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BOARD OF EQUALIZATION
STATE OF CALIFORNIA

In the Matter of the Appeal of:) **HEARING SUMMARY**
) **PERSONAL INCOME TAX APPEAL**
) **DAVID E. HOUTZ**¹) Case No. 389846

<u>Year</u>	<u>Claim For Refund</u>
2002	\$452.21 ²

Representing the Parties:

For Appellant: Pilar Garcia, TAAP

For Franchise Tax Board: Jane Perez, Tax Counsel³

QUESTION: (1) Whether this Board has jurisdiction to waive the post-amnesty penalty imposed by respondent.

(2) Whether appellant has met the statutory requirements for abatement of interest.

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¹ Appellant's mailing address is in Los Olivos.

² Respondent states that this is the amount acknowledged by the Board staff in a letter dated March 16, 2007, and is the amount of appellant's payment made on November 29, 2006. However, respondent states that the actual amount in dispute is a post-amnesty penalty of \$144.35 and interest of \$311.60, which totals \$455.95.

³ Respondent has stated that, although Jane Perez filed a brief in this matter, FTB attorney Bruce Langston will be presenting for it at the oral hearing.

1 HEARING SUMMARY

2 Background

3 Appellant timely filed his 2002 return and reported taxable income of \$672,618.00, a
4 total tax liability of \$58,803.00, estimated tax payments of \$25,460.00, and a balance due of \$33,344.00.
5 Appellant made a payment of \$33,417.00 with his return and respondent processed the return and
6 accepted appellant's self-assessed amount. Respondent imposed a penalty of \$60.48 for underpayment
7 of estimated tax and issued a refund of \$13.52 to appellant on April 29, 2003. (Resp. Opening Br., p. 1.)

8 On May 15, 2006, appellant filed an amended return for tax year 2002 reporting
9 additional income of \$40,414 and additional tax due of \$3,759. Appellant included the tax payment
10 with the return and respondent applied the payment to the additional tax due. Respondent also imposed
11 a post-amnesty penalty of \$144.35, calculated the accrued interest of \$621.21 and sent appellant a
12 Notice of State Income Tax Due on September 14, 2006. Appellant requested abatement of penalties
13 and interest and by letter dated October 19, 2006, respondent informed appellant that the interest amount
14 would be reduced by \$318.05 in accordance with the new Internal Revenue Service Revenue Ruling
15 2005-4. On November 16, 2006, respondent notified appellant that the post-amnesty penalty could not
16 be waived. On November 29, 2006, appellant paid \$452.21 with a letter of protest that respondent
17 treated as a claim for refund. Respondent denied appellant's claim for refund by letter dated January 12,
18 2007, which explained that the post-amnesty penalty could have been avoided only if the amended
19 return had been filed and additional tax had been paid in full on or before March 31, 2005. Appellant
20 filed this timely appeal of the denial. (Resp. Opening Br., p. 2.)

21 Contentions

22 Appellant's Contentions

23 Appellant contends that the post-amnesty penalty was improperly imposed because the
24 statutory amendment that resulted in appellant's additional tax liability for tax year 2002 (Assembly Bill
25 2328) was not enacted until 2004. Appellant states that the legislation provided that a California
26 subchapter C corporation that had converted to a subchapter S corporation in 2002 was required to use
27 the effective date of the federal election to be treated as an S corporation to compute built-in gains
28 resulting from the conversion pursuant to Internal Revenue Code (IRC) section 1374. Appellant

1 explains that he was a shareholder in Brentwood Properties, Inc. (Brentwood) which computed the tax
2 on the built-in gain on its original 2002 return based on the effective date of the S corporation for
3 California purposes. As a result, appellant states that Brentwood paid the California state income tax for
4 2002 as a subchapter C corporation. In accordance with AB 2328, Brentwood then filed an amended tax
5 return for 2002 which resulted in a refund to Brentwood. Appellant states that it took respondent a
6 number of months to issue the refund to Brentwood and, upon receiving the refund, Brentwood sent
7 each of its shareholders an amended Schedule K-1 with each shareholder's distributive share of the
8 refund amount. Appellant states that he received \$40,415 of that distribution on March 17, 2006 and on
9 May 11, 2006, he filed his amended return for 2002 reporting the additional tax liability with the tax
10 payment. (Appeal Letter.)

