

2009 WL 532507 (Cal.St.Bd.Eq.)

State Board of Equalization

State of California

IN THE MATTER OF THE APPEAL OF: MD BIOTECH CORP.

Not to be Cited as Precedent

Case No. 398016

January 21, 2009

***1 Personal Income Tax Appeal**

Representing the Parties:

For Appellant:

Poku Chan
President

For Franchise Tax Board:

Kenneth A. Davis
Tax Counsel III

Counsel for the Board of Equalization:

Linda Frenklak
Tax Counsel

SUMMARY DECISION

This appeal is made pursuant to [section 19324 of the Revenue and Taxation Code \(R&TC\)](#) from the action of the Franchise Tax Board (FTB or respondent) in denying appellant's claim for a refund in the amount of \$927.34 for the year ended 2004.¹ The following issues are presented in this appeal: (1) whether appellant is liable for the 2004 minimum franchise tax; (2) whether appellant has established reasonable cause for abatement of the late payment of tax penalty (late payment penalty); (3) whether appellant has shown that respondent improperly imposed the underpayment of estimated tax penalty; and (4) whether appellant is entitled to interest abatement.

FINDINGS AND DISCUSSION

Background

Appellant is a Washington corporation that qualified to do business with the California Secretary of State's Office (SOS) on December 12, 2003.² On April 15, 2005, appellant filed a California Form 100 return for the tax year ending on December 31, 2004. In its 2004 return, appellant reported a net loss of \$340.84, which resulted in no income tax liability; however, appellant did not pay a minimum franchise tax for 2004. In its 2004 return, appellant states that it only began to conduct business in California on January 1, 2004, and that this is its first California return.

Respondent issued to appellant a Return Information Notice (RIN) dated October 13, 2005,³ and a Notice of Balance Due dated November 9, 2005, which informed appellant that it owed a minimum franchise tax of \$800, an underpayment of estimated tax penalty of \$30.88, and a late payment penalty of \$72.00, consisting of a \$32.00 monthly penalty and a \$40.00 underpayment penalty, plus interest of \$24.46. On November 23, 2005, appellant paid the balance due; respondent credited appellant's account effective November 9, 2005.

On January 15, 2006, appellant filed a California Form 100 for the short period of December 12, 2003, through December 31, 2003, in which it reported a net loss of \$545.57, resulting in a zero tax liability; appellant did not pay a minimum franchise tax for this short accounting period. In its 2003 return, appellant again stated that it only began to conduct business in California on January 1, 2004.

On September 29, 2006, respondent received appellant's protest letter dated October 20, 2005 [sic]. In the protest letter, appellant requests that respondent rescind the November 9, 2005, Notice of Balance Due because it did not owe any minimum franchise tax in 2004. The FTB accepted the protest letter as a timely claim for refund of the minimum franchise tax, the late payment penalty, and the underpayment of estimated tax penalty, as well as the interest; the FTB denied the claim. Appellant then filed this timely appeal.

Contentions

*2 Appellant argues that it is exempt from paying the 2004 minimum franchise tax under [R&TC section 23153](#), subdivision (f)(1) because 2004 was the first year that it was otherwise subject to the minimum franchise tax. Appellant argues that it would suffer a financial hardship if it had to pay the assessment because it operated at a loss in 2004 and 2005. Lastly, appellant appears to contend that it is entitled to a refund because it would not be liable for the 2004 franchise minimum tax if it had simply commenced its 2003 taxable year three days later than December 12, 2003. Appellant fails to set forth any arguments with regard to the late payment penalty, the underpayment of estimated tax penalty, or the interest.

Respondent argues that appellant is required to pay the minimum franchise tax in 2004 because it was the second taxable year in which appellant was subject to the minimum franchise tax. Respondent contends that appellant has failed to establish reasonable cause to abate the late payment penalty and the underpayment of estimated tax penalty is mandatory upon a finding of underpayment. Respondent further contends that there is no statutory basis to abate the interest.

