2001-SBE-002-A

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of	)	
	)	No. 56334
Reitman Atlantic Corporation	)	
	)	

OPINION ON PETITION FOR REHEARING

Upon consideration of the petition for rehearing filed by respondent pursuant to Revenue and Taxation Code (R&TC) section 19048, we hereby restate and amend our original opinion as indicated below. In its petition, respondent offers technical amendments to our original opinion, which we adopt as part of our opinion. We deny respondent's petition for rehearing, however, because the arguments set forth in the petition do not constitute sufficient grounds to grant a rehearing.

The appeal, pursuant to section 19045 of the Revenue and Taxation Code, originated with the action of respondent on the protest of appellant against a proposed assessment of tax in the amount of $80,536.14, a delinquent filing penalty of $20,134.03, and a notice and demand penalty of $20,134.00, for income year ended December 31, 1993. The appeal presented three issues: 1) Whether appellant, a foreign corporation not having qualified to transact intrastate business in California pursuant to California Corporations Code section 2105, qualifies to maintain an appeal before this Board; 2) whether appellant established it was not a limited partner in California Opimian Vineyard III (COV-III) and therefore did not have a filing requirement in California; and 3) whether the penalties for failure to file a return on or before the due date of the return and for failure to furnish information requested in writing by respondent or to file a return upon notice and demand by respondent should be abated for reasonable cause.

COV-III filed a California partnership income tax return for year ended December 31, 1993, indicating it commenced operations as a limited partnership in California on January 6, 1993. On a California Schedule K-1 (K-1) attached to its tax return, COV-III identified appellant as a limited partner with a profit and loss share of 80 percent and ownership of capital of 99 percent. The K-1 also identified appellant's share of partnership nonrecourse liabilities as $917,479, appellant's distributive share of California ordinary loss as $446,599, interest income as $63,789, and Internal Revenue Code section 1231 gain as $1,248,479. The K-1 listed appellant's address in care of a firm of barristers and solicitors in Toronto, Canada.

Respondent's records did not indicate receipt of a 1993 California income tax return from appellant. Respondent sent two separate letters to appellant requesting appellant to file a return for 1993 and pay the balance due within 25 days, without response from appellant.[1] Respondent then sent correspondence advising appellant it intended to issue a Notice of Proposed Assessment (NPA) based on the partnership return filed by COV-III. Respondent thereafter received telephone calls on behalf of appellant from an attorney and an accountant. These individuals advised respondent that appellant was not a partner in COV-III and that two other corporations received the income from COV-III. Although respondent requested additional information and documentation to support these assertions, respondent received no further information or documentation. Respondent, therefore, issued an NPA indicating a proposed tax liability of $80,356.14, a penalty for failure to file a return on or before the due date of the return of $20,134.03, and a penalty for failure to furnish information (a return) requested in writing by respondent of $20,134.00. Appellant protested the NPA. Respondent eventually affirmed the NPA in a Notice of Action. Appellant appealed to this Board.

Initially, an issue arises as to whether appellant qualifies to maintain an appeal before this Board. Appellant incorporated in South Carolina and did not obtain a certificate of qualification from the California Secretary of State pursuant to California Corporations Code section 2105 to transact intrastate business in California. In the *Appeal of Al Tirpa & Associates, Inc.* (97-SBE-007), decided on February 26, 1997 (*Al Tirpa*), we held a nonqualified foreign corporation (i.e., one failing to obtain a certificate of qualification to transact intrastate business in California from the Secretary of State) may not exercise the right to bring an administrative appeal before this Board. The stated basis for our conclusion rested on the refusal by California courts to entertain legal actions instituted by nonqualified foreign corporations and on our own precedents holding suspended domestic corporations without authority to bring or maintain administrative appeals.[2] We cited language from *United Medical Management Ltd. v. Gatto* (1996) 49 Cal.App.4th 1732 (*United Medical*), recognizing the underlying policy of encouraging qualification of foreign corporations in order to facilitate service of process and to prevent state tax evasion. We also noted a foreign corporation may forfeit the exercise in this state of its corporate powers, rights, and privileges if it fails to pay any tax, penalty, or interest due. (Rev. & Tax. Code, § 23301.) We recognized the policy of this statutory provision as one "to prohibit the delinquent corporation from enjoying the ordinary privileges of a going concern, in order that some pressure will be brought to bear to force the payment of taxes." (*Belle Vista Investment Co. v. Hassen* (1964) 227 Cal.App.2d 837, 840, disapproved on another ground in *The Traub Company v. Coffee Break Service, Inc.* (1967) 66 Cal.2d 368, 371.)