11 Respondent's Contentions

12 Respondent states that the post-amnesty penalty was imposed based on the additional tax
13 liability shown on appellant's 2002 amended tax return. Respondent asserts that eligible taxpayers who
14 did not participate in the income tax amnesty program for taxable years prior to January 1, 2003, were
15 subject to a post-amnesty penalty in an amount equal to 50 percent of the interest computed on the tax
16 underpayment amount for the period beginning on the last date prescribed by law for the payment of the
17 tax and ending on March 31, 2005, the last day of the amnesty period. Because appellant filed his
18 amended 2002 return and paid the additional tax after the end of the amnesty period, respondent
19 contends that the post-amnesty penalty was properly imposed and computed. Respondent also contends
20 that a claim for refund of the penalty amount may be brought only on the grounds that respondent failed
21 to compute the penalty amount properly. Respondent states that appellant has not asserted that
22 respondent's computation was in error and, for that reason, appellant has not stated grounds under which
23 the Board has jurisdiction to consider appellant's claim for refund. (Resp. Opening Br., p. 3.)

24 In response to appellant's contentions, respondent notes that Brentwood did not file its
25 2002 amended return until almost one year after the enactment of AB 2328. Respondent asserts that if
26 Brentwood's amended return had been filed earlier, appellant may have been able to file his amended
27 individual income tax return before March 31, 2005, and would have avoided the post-amnesty penalty.
28 Respondent also states that Brentwood could have provided amended Schedule K-1's to its shareholders

1 prior to actual receipt of the refund from respondent in order to allow its shareholders to report the
2 additional income for 2002 and avoid interest charges and penalties. Finally, respondent asserts that
3 appellant, as a substantial shareholder in Brentwood, could have requested the information necessary to
4 determine his distributive share of the refund so that he could file his amended return earlier. (Resp.
5 Opening Br., pp. 3-4.)

6 With respect to the interest charged on the additional tax amount, respondent states that
7 interest was initially computed based on accrual from the due date of the 2002 return, April 15, 2003,
8 until May 15, 2006, the date of payment. However, respondent explains that the interest charge was
9 later reduced by \$318.05 to \$311.60 in conformity with Internal Revenue Service Revenue Ruling 2005-
10 4, which provided for suspension of interest in a situation like appellant's. Respondent maintains that
11 the imposition of interest is mandatory and that respondent may abate interest only if appellant shows
12 that there was an error or delay in the performance of a ministerial or managerial act by respondent.
13 Respondent contends that appellant has not made such a showing. Furthermore, appellant maintains that
14 this Board may reverse respondent's action only if it is shown that respondent committed an abuse of
15 discretion in denying appellant's request for abatement of interest. Respondent contends that there has
16 been no showing that respondent abused its discretion in denying appellant's request. (Resp. Opening
17 Br., pp. 4-5.)

18 Applicable Law

19 Income Tax Amnesty Program

20 In 2004, the Legislature enacted Senate Bill 1100 (Stats. 2004, Ch. 226) adding Revenue
21 and Taxation Code (R&TC) sections 19730 through 19738, which set forth the provisions for the
22 income tax amnesty program whereby taxpayers who paid tax and interest liabilities were granted relief
23 from most penalties, including the penalty for late filing of the return. The tax amnesty program was
24 conducted during a two-month period from February 1, 2005, through March 31, 2005, inclusive and
25 applied to tax liabilities for taxable years beginning before January 1, 2003. (Rev. & Tax. Code,
26 § 19731.) R&TC section 19733, subdivision (a) provides, in relevant part, that the amnesty program
27 applied to any taxpayer under the following conditions:

- 28 • The taxpayer was eligible to participate and filed an application electing to participate in the

1 program during the period specified in R&TC section 19731.