Discussion

Minimum Franchise Tax

Every corporation subject to the franchise tax is required to pay a minimum franchise tax of \$800 for each tax year, from the earlier of the date of its incorporation, qualification, or commencing to do business in California, until the date when it is deemed dissolved or withdrawn, as provided in [R&TC section 23331](#) or, if later, the date when it ceases to do business within the state. ([Rev. & Tax. Code, § 23153](#), subd. (a).) Every corporation must pay no less than the minimum franchise tax for each "taxable year." ([Rev. & Tax. Code, § 23151.1](#), subd. (e).) The "taxable year" generally is the corporation's annual accounting period, whether it be a calendar or fiscal year. ([Rev. & Tax. Code, § 24631](#), subd. (b)(1).) However, the "taxable year" is a period of less than 12 months when the corporation is required to file a short-period return. ([Rev. & Tax. Code, §§ 24631](#), subd. (b)(3) & [24634](#), subd. (c).) The sole statutory exception to this rule is that a corporation shall not be subject to the minimum franchise tax if the corporation did not transact any business in this state during the taxable year and the taxable year was 15 days or less. ([Rev. & Tax. Code, § 23114](#), subd. (a).) In addition, [R&TC section 23153](#), subdivision (f)(1) exempts corporations incorporated or qualified to do

business in California on or after January 1, 2000, from the minimum franchise tax requirement for their first taxable year (minimum franchise tax exemption).

Since appellant first qualified to transact business in California on December 12, 2003, it was required to file a return for the short-period that constitutes its 2003 taxable year. (See [Rev. & Tax. Code, § 24634](#), subd. (c).) It is undisputed that appellant's 2003 taxable year is for the short period from December 12, 2003, through December 31, 2003. Appellant did in fact file a late California Form 100 for its 2003 taxable year on January 15, 2006. Appellant's 2003 taxable year was in excess of 15 days and appellant therefore was generally subject to the minimum franchise tax for its short 2003 taxable year. (See [Rev. & Tax. Code, § 23114](#), subd. (a).) However, because appellant's 2003 taxable year was the first year that it was subject to tax, appellant was exempt from paying the tax. ([Rev. & Tax. Code, § 23153](#), subd. (f)(1).) We find that the minimum franchise tax exemption does not apply in 2004 due to the fact that 2004 is the second year in which appellant was subject to the minimum franchise tax.

*3 Appellant appears to argue in its letter dated October 20, 2005, that it should not be liable for the 2004 minimum franchise tax since it operated at a loss in 2004, as well as 2005. This Board has previously determined that a corporation is still liable for the minimum franchise tax even if it does not conduct any business or have any income upon which to measure the franchise tax. (*Appeal of Vitmora Company*, 78-SBE-079, Sept. 27, 1978; *Appeal of Mission Valley East*, 74-SBE-039, Oct. 7, 1974; *Appeal of Tip Top Delights, Inc.*, 70-SBE-046, Dec. 7, 1970.)⁴ Appellant also appears to argue that it is entitled to a refund because it would not be liable for the franchise minimum tax if it had simply commenced its 2003 taxable year three days later than December 12, 2003.

The plain meaning of statutory language ordinarily is conclusive. (*Appeal of Michael and Sonia Kishner*, 99-SBE-007, Sept. 29, 1999 (citing *United States v. Ron Pair Enters, Inc.* (1989) 489 U.S. 235, 241-242.)). The language of [R&TC section 23114](#), subdivision (a) is explicit and does not provide exceptions. Although we sympathize with appellant's position, we are required to apply the R&TC in a fair and impartial manner. For these reasons, we conclude that appellant is liable for the 2004 minimum franchise tax.