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[1] When no response was received to its notice of November 5, 1996, respondent issued a second notice dated December 3, 1996. Respondent sent this notice by certified mail, which indicated appellant received it on December 16, 1996.

[2] In *Al Tirpa*, we cited the following cases in support of this proposition: *Appeal of Atlantic and Pacific Wrecking Co., Inc.*, Cal. St. Bd. of Equal., July 22, 1958; *Appeal of Western Miracle Water Softener, Inc.*, Cal. St. Bd. of Equal., Oct. 13, 1959; *Appeal of Celeron Realty Corporation*, Cal. St. Bd. of Equal., Aug. 7, 1963.

Respondent specifically addresses this issue of appellant's qualification to maintain an appeal before this Board and asks us to reconsider our conclusion in *Al Tirpa* on several grounds. First, respondent agrees our denial of administrative appeal rights to suspended domestic corporations[3] advances the policy of bringing pressure to force payment of taxes. (See *Belle Vista Investment Co. v. Hassen, supra*.) Respondent, however, asks us to distinguish between suspended domestic corporations and nonqualified foreign corporations, contending the policy is not advanced in the case of a nonqualified foreign corporation. Respondent argues a nonqualified foreign corporation may not have anticipated a filing obligation in California through its actions, and thus not knowingly violated such a filing obligation. In such a circumstance, respondent asserts the nonqualified foreign corporation should be able to seek a ruling from this Board to determine its disputed filing obligation. In support of this position, respondent cites *Mediterranean Exports, Inc. v. Superior Court* (1981) 119 Cal.App.3d 605, in which the court of appeal allowed a foreign corporation to defend itself in state court despite the fact the corporation had not qualified to transact intrastate business in California. The court concluded a triable issue of fact existed as to whether the corporation's activities amounted to transaction of intrastate business, and thus whether qualification with the Secretary of State was even required. (*Id*. at p. 617.)

In conjunction with its first contention, respondent also contends the discussion in *Al Tirpa* does not address the distinction between "doing business," as defined in R&TC section 23101, and "transacting intrastate business," as used in Corporations Code section 2105 and defined in Corporations Code section 191. Respondent cites *Detsch & Co. v. Calbar, Inc.* (1964) 228 Cal.App.2d 556, 568, for the proposition that a corporation may be "doing business" in California without the requirement of qualifying to "transact intrastate business" under Corporations Code section 2105. Thus, respondent points out, the courts interpret the standard "doing business" more broadly than "transacting intrastate business." (*Carl F. W. Borgward, G.M.B.H. v. Superior Court* (1958) 51 Cal.2d 72 (*Borgward*).) This Board, respondent contends, by reaching its conclusion in *Al Tirpa* without considering the distinction between "doing business" and "transacting intrastate business," may inappropriately preclude a taxpayer merely doing business in California from seeking a remedy from this Board when the corporation correctly did not seek qualification with the Secretary of State. This result, respondent contends, may constitute a violation of a taxpayer's constitutional rights.

Secondly, respondent contends the provisions of R&TC section 23301 are not self-executing; a domestic corporation is suspended only upon action by respondent. As such, a domestic corporation, not having paid the franchise tax, might still be able to pursue or defend an action before this Board because respondent failed to take the appropriate suspension action. Respondent contends this places a nonqualified foreign corporation in a worse position than a corporation subject to suspension, but not yet suspended. Specifically, the nonqualified foreign

[3] R&TC section 23301 provides that the corporate powers, rights, and privileges of a domestic corporation may be suspended, while the corporate powers, rights, and privileges of a foreign corporation may be forfeited.

corporation may not bring an appeal before this Board, whereas the domestic corporation may bring an appeal if respondent neglected to seek its suspension.

California Corporations Code section 2105 requires a foreign corporation to obtain a certificate of qualification from the Secretary of State before transacting intrastate business in California.[4] Corporations Code section 191, subdivision (a), defines the term "transact intrastate business" as "entering into repeated and successive transactions of its business in this state, other than interstate or foreign commerce."[5] Corporations Code section 2203 sets forth various penalties for transacting intrastate business in California without obtaining a certificate of qualification, which include precluding a nonqualified foreign corporation from maintaining any action or proceeding in a state court upon any intrastate business it has transacted, until it complies with section 2105 and pays all taxes and penalties due.

