

1 Linda Frenklak
2 Tax Counsel III
3 Board of Equalization, Appeals Division
4 450 N Street, MIC: 85
5 PO Box 942879
6 Sacramento CA 95814
7 Tel: (916) 445-9406
8 Fax: (916) 324-2618

6 Attorney for the Appeals Division

7 **BOARD OF EQUALIZATION**

8 **STATE OF CALIFORNIA**

9
10 In the Matter of the Appeal of:) **HEARING SUMMARY²**
11) **CORPORATION FRANCHISE TAX APPEAL**
12 **FILTRONA INDUSTRIAL CORPORATION¹**) Case No. 427430
13)
14)

15 Year
16 2005

Claim
For Refund³
\$4,354.08

17 Representing the Parties:

18 For Appellant: Jeffrey M. Healy
19 For Franchise Tax Board: Anne B. Mazur, Specialist
20 Counsel for the Board of Equalization: Linda Frenklak, Tax Counsel III
21
22

23 ¹ According to the appeal letter, appellant is located in Colonial Heights, Virginia.

24 ² This appeal was pulled from the July 21, 2009, nonappearance consent calendar due to Board Member contact and then
25 rescheduled to the August 31, 2009 nonappearance adjudicatory calendar. At the request of appellant, this appeal was later
rescheduled for the November 17-19, 2009, oral hearing calendar.

26 ³ This amount consists of a late payment penalty of \$2,895.36 and an underpayment of estimated tax penalty of \$1,458.72.
27 Respondent asserts that the actual amount of penalties is \$4,228.75, which consists of a late payment penalty of \$2,770.03
28 and an underpayment of estimated tax penalty of \$1,458.72. Respondent asserts that the difference (\$125.33) is due to
one month of the monthly component (0.5 percent of the tax due) of the late payment penalty and, although the bill
amount reflects a late payment penalty for 13 months, the imposed late payment penalty was imposed for only 12 months.
(Resp. Opening Br., fn 1, exhibit C, p. 2.)

1 QUESTIONS: (1) Whether appellant has demonstrated reasonable cause to abate the late payment
2 penalty.
3 (2) Whether appellant has demonstrated that the Franchise Tax Board (FTB or
4 respondent) erred by not refunding the underpayment of estimated tax penalty.

5 HEARING SUMMARY

6 Background

7 During the 2005 tax year, appellant was created as the surviving corporation of a
8 corporate reorganization the parties refer to as a demerger involving appellant's predecessor corporation,
9 Bunzl Plastics, Inc. (Bunzl). After the demerger, Bunzl was no longer in existence. On October 15,
10 2006, appellant filed a timely California tax return for the period March 11, 2005, through December 31,
11 2005, on which it reported California net income of \$885,961 and a franchise tax liability of \$79,119,
12 and claimed estimated tax payments of \$30,500 and a prior year credit of \$53,942. Bunzl filed a timely
13 California tax return for the period January 1, 2005, through March 10, 2005.

14 Respondent accepted and processed appellant's 2005 return. According to respondent's
15 records, however, appellant did not make any estimated tax payments in 2005. Instead, respondent
16 received an estimated tax payment of \$30,500 along with a payment voucher with Bunzl's name and
17 identification number on it for the third quarter of 2005. Since Bunzl apparently did not have any
18 outstanding tax liability, respondent transferred \$22,608.06 of the estimated tax payment to Bunzl's
19 account with the Employment Development Department (EDD), and refunded the remaining amount of
20 \$7,891.94 (\$30,500.00 - \$22,608.06) to Bunzl. On March 7, 2007, respondent transferred the credit
21 balance of Bunzl, which was \$53,942, to appellant's 2005 account, effective December 31, 2005, which
22 resulted in an unpaid 2005 tax balance of \$25,177 (\$79,119 - \$53,942) for appellant.⁴

23 Respondent issued to appellant a Return Information Notice dated March 21, 2007, which
24 shows the unpaid tax balance of \$25,177.00, a late payment penalty of \$2,895.36 and an underpayment

25 ///

26 ///

27 _____
28 ⁴ In its opening brief, respondent inadvertently referred to an unpaid tax balance of \$25,117.

1 of estimated tax penalty of \$1,458.72, plus interest. Appellant subsequently remitted the balance due⁵
2 and filed a claim for refund dated August 22, 2007, in which it requested abatement of all penalties
3 imposed for 2005. Respondent denied its claim for refund. This timely appeal followed.