Late Payment Penalty

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

Pursuant to [R&TC section 19132](#), a late payment penalty is imposed when a taxpayer fails to pay the amount shown as due on the return on or before the due date of the return. However, the penalty may be abated if an appellant can show that the failure to make a timely payment of tax was due to reasonable cause and not due to willful neglect. ([Rev. & Tax. Code, § 19132](#), subd. (a).) The taxpayer bears the burden of proving reasonable cause. (*Appeal of Roger W. Sleight*, 83-SBE-244, Oct. 26, 1983.) To establish "reasonable cause" for late payment of tax, the taxpayer must show that its failure to make a timely payment of the proper amount of tax occurred despite the exercise of ordinary business care and prudence. (*Id.*)

We have determined that respondent properly assessed the minimum franchise tax for appellant's taxable year ending December 31, 2004. Appellant has offered no explanation for its failure to timely pay the minimum franchise tax other than its apparent misunderstanding of the R&TC. We therefore find no reasonable cause for appellant's failure to timely pay and we uphold the late payment penalty.

Underpayment of Estimated Tax Penalty

A corporation subject to the franchise or income tax imposed by Part 11 of the R&TC must file a declaration of estimated tax and pay the estimated tax for each year. ([Rev. & Tax. Code, §§ 19023 & 19025.](#)) When the amount of estimated tax does not exceed the minimum franchise tax, the entire amount of the estimated tax shall be due and payable on or before the 15th day of the fourth month of the taxable year; otherwise, the amount payable shall be paid in installments throughout the taxable year. ([Rev. & Tax. Code, § 19025.](#)) A corporation that underpays estimated tax is penalized by an addition to tax equal to a specified rate of interest applied to the amount of the underpayment. ([Rev. & Tax. Code, §§ 19142, 19144.](#))

*4 A penalty for the underpayment of estimated tax is properly imposed when the corporate taxpayer's installment payments are less than the amounts due at the end of the installment periods. (*Appeal of Bechtel, Inc.*, 78-SBE-052, July 26, 1978.) In addition, a corporate taxpayer is subject to the underpayment of estimated tax penalty when it fails to make any payments of estimated tax until after the end of its fiscal year. (*Appeal of North American Exploration Co., Inc.*, 85-SBE-092, Aug. 20, 1985.) The R&TC does not contain a reasonable cause or extenuating circumstances exception to the underpayment of estimated tax penalty. Respondent imposed the underpayment of estimated tax penalty because appellant did not timely pay the minimum franchise tax. Appellant has not shown that the underpayment of estimated tax penalty was improperly imposed; therefore, it must be sustained.

Interest Abatement

The assessment of interest on unpaid tax is mandatory; interest is not a penalty but is merely compensation for the taxpayer's use of the money. ([Rev. & Tax. Code, § 19101](#), subd. (a); *Appeal of Amy M. Yamachi*, 77-SBE-095, June 28, 1977; *Appeal of Audrey C. Jaegle*, 76-SBE-070, June 22, 1976.) Interest is also mandatory with respect to the imposition of a failure to file penalty, a failure to pay penalty, or an accuracy-related penalty pursuant to [R&TC sections 19131, 19132, and 19164](#), respectively. ([Rev. & Tax. Code, § 19101](#), subd. (c)(2)(B).) Interest shall not apply, however, to any failure to pay estimated tax penalty imposed under [R&TC section 19025](#) or [19136](#). ([Rev. & Tax. Code, § 19101](#), subd. (d).) In order to obtain interest abatement, appellant must qualify under one of the following three statutes: [R&TC sections 19104, 19112](#) or [21012](#). [R&TC section 21012](#) is not applicable because there has been no reliance on any written advice requested of respondent. [R&TC section 19112](#) requires a showing of extreme financial hardship caused by significant disability or other catastrophic circumstance, which appellant has not alleged; the mere allegation of a financial hardship because appellant operated at a loss in 2004 and 2005 is insufficient. We therefore consider appellant's interest abatement request under the provisions of [R&TC section 19104](#).