The court in *United Medical, supra*, however, recognized that the language of Corporations Code section 2203, subdivision (c), allows a nonqualified foreign corporation to commence an action in state court, but does not allow it to maintain an action commenced prior to compliance with Corporations Code section 2105, until it complies with section 2105. (*United Medical, supra*, 49 Cal.App.4th at p. 1739.) This, the court held, is a matter of abatement of the action. (*Id.* at p. 1740.) If a nonqualified foreign corporation commences an action regarding intrastate business, the defendant may assert the nonqualified foreign corporation's lack of capacity to maintain the action.[6] (*Ibid.*) Notably, this abatement procedure allows the foreign corporation to obtain judicial determination as to whether it actually transacted intrastate business. (*Ibid.*) The court also noted the purpose of Corporations Code section 2105 is to facilitate service of process and to protect against state tax evasion, although it is not primarily a taxation measure.[7] (*Id.* at p. 1741.)

R&TC section 23151 requires every corporation doing business within this state to pay a tax for the privilege of exercising its corporate franchises within this state. The term "doing business" is defined to mean "actively engaging in any transaction for the purpose of

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[4] Corporations Code section 2105 sets forth specified information required from the foreign corporation in order to obtain the certificate of qualification.

[5] Corporations Code section 191, subdivision (c), sets forth specific activities which do not constitute transacting intrastate business.

[6] The defendant bears the burden of proving (1) the action arises out of the transaction of intrastate business by the foreign corporation, and (2) the action was commenced by the foreign corporation prior to qualifying to transact intrastate business. (*United Medical, supra*, 49 Cal.App.4th at p. 1740.)

[7] The court in *United Medical* noted that Corporations Code section 2105 is a mechanism "to encourage qualification of foreign corporations, rather than to penalize the failure to qualify earlier." (*United Medical, supra*, 49 Cal.App.4th at p. 1741.)

financial or pecuniary gain or profit." (Rev. & Tax. Code, § 23101.) R&TC sections 23301 and 23301.5 allow the corporate powers, rights, and privileges of a domestic corporation to be suspended, and the corporate powers, rights, and privileges of a foreign corporation to be forfeited, if the corporation fails to pay any tax, penalty, or interest due, or to file a required tax return. R&TC section 23301.6, however, limits the application of R&TC sections 23301 and 23301.5 only to foreign corporations "qualified to do business in California" pursuant to Corporations Code section 2105.

In *Borgward, supra*, the California Supreme Court discussed the distinction between the phrases "doing business," as found in the Code of Civil Procedure section 411, subdivision (2), governing service of process on foreign corporations, and "transact intrastate business," as found in Corporations Code section 6203, the predecessor to Corporations Code section 191. Justice Traynor, writing for the court, stated the phrase "doing business" was "equated with such minimum contacts with the state 'that the maintenance of the suit does not offend "traditional notions of fair play and substantial justice." ' [Citations omitted.] Whatever limitations it imposes is equivalent to that of the due process clause." (*Borgward, supra*, 51 Cal.2d at p. 75.) Justice Traynor noted the definition of the phrase "transact intrastate business" excluded a corporation's activities in interstate or foreign commerce. (*Ibid*.) Thus, the court concluded that by excluding acts in interstate and foreign commerce from the definition of the phrase "transact intrastate business," the definition in the Corporations Code clearly indicated a corporation may do business in California without transacting intrastate business. (*Id.* at p. 76.)

In light of the statutory scheme set forth in the R&TC and the Corporations Code, and the judicial interpretation of such statutory scheme, we accept respondent's invitation to recognize the existence of a distinction between a suspended domestic corporation and a nonqualified foreign corporation for purposes of commencing and maintaining an appeal before this Board.[8] A domestic corporation anticipates the assumption of certain obligations within the state, such as the payment of state taxes. If the domestic corporation fails to satisfy its tax filing and/or payment obligations, respondent may initiate suspension of the domestic corporation's powers, rights, and privileges pursuant to R&TC sections 23301 and 23301.5. The court of appeal enunciated the policy underlying these provisions as one to prohibit a delinquent corporation from enjoying the "ordinary privileges of a going concern, in order that some pressure will be brought to bear to force payment of taxes." (*Belle Vista Investment Co. v. Hassen, supra*, 227 Cal.App.2d at p. 840.) Thus, we continue to conclude that precluding a domestic corporation under suspension from exercising an administrative appeal right to this Board recognizes and advances this policy.