4 Contentions

5 Appellant contends that it has shown reasonable cause for abatement of both the late
6 payment of tax penalty and the underpayment of estimated tax penalty. Appellant contends that it
7 timely remitted a 2005 estimated tax payment of \$30,500 for itself, but inadvertently submitted with it a
8 payment voucher for Bunzl. Appellant contends that respondent held the estimated tax payment in an
9 inactive Bunzl account instead of applying it to appellant's account and that \$22,608.06 of the \$30,500
10 estimated tax payment was applied to Bunzl's EDD account. According to appellant, EDD later reduced
11 Bunzl's liability from \$22,608.06 to \$8,067.47 and credited Bunzl's EDD account for the remaining
12 \$14,540.59 (\$22,608.06 - \$8,067.47). Appellant contends that Bunzl never requested the \$7,891.94
13 refund and cashed it merely as a result of a company policy requiring Bunzl to deposit checks at the time
14 they are received. Appellant argues that the demerger caused confusion in the application of the
15 payment and the split of accounting and tax functions between Bunzl and appellant at the time of the
16 demerger caused a delay in appellant's understanding that the estimated tax payment had not been
17 properly applied. Appellant also argues that it acted in good faith when it remitted the estimated tax
18 payment with the wrong payment voucher, Bunzl had an excellent tax paying history, and the State of
19 California (by EDD) retained over half of the funds at all times at issue. Alternatively, appellant argues
20 that it is entitled to abatement of 58 percent of all imposed penalties because that percentage represents
21 the \$14,540.59 portion of the \$25,177.00 tax liability that EDD retained ($\$14,540.59 / \$25,177.00$).
22 Lastly, appellant argues that respondent's opening brief does not accurately analyze the facts at issue
23 and cites a number of cases that, appellant argues, are not on point.

24 ///

25 _____
26 ⁵ Although the Return Information Notice is dated March 21, 2007, the check issued for the payment of the unpaid balance
27 due of \$25,177 is dated March 14, 2007, and it lists the FEIN for another related entity, Filtrona Plastics, LLC. Respondent
28 consequently applied the \$25,177.00 payment to that entity's account, which had a balance due of \$111.36. Respondent then
transferred the remaining portion of the payment, \$25,065.64, to appellant's 2005 account, effective March 15, 2007, and
appellant paid the remaining balance on April 15, 2007.

1 Respondent contends that confusion and personnel issues related to the demerger of
2 Bunzl do not constitute reasonable cause to abate the late payment penalty and there is no reasonable
3 cause exception to the underpayment of estimated tax penalty. Respondent further contends that
4 appellant's use of an incorrect payment voucher when remitting the \$30,500 estimated tax payment was
5 not an isolated incident with respect to the 2005 tax year. Respondent contends that on December 5,
6 2005, a fourth quarter payment in the amount of \$51,000 was erroneously remitted for the benefit of
7 Bunzl via electronic funds transfer. According to respondent, this \$51,000 fourth quarter payment made
8 up a portion of Bunzl's credit balance of \$53,942, which respondent transferred to appellant's 2005
9 account in partial satisfaction of appellant's self-assessed franchise tax liability of \$79,119. In addition,
10 respondent contends that a check dated March 14, 2007, in the amount of \$25,177 was remitted to
11 respondent in satisfaction of appellant's remaining 2005 balance due, which incorrectly lists the FEIN of
12 a different entity, Filtrona Plastics, LLC. Respondent contends that Bunzl's prior tax paying history has
13 no relevance to appellant's tax obligations and each tax year stands alone and must be examined
14 separately. Respondent nonetheless asserts that it imposed the underpayment of estimated tax penalty
15 on Bunzl for the three tax years preceding 2005. Respondent further contends that there is no reasonable
16 cause for abatement of the late payment penalty due to the fact that a portion of the \$30,500 estimated
17 tax payment was transferred to Bunzl's EDD account.

18 Applicable Law

19 Late Payment Penalty

20 Revenue and Taxation Code (R&TC) section 19132 imposes a penalty on any taxpayer
21 failing to timely pay the amount of tax owed, unless the taxpayer's failure to timely pay the tax is due to
22 reasonable cause and not due to willful neglect. The taxpayer bears the burden of proving that both
23 conditions existed. (*Appeal of M.B. and G.M. Scott*, 82-SBE-249, Oct. 14, 1982.)⁶ In order to establish
24 reasonable cause, the taxpayer must show the failure to timely pay the proper amount of tax occurred

25 ///

26 ///

27 _____

28 ⁶ State Board of Equalization cases (designated "SBE") can be viewed on the Board's website (www.boe.ca.gov).