- 2 • For any taxable year eligible for the tax amnesty program where the taxpayer filed a return but
3 underreported tax liability on that return, the taxpayer filed an amended return for that year
4 within 60 days after the conclusion of the tax amnesty period.

5 R&TC section 19777.5, subdivision (a), imposes the amnesty penalty for each taxable
6 year for which amnesty could have been requested. R&TC section 19777.5 generally provides that the
7 amnesty penalty will be imposed in an amount equal to 50 percent of interest accrued on unpaid tax as
8 of the last day of the amnesty period (March 31, 2005). The amnesty penalty is imposed in addition to
9 any other applicable penalties. Under the statutory provisions, respondent has no discretion to determine
10 whether the amnesty penalty should be imposed. In addition, the amnesty provisions limit the Board's
11 review of respondent's imposition of the amnesty penalty. Subdivision (e)(2) of R&TC 19777.5 grants
12 the Board jurisdiction to review respondent's imposition of the amnesty penalty in a single
13 circumstance: where a taxpayer paid the amnesty penalty and filed a refund claim asserting that
14 respondent failed to "properly compute" the amount of the penalty which claim was denied by
15 respondent.

16 Tax Treatment of Subchapter S Corporation

17 Chapter 782, section 1 of the Statutes of 2004 (AB 2328) effective September 25, 2004,
18 amended R&TC section 23809 by specifying that in the case of a "C" corporation, that became an "S"
19 corporation for state tax purposes (as a result of the enactment of Chapter 35 of the Statutes of 2002, as
20 amended by Chapter 807 of the Statutes of 2002) for taxable years beginning on or after January 1,
21 2002, the built-in gain provisions of IRC section 1374, subdivisions (c)(1) and (d)(7) would apply based
22 on the effective date of the election by that corporation to be treated as an "S" corporation for federal tax
23 purposes, regardless of the effective date of such an election for state tax purposes. (Rev. & Tax. Code,
24 § 23809, subd. (d) & (e).) The uncodified note to chapter 782 states "[t]he Legislature finds and
25 declares that the application of this act to taxable years beginning on and after January 1, 2002, serves a
26 public purpose by ensuring the fair and consistent application of California tax law, and by avoiding
27 possible legal challenges to that law or its application."

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1 Interest Abatement

2 If a taxpayer fails to pay tax by the due date, the law imposes interest on the balance due.
3 (Rev. & Tax. Code, § 19101.) Respondent’s assessment of interest on unpaid tax is mandatory. (*Appeal*
4 *of Amy M. Yamachi*, 77-SBE-095, June 28, 1977.) Interest is not a penalty but is simply compensation
5 for a taxpayer’s use of money after the due date of the tax. (*Appeal of Audrey C. Jaegle*, 76-SBE-070,
6 June 22, 1976.) There is no reasonable cause exception to the imposition of interest. (*Id.*) For the years
7 at issue in this appeal, respondent may abate interest on appeal only when (1) the interest is attributable
8 to an unreasonable error or delay committed by respondent in the performance of a ministerial or
9 managerial act, (2) no significant aspect of the error or delay is attributable to the taxpayer, and (3) the
10 error or delay occurred after respondent has contacted the taxpayer in writing with respect to the
11 deficiency. (*Appeal of Michael and Sonia Kishner*, 99-SBE-007, Sept. 29, 1999; Rev. & Tax. Code,
12 § 19104, subs. (a)(1) & (b)(1).)

