STATE OF CALIFORNIA
TAXPAYERS' RIGHTS ADVOCATE'S OFFICE MS F280
FRANCHISE TAX BOARD
PO BOX 1468
SACRAMENTO CA 95812-1468

01.28.2021

LYNN FREER, EA
SPIDELL PUBLISHING, INC.

DEAR MS. FREER,

I would like to thank Spidell Publishing for attending and presenting your issues at the December 2020 Taxpayers' Bill of Rights Hearing. The following responses were provided by the appropriate program areas within the Department. As the Taxpayers' Rights Advocate, your concerns are important to me. During the year, I will keep track of issues requiring longer-term solutions.

1. E-pay Penalty

FTB Response:

FTB realizes there were many challenges for taxpayers in 2020. It is correct that if taxpayers combined estimate payments that exceeded the payment threshold for mandatory e-Pay participation that would automatically trigger their requirement to make future payments electronically. It is also correct that FTB would not know that payments may have been combined to trigger the requirement. Finally, it is also correct that if a taxpayer became subject to the requirement and made a future payment other than electronically, they would be automatically assessed a mandatory e-Pay Penalty.

When a payment or filing occurs that triggers the mandatory requirement, FTB sends Form 4106, *Mandatory Electronic Payment Notice*, advising taxpayers that they have made a payment or filed a return that now requires them to make all future payments electronically. The letter advises the taxpayer about their electronic payment options and provides information on how to request a waiver from the requirement if their payment was not representative of their tax liability. The assessment of a penalty does not occur for approximately 45 days after the taxpayer becomes required to pay electronically in order to allow taxpayers time to make adjustments to pay electronically in the future or to request a waiver from the requirement altogether.

Earlier in the year, when FTB advised estimate payments could be combined, FTB informed taxpayers in its Covid-19 FAQ web page that if their combined estimated payment is more than $20,000, they must make all future payments to the FTB electronically. We also advised that if a taxpayer was notified of the Mandatory e-Pay requirement, they could request a waiver from the requirement by submitting a FTB 4107, *Mandatory e-Pay Requirement – Waiver Request*.

FTB cannot issue a "blanket waiver" or prevent the assessment of a penalty due to someone combining their estimated tax payments that exceeded the threshold.

FTB realizes that if the taxpayer did not take any action to request a waiver from the mandatory e-Pay requirement after receiving the FTB 4106, the first time they will be assessed a penalty is when they make a fourth quarter estimated tax payment in January 2021, or possibly later in 2021 if no estimate payment was needed in January 2021.

Currently, if a taxpayer submits a waiver form FTB 4107 stating that they exceeded the e-Pay payment threshold because they combined their estimate payments due to Covid-19 related reasons, we generally waive the mandatory e-Pay requirement. However, as noted in form FTB 4107, taxpayers must continue to make electronic payments until the waiver is granted. The waiver does not excuse the taxpayer's past failure to pay electronically. If a mandatory e-Pay penalty has already been imposed then the taxpayer will need to pay the penalty and file a form FTB 2917, *Reasonable Cause – Individual and Fiduciary Claim for Refund*, to request an abatement. The e-Pay penalty may be abated if the taxpayer establishes that their failure to pay electronically was due to reasonable cause and not willful neglect.

FTB recommends and encourages taxpayers intending to request a waiver from the requirement to do so as soon as possible. If they request and are granted a waiver from the requirement, they will not be required to make future payments electronically.

2. CA Resident with an out-of-state LLC

FTB Response:

We are sorry to hear that there was a misunderstanding with our provided response to your comments regarding Franchise Tax Board's response to Question 5. The known facts for Question 5 is that a California resident creates a Missouri limited liability company ("LLC") to manage rental property in Missouri. The definition of "doing business" under Revenue and Taxation Code section 23101(a) as actively engaging in any transaction for the purpose of financial or pecuniary gain or profit has been interpreted broadly. In *Golden State Theatre & Reality Corp. v. Johnson* (1943) 21 Cal.2d 493, the California Supreme Court stated:

> The doing of business, however, does not necessarily mean a regular course of business under the section 5 of the California Bank and Corporation Tax Act (predecessor to section 23101), for by its plain terms a corporation is doing business if it actively engages in any transaction for pecuniary gain or profit. [The taxpayer] would identify "doing business" with "carrying on a trade or business." A series of transactions regularly engaged in may be necessary to establish the "carrying on of a trade or business" but the Legislature made it clear that it had no such concept in mind when it referred to transaction in the singular as "any transaction." The word "actively" must therefore be interpreted as the opposite of passively or inactively, and as used in [the predecessor to section 23101] it means active participation in any transaction for pecuniary gain or profit.

Further, the transaction does not need to result in an actual profit; the relevant inquiry is whether the activity or transaction was motivated by a financial or pecuniary gain. (*Appeal of Wright Capital Holdings LLC* (2019-OTA-219P) citing *Hise v. McColgan* (1944) 24 Cal.2d 147; *Appeal of Columbia Supply Co*. (60-SBE-012) 1960 WL 1391.)

Therefore, conducting managerial activities within California would constitute "doing business" in California. The Board of Equalization has held that the management of an entity from within California, whose property or business is located or operated outside of California, is sufficient to constitute as active participation in an activity for pecuniary gain or profit. (*Appeal of Reno Liquor Company, Inc.,* 59-SBE-004, February 17, 1959; for informational purposes, see also the Board of Equalization's unpublished summary decisions in *Appeal of International Health Institute, LLC*, Case No. 305199 (March 7, 2006), *Appeal of Mockingbird Partners, LLC,* Case No. 306061 (May 17, 2006), and *Appeal of Legend Plus Enterprise, LLC*, Case No. 486026 (February 22, 2011)).

In Question 5, the Franchise Tax Board would need additional facts in order to determine whether the Missouri LLC is conducting management activities within California. For example, no information was provided on the tax classification of the Missouri LLC or the relationship of the California resident to the LLC besides being the organizer. If the additional facts show that the Missouri LLC or its members are managing the Missouri property in California, then the Missouri LLC is "doing business" in California.

Sincerely,

Chris Smith

Taxpayers' Rights Advocate (Acting)

cc: Irena Asmundson
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Kari Hammond
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