1 despite the exercise of ordinary business care and prudence. (*Ibid.*)⁷

2 In previous appeals, we determined that a taxpayer's discovery of reportable income after
3 the original due date (*Appeal of Elixir Industries*, 83-SBE-248, Dec. 14, 1983), a taxpayer's difficulty in
4 obtaining necessary information (*Appeal of J.B. and P.R. Campbell*, 85-SBE-112, Oct. 9, 1985; *Appeal*
5 *of Stephen C. Bieneman*, 82-SBE-148, July 26, 1982; *Appeal of William T. and Joy P. Orr*, 68-SBE-010,
6 Feb. 5, 1968.), a taxpayer's difficulty in resolving accounting problems (*Appeal of Cerwin-Vega*
7 *International*, 78-SBE-070, Aug. 15, 1978), a taxpayer's difficulty in determining income with
8 exactitude (*Appeal of Roger W. Sleight*, 83-SBE-244, Oct. 26, 1983; *Appeal of Avco Financial Services,*
9 *Inc.*, 79-SBE-084, May 9, 1979), a taxpayer's unresolved business matters (*Appeal of Bild Industries,*
10 *Inc.*, 82-SBE-212, Sept. 21, 1982), or the failure of the taxpayer's accountant to properly account for
11 income (*Appeal of M.B. and G.M. Scott, supra*) did not constitute reasonable cause for abating penalties.

12 Underpayment of Estimated Tax Penalty

13 A corporation subject to the franchise or income tax imposed by Part 11 of the R&TC
14 must file a declaration of estimated tax and pay the estimated tax for each year. (R&TC, §§ 19023 &
15 19025.) A corporation that underpays estimated tax is penalized by an addition to tax equal to a
16 specified rate of interest applied to the amount of the underpayment. (R&TC, §§ 19142, 19144.)

17 A penalty for the underpayment of estimated tax is properly imposed where the
18 taxpayer's installment payments are less than the amounts due at the end of the installment periods.
19 (*Appeal of Bechtel, Inc.*, 78-SBE-052, July 26, 1978.) The R&TC does not contain a reasonable cause
20 or extenuating circumstances exception to the underpayment of estimated tax penalty. (*Appeal of*
21 *Weaver Equipment Company*, 80-SBE-048, May 21, 1980.) There are a few limited statutory exceptions
22 to the estimated tax penalty. (See Rev. & Tax. Code, § 19147.) A corporation can avoid the penalty if it
23 falls under the "prior year" exception or the "annualize income" exception. (Rev. & Tax. Code, § 19147,
24 subds. (a)(1)(A) - (B) & (2)(A).)

25 ///

26 _____
27 ⁷ The United States Supreme Court defined willful neglect as a "conscious, intentional failure or reckless indifference."
28 (*United States v. Boyle*, (1985) 469 U.S. 241, 245-246.) Respondent does not appear to allege the existence of willful neglect
on the part of appellant.

1 STAFF COMMENTS

2 Late Payment Penalty

3 The parties should be prepared to argue as to whether reasonable cause for relief from the
4 late payment penalty exists. It appears that the Board must determine whether appellant exercised
5 ordinary business care and prudence when it remitted the third quarter tax payment with the wrong
6 payment voucher; if not, reasonable cause to abate the late payment penalty will not exist. Staff notes
7 that the Board's previous holdings indicate the importance of preparing and filing a timely tax return and
8 timely paying the tax due, even in the face of business difficulties or difficulties in obtaining necessary
9 information. The Board may consider whether there is any merit in appellant's argument that it should
10 be granted relief because it complied with *the intent of the law* when it made a tax payment on behalf of
11 a non-existent entity, Bunzl. It appears that appellant has not presented any evidence that it had reason
12 to believe that Bunzl was the entity that was required to remit an estimated tax payment for the third
13 quarter of 2005, which was after the demerger. Appellant contends that there was confusion among its
14 personnel as a result of the demerger. The Board may consider whether a prudent business person,
15 exercising ordinary caution in the use of payment vouchers, would not have used its predecessor's
16 payment voucher when remitting an estimated tax payment. It appears that appellant has not provided
17 an explanation, other than lack of personnel and confusion, for its failure to correctly identify the correct
18 entity (i.e., appellant) for which the third quarter estimated tax payment was remitted. It appears that
19 appellant and its related entities made a business decision to dissolve Bunzl and separate the remaining
20 entities, taking advantage of the related business and tax advantages of these corporate maneuvers. It
21 appears that decision carries with it certain responsibilities and obligations, not the least of which is the
22 timely payment of any and all taxes arising from the demerger.

23 In the event that the Board sustains respondent's action with respect to the imposition of
24 the late payment penalty, it should be modified by conforming to the FTB's concession that the amount
25 of the late payment of tax penalty should be reduced from \$2,895.36 to \$2,770.03. (See fn. 3.)
26 Similarly, in the event that the Board abates any or all of the interest on the late payment penalty, such
27 abatement should be based on a late payment penalty of \$2,770.03, rather than \$2,895.36.

28 ///

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

Underpayment of Estimated Tax Penalty

The parties should also be prepared to argue whether any of the exceptions to the imposition of the underpayment of estimated tax penalty apply to this case. (See Rev. & Tax. Code, § 19147.) Appellant does not argue, and there is no evidence to indicate, that any of them apply to this case. In the absence of any such exception, it appears the imposition of the penalty should be sustained.

///
///
///

Filtrona_lsf