The considerations change with respect to a nonqualified foreign corporation, however. A nonqualified foreign corporation may be "doing business" in California sufficient to

[8] We also recognize a similarity between a domestic corporation in good standing and a qualified foreign corporation (i.e., one having obtained a certificate of qualification from the Secretary of State). For the remainder of our discussion, references to a "domestic corporation" also include a qualified foreign corporation.

require it to file a tax return and pay taxes, while not "transacting intrastate business" requiring qualification with the Secretary of State. We agree it would be inappropriate to prohibit such a corporation from seeking redress before this Board, given the fact it may be complying fully with California law. This conclusion is in accord with that found in *United Medical* in which the court recognized an abatement procedure allowing a nonqualified foreign corporation to seek judicial determination of whether or not it actually transacted intrastate business. We adopt a similar approach. Although our inquiry will be limited to determining the corporation's California tax filing requirements and appropriate tax liability, we will dismiss a nonqualified foreign corporation's appeal if we determine the nonqualified foreign corporation transacted intrastate business in California.[9] (Corp. Code, §§ 2105, 2203.) We believe this approach advances the policies of preventing tax evasion through the even-handed administration of the tax laws, while encouraging qualification of foreign corporations by prohibiting a delinquent corporation from enjoying the privileges of a going concern. In further support of our conclusion, we note the legislature did not grant respondent the authority to cause forfeiture of a nonqualified foreign corporation's powers, rights, and privileges merely for the failure to file a return or to pay taxes. (Rev. & Tax. Code, § 23301.6.) We, therefore, do not find justification for our exercise of such authority, without a determination that the foreign corporation transacted intrastate business. Finally, we note that under our ruling in *Al Tirpa*, a nonqualified foreign corporation is precluded from commencing an administrative appeal before this Board, while a domestic corporation subject to suspension, but not yet suspended, continues to have this opportunity. We find no statutory, judicial, or policy reason sufficient to continue this distinction. We conclude, therefore, that to preclude a nonqualified foreign corporation from commencing an administrative appeal before this Board because it has not qualified with the Secretary of State is contrary to the statutory scheme found in the Corporations Code and the R&TC, as well as the weight of judicial opinion.[10] To the extent our decision in *Al Tirpa* conflicts with our conclusions here, it will not be followed.

With these conclusions in mind, we turn to the appeal at hand. Appellant did not obtain a certificate of registration from the Secretary of State. Respondent, however, has not alleged that appellant transacted intrastate business in California; and, we find no evidence to support such a finding (see discussion below). In light of these determinations, we conclude

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[9] Pursuant to Corporations Code § 2203, subdivision (c), and as recognized in *United Medical, supra*, and *Mediterranean Exports, Inc. v. Superior Court, supra*, a nonqualified foreign corporation is prohibited from maintaining an action in state court only until it complies with Corporations Code section 2105, pays to the Secretary of State a penalty of $250 and the fees for filing the required statement, and files with the court clerk receipts substantiating payment of such fees and franchise taxes and any other business taxes. Since the tax liability will be the issue presented to us, we will allow a nonqualified foreign corporation to maintain an action before us if it presents evidence substantiating it has qualified with the Secretary of State and paid the $250 penalty pursuant to Corporations Code section 2203, subdivision (c).

[10] As indicated, however, a nonqualified foreign corporation determined to be transacting intrastate business in California will not be able to maintain an appeal before this Board without first qualifying with the Secretary of State. (Corps. Code, § 2203, subd. (c); *United Medical, supra*, 49 Cal.App.4th at p. 1740.)

appellant may commence and maintain an appeal before this Board seeking our determination of its tax filing requirements and/or its California tax liability.

Given our conclusion that appellant may commence and maintain an appeal before this Board, we next consider whether appellant established it was not a limited partner of COV-III, and therefore did not have a filing requirement in California. In resolving an issue on appeal, respondent's determination is presumed correct and appellant has the burden of proving it to be wrong. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Myron E. and Alice Z. Gire*, Cal. St. Bd. of Equal., Sept. 10, 1969.) We initially note appellant provided no further information for our consideration following its initial appeal dated March 8, 2000. Respondent provided the record we reviewed, apparently from its protest files in this matter.