Respondent may abate all or a part of any interest on a deficiency to the extent that interest is attributable, in whole or in part to any unreasonable error or delay committed by respondent in the performance of a ministerial or managerial act. ([Rev. & Tax. Code, § 19104](#), subd. (a)(1).) Further, an error or delay can only be considered when no significant aspect of the error or delay is attributable to appellant and after respondent has contacted appellant in writing with respect to the deficiency or payment. ([Rev. & Tax. Code, § 19104](#), subd. (b)(1).) There is no reasonable cause exception to the imposition of interest. (*Appeal of Audrey C. Jaegle, supra.*)

In the *Appeal of Michael and Sonia Kishner, supra*, this Board adopted the language from [Treasury Regulation section 301.6404-2\(b\)\(2\)](#), defining a “ministerial act” as:

*5 [A] procedural or mechanical act that does not involve the exercise of judgment or discretion, and that occurs during the processing of a taxpayer's case after all prerequisites to the act, such as conferences and review by supervisors, have taken place.

A decision concerning the proper application of federal tax law (or other federal or state law) is not a ministerial act.

This Board has not yet adopted a definition for the term “managerial act.” However, when a California statute is substantially identical to a federal statute (such as with the interest abatement statute in this case),⁵ we may consider federal law interpreting the federal statute as highly persuasive. (*Appeal of Michael and Sonia Kishner, supra*, (citing *Douglas v. State of California* (1942) 48 Cal.App.2d 835.) In this regard, Treasury Regulations 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.

Respondent's determination not to abate interest is presumed correct, and the burden is on appellant to prove error. (*Appeal of Michael E. Myers*, 2001-SBE-001, May 31, 2001.) This Board's jurisdiction in an interest abatement case is limited by statute to a review of respondent's determination for an abuse of discretion. (Rev. & Tax. Code, § 19104, subd. (b)(2)(B).) To show an abuse of discretion, appellant must establish that in refusing to abate interest respondent exercised its discretion arbitrarily, capriciously, or without sound basis in fact or law. (*Woodral v. Commissioner* (1999) 112 T.C. 19, 23.) Interest abatement provisions are not intended to be routinely used to avoid the payment of interest, thus abatement should be ordered only “where failure to abate interest would be widely perceived as grossly unfair.” (*Lee v. Commissioner* (1999) 113 T.C. 145, 149.) The mere passage of time does not establish error or delay that can be the basis of an abatement of interest. (*Id.* at p. 150.)

Here, appellant does not specifically address the abatement of interest of \$24.46. Appellant does not allege, nor does the record show, that respondent committed any error or delay in the performance of a ministerial or managerial act after contacting appellant in writing concerning either the deficiency or the November 9, 2005, payment. Nor does appellant contend that respondent improperly imposed interest on the failure to pay estimated tax penalty of \$30.88. Appellant merely failed to timely pay the minimum franchise tax and appellant has not shown that respondent misdirected any payments. Accordingly, we conclude that appellant has not met its burden to show that respondent's determination not to abate interest amounts to an abuse of discretion.

CONCLUSION

*6 For the foregoing reasons, respondent's denial of appellant's claim for refund is sustained.

Footnotes

- 1 This amount is composed of the \$800 minimum franchise tax, an underpayment penalty of \$30.88, a late payment penalty of \$72.00, and interest of \$24.46.
- 2 We note that appellant refers to itself as a “newly incorporated company doing business in CA” in its letter dated October 20, 2005, and respondent states in its letter dated December 1, 2006, that appellant's incorporation date is December 12, 2003. It appears that appellant filed a Statement and Designation by Foreign Corporation form with the SOS on December 12, 2000. SOS records indicate that appellant is incorporated in Washington. The California Secretary of State's Office issues a Certificate of Qualification to an out-of-state corporation upon

the filing of the corporation's Statement and Designation by Foreign Corporation form, which qualifies the corporation to transact business in California. SOS records show that on January 25, 2006, appellant filed a Certificate of Surrender By Foreign Corporation with the California Secretary of State's Office, which means that it has voluntarily surrendered its right to transact business in California. It appears that, during the times relevant to this appeal, appellant was an out-of-state corporation qualified to transact business in California.

- 3 The record does not include a copy of the RIN.
- 4 State Board of Equalization cases (designated "SBE") can be viewed on the Board's website (www.boe.ca.gov).
- 5 The R&TC provisions at issue here are substantially identical to [Internal Revenue Code section 6404\(e\)](#) and [\(h\)](#).
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