 a return, but an extension of time to file a return does not extend the time for payment of tax required to
25 be paid on or before the original due date of the return. (Rev. & Tax. Code, § 18567, subd (b).)

26 California imposes a penalty for the failure to file a return on or before the due date,

27 ¹⁰ The tax years for which appellant is requesting interest abatement span a period in which several amendments were made
28 to R&TC section 19104. Most of the changes were procedural or involved restructuring of the statutory language and were
effective based on the claim date rather than the tax year, and will not cause a disparity in review standards. For tax years
ending 12/31/1994 through 12/31/1997, however, there are two significant changes: 1) there is no clause allowing for the
abatement of interest based on a "managerial act" by respondent, and 2) the statute does not contain the "unreasonable"
modifier when describing the error or delay. There is no interest to abate for the tax year ending December 31, 1993.

1 unless it is shown that the failure is due to reasonable cause and not due to willful neglect.¹¹ (Rev. &
2 Tax. Code, § 19131.) The burden lies with the taxpayer; in order to establish reasonable cause, the
3 taxpayer “must show that the failure to file a timely return occurred despite the exercise of ordinary
4 business care and prudence, or that cause existed as would prompt an ordinary intelligent and prudent
5 businessman to have so acted under similar circumstances.” (*Appeal of Howard G. and Mary Tons*, 79-
6 SBE-027, Jan. 9, 1979.) Reliance on an agent generally does not relieve a taxpayer of liability for a
7 penalty. (See *United States v. Boyle* (1985) 469 U.S. 241; *Appeal of Thomas K. and Gail G. Boehme*,
8 85-SBE-134, Nov. 6, 1985.) Further, ignorance of the law does not constitute reasonable cause for the
9 late filing of a return. (*Appeal of Byron C. Beam*, 78-SBE-042, June 29, 1978.)

10 Post-Amnesty Penalties

11 California imposes a post-amnesty penalty under R&TC section 19777.5, subdivision
12 (a)(2), for any underpayment of an eligible tax year beginning before January 1, 2003, that became final
13 after the end of the amnesty period (March 31, 2005). The amnesty provisions give respondent no
14 discretion to determine whether the amnesty penalty should be imposed and provide no exceptions for
15 taxpayers who may have acted in good faith or had reasonable cause for failing to participate in the
16 amnesty program. In addition, the amnesty provisions strictly limit the Board’s ability to review
17 respondent’s imposition of the amnesty penalty. Subdivision (d) of R&TC section 19777.5 provides that
18 a taxpayer may not contest the assessment of the amnesty penalty by respondent under the protest
19 procedures that are applicable to deficiency assessments. The taxpayer also has no right to file an
20 administrative claim for refund of a paid amnesty penalty, except upon the basis that the penalty was not
21 properly computed. (Rev. & Tax. Code, § 19777.5, subd. (e).) Therefore, this Board’s jurisdiction to
22 review the amnesty penalty is limited to situations where the penalty is assessed and paid, the taxpayer
23 files a timely appeal from a denial of a refund claim, and the taxpayer alleges a computational error in
24 the penalty.

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28 ¹¹ The penalty is calculated at 5 percent of the tax due, after allowing for payments made, for each month the return is late, up
to a maximum of 25 percent. (Rev. & Tax. Code, § 19131, subd. (a).) In this appeal, late filing penalties were assessed for
tax years ending December 31, 1994 through the tax year ending December 31, 2005. These penalties were equal to 25
percent of the \$800 minimum franchise tax for each year, or \$200 per penalty. (Resp. Reply Br., p. 3.)

1 STAFF COMMENTS

2 Interest Abatement

3 Although appellant appears to rely on R&TC section 19104 for its interest abatement
4 argument, the parties should be prepared to discuss the requirements for interest abatement under R&TC
5 section 19104. If the taxpayer intends to argue that interest should be abated under R&TC
6 section 19104, it should be prepared to demonstrate that the requirements for interest abatement under
7 that statute have been met, and that respondent abused its discretion by not abating interest.

8 With regard to R&TC section 19112, staff notes that, although appellant's president may
9 have suffered extreme financial hardship caused by significant disability or other catastrophic
10 circumstance for at least a portion of the years at issue, it is unclear if this would mean that appellant, the
11 corporation, suffered an extreme financial hardship. In addition, respondent contends that appellant is
12 not an individual or fiduciary, and therefore R&TC 19112 cannot apply to it. Staff also notes that, while
13 the Legislature expressly gave the Board limited jurisdiction to review interest abatement under R&TC
14 section 19104, R&TC section 19112 does not include any such grant of jurisdiction. Both parties should
15 be prepared to discuss whether R&TC section 19112 can apply to appellant for the years at issue and
16 whether the Board has jurisdiction to determine whether interest should be abated under R&TC section
17 19112.

18 Late Filing Penalties

19 Both parties should be prepared to discuss whether reasonable cause for the late filing
20 existed, and, in this connection, to discuss whether Virginia Kellner as secretary, Cleo Kellner as
21 president, or any other fiduciaries or officers were unable to file timely returns for appellant despite the
22 exercise of ordinary business care and prudence. Appellant states that Cleo Kellner was aware of his
23 medical condition in early 1990, and mentions that he may not have dissolved the corporation when it
24 apparently ceased being a functioning company because he was unaware of the requirement. (App.
25 Reply Br., p. 2.) However, ignorance of the formal requirements of law is not an excuse. (See *Appeal*
26 *of Byron C. Beam, supra.*) Appellant indicates that there was a CPA providing accounting services that
27 should have performed the dissolution rather than let the company go untended. (App. Reply Br., p. 2.)
28 The United States Supreme Court found that “[t]he failure to make a timely filing of a tax return is not

1 excused by the taxpayer's reliance on an agent, and such reliance is not "reasonable cause" for a late
2 filing" (*United States v. Boyle, supra*, 469 U.S. at 252.) In addition, the Board has previously
3 decided that the appointment of a competent employee at one point in time does not protect a
4 corporation from the ultimate responsibility of timely filing its tax returns in subsequent years. (*Appeal*
5 *of Citicorp Lea Sing, Inc.*, 76-SBE-001, Jan. 6, 1976.)

6 Post-Amnesty Penalties

7 Because the standard appeal provisions are not applicable to the post-amnesty penalty, it
8 appears as though this Board only has authority under the R&TC to review whether the amount of the
9 penalty was improperly calculated by the FTB. Because appellant has not contested that the amount of
10 the post-amnesty penalty is incorrect, it appears that the Board does not have jurisdiction to consider the
11 post-amnesty penalties in this appeal. Appellant has asserted constitutional challenges to the penalty. In
12 the absence of an appellate court decision, the Board is precluded from refusing to enforce a California
13 statute based on constitutional arguments, and it has an established policy of declining to consider
14 constitutional issues. (Cal. Const., art III, § 3.5; *Appeal of Aimor Corp.*, 83-SBE-221, Oct. 26, 1983;
15 *Appeals of Walter Bailey*, 92-SBE-001, Feb. 20, 1992.)

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