Appellant primarily contends it never owned a limited partnership interest in COV-III. Specifically, appellant contends it held the partnership interest as a nominee for S.P. Investment Corporation. We note, however, that neither appellant nor any other party advised respondent that appellant held the limited partnership interest as a nominee for another party. (See Rev. & Tax. Code, § 18633, subd. (c), formerly Rev. & Tax. Code, § 17932, subd. (c), renumbered Jan. 1, 1994.) Appellant further contends COV-III submitted an erroneous K-1 identifying appellant as a limited partner. Yet, COV-III never submitted a corrected K-1 to respondent. Also of note, the original K-1 was accompanied by a California partnership return, signed under penalty of perjury apparently by a representative of COV-III. The K-1 reported appellant's share of profits and losses as 80 percent and ownership of capital as 99 percent.

Upon review of the record on appeal, we conclude appellant failed to provide information sufficient to rebut the presumption in favor of respondent's determination, which is based on information obtained from a California tax return signed under penalty of perjury. Appellant does not sufficiently clarify or explain the differences between the information contained in the K-1 and its allegations. Appellant's evidence also fails to make the necessary connections in the information provided. We are required to make too many assumptions about the nature of the connections between the various entities to conclude in appellant's favor.[11] Therefore, based on the record before us, we must conclude respondent's determination with respect to appellant's tax liability to be correct.

Finally, we consider whether the penalties imposed should be abated for reasonable cause. R&TC section 19131 imposes a penalty on any taxpayer failing to make and file a return on or before the due date of the return. R&TC section 19133 authorizes respondent to impose a penalty on any taxpayer failing or refusing to furnish information requested in writing by respondent, or failing or refusing to make and file a return upon notice and demand by respondent. Both penalties may be abated if the taxpayer's failure to provide information or to

[11] We also note that appellant's representative initially reserved the right to supplement appellant's opening brief. Appellant failed to provide any additional argument or evidence, even after respondent noted the lack of information from appellant in this appeal.

file a return is due to reasonable cause and not willful neglect. (Rev. & Tax. Code, §§ 19131, subd. (a), and 19133.) A taxpayer bears the burden of showing imposition of a penalty was improper. (*Appeal of Kerry and Cheryl James*, Cal. St. Bd. of Equal., Jan. 3, 1983.) Further, reasonable cause means such cause as would prompt an ordinarily intelligent and prudent businessperson to so act under similar circumstances. (*Appeal of Elmer R. and Barbara Malakoff*, Cal. St. Bd. of Equal., June 21, 1983.) Without evidence to the contrary, we presume as correct respondent's determinations of penalties. (See *Appeal of Robert Scott*, Cal. St. Bd. of Equal., Apr. 5, 1993.) Our review of the record before us reveals appellant failed to provide evidence sufficient to support its claim for abatement of the penalties for reasonable cause. We note appellant received a K-1 alerting it to the potential errors in the California partnership return, as well as to a potential filing requirement in California. We also note the fact that respondent sent three notices to appellant (the second by certified mail indicating receipt by appellant) requesting appellant to file a return for the year in issue. No response was received until after the third notice. We conclude appellant received sufficient notice of the necessity of action from the outset, but failed to so act. We cannot, therefore, conclude appellant established reasonable cause for abatement of the penalties.

In conclusion, we allowed appellant to commence and maintain the appeal because, despite the fact that appellant is a nonqualified foreign corporation, we concluded appellant was not transacting intrastate business in California and should have the opportunity to seek a determination of its California tax filing requirements and its appropriate California tax liability. Further, we determined that appellant failed to provide evidence sufficient to establish it was not a limited partner of COV-III or to establish reasonable cause for abatement of the penalties.

We deny respondent's petition for rehearing, and restate and amend our original decision as indicated above.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED, pursuant to section 19048 of the Revenue and Taxation Code, that the petition for rehearing filed by respondent is denied and that our original opinion in this matter is restated and amended as reflected in the attached written opinion. The action of respondent on the protest of appellant against a proposed assessment of tax in the amount of $80,536.14, a delinquent filing penalty of $20,134.03, and a notice and demand penalty of $20,134.00 for income year ended December 31, 1993, be and the same is hereby sustained.

Done at Sacramento, California, this 29th day of November, 2001, by the State Board of Equalization, with Board Members Mr. Parrish, Mr. Klehs, Mr. Andal, and *Ms. Marcy Jo Mandel present.

Claude Parrish, Chairman

Johan Klehs, Member

Dean Andal, Member

*Marcy Jo Mandel, Member

_____, Member

*For Kathleen Connell per Government Code section 7.9.