13 Respondent’s determination not to abate interest is presumed correct, and the burden in
14 on the appellant to prove error. (*Appeal of Michael E. Myers*, 01-SBE-001, May 31, 2001.) The Board
15 has jurisdiction to review respondent’s refusal to abate interest under the “abuse of discretion” standard.
16 (Rev. & Tax. Code, §19104, subd. (b)(2)(B).) Abuse of discretion occurs when, considering all the
17 relevant circumstances, the decision-maker has exceeded the bounds of reason, or when it could be
18 fairly said that no decision-maker would reasonably make the same order under the same circumstances.
19 (*In re Marriage of Smith* (1990) 225 Cal.App.3d 469; *City of Sacramento v. Drew* (1989) 207
20 Cal.App.3d 1287.)

21 STAFF COMMENTS

22 Post-Amnesty Penalty

23 Appellant argues as a threshold issue that the tax amnesty program did not apply under
24 these circumstances and, therefore, that the post-amnesty penalty should not have been imposed. As
25 stated above, the amnesty program applied to “tax liabilities for taxable years beginning before
26 January 1, 2003.” (Rev. & Tax. Code, § 19731.) A taxpayer was eligible for the program if he or she
27 had “underreported tax liability” on his or her original return for any taxable year under the amnesty
28 program but filed an amended return for that year and paid the tax liability within the prescribed time

1 period. In this case, appellant correctly reported, self-assessed and paid his tax liability for tax year
2 2002 as of the date of his timely filing of the return and payment of the tax. However, the subsequent
3 legislative amendment to R&TC section 23809 in 2004 had retroactive effect to January 1, 2002, which
4 resulted in an “underreporting” of appellant’s tax liability for tax year 2002. It appears to staff that
5 appellant “could have” requested amnesty for the 2002 deficiency, as it arose in 2004 when the
6 amendments to R&TC section 23809 became effective on September 25, 2004 (four months prior to the
7 commencement of the amnesty period on February 1, 2005). Thus, respondent’s imposition of the
8 penalty appears to be proper.

9 However, as discussed above, the amnesty program provisions strictly limit the Board’s
10 review of respondent’s imposition of the amnesty penalty under R&TC section 19777.5. In general, the
11 Board’s authority to review respondent’s final actions is based on R&TC section 19045, which provides
12 the Board with jurisdiction to review actions on a taxpayer’s protest of an unpaid assessment, and
13 R&TC section 19324, which provides the Board with jurisdiction to review action on a taxpayer’s
14 refund claim. With respect to the amnesty penalty, subdivision (d) of R&TC section 19777.5 eliminates
15 the first potential basis for jurisdiction under R&TC section 19045 to review an action on a taxpayer’s
16 protest of unpaid assessments.

17 Of relevance to this discussion, subdivision (e) of R&TC section 19777.5 limits the
18 grounds upon which a taxpayer may file a refund claim with respect to the imposition of the amnesty
19 penalty by providing that “[n]otwithstanding Chapter 6 [which commences with section 19301 and
20 includes section 19324], a taxpayer may not file a claim for refund or credit for any amounts paid in
21 connection with [the amnesty penalty,] except as provided in paragraph 2.” Paragraph 2 states that a
22 taxpayer may file a claim for refund for any amounts paid to satisfy the amnesty penalty “on the grounds
23 that the amount of the penalty was not properly computed by the Franchise Tax Board.” Thus, a
24 taxpayer may not file a claim for refund of the amnesty penalty unless the refund claim asserts that
25 respondent failed to “properly compute” the amount of the penalty. Here, it does not appear that
26 appellant has contended that respondent failed to properly compute the amount of the penalty and, thus,
27 appellant has not set forth valid grounds for the claim for a refund which may be reviewed by the Board.

28 At the hearing, appellant should be prepared to explain why he believes that he has

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asserted valid grounds for his claim for refund pursuant to R&TC 19777.5, subdivision (e).

Interest Abatement

With respect to the abatement of the interest charged by respondent, as noted in Applicable Law, there is no general reasonable cause exception to the assessment of interest on unpaid tax. Appellant has not alleged any delay that is attributable to an error or delay committed by respondent.

At the hearing, appellant should be prepared to discuss whether he believes that the interest charge or any portion thereof was due to a delay attributable to an error or delay by respondent.

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