

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case Nos. 18011350; 18011352
)
ERIC A. THORESON) Date Issued: August 30, 2018
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)
_____)

OPINION

Representing the Parties:

For Appellant: Eric A. Thoreson

For Respondent: Andrew Amara, Tax Counsel III

HOSEY, Administrative Law Judge: Pursuant to California Revenue and Taxation Code section 19045,¹ Eric Thoreson (appellant) appeals an action by the Franchise Tax Board (FTB or respondent) on appellant’s notice of action proposing assessments for tax years 2007, 2008, 2009, 2010, 2011, 2012 and 2013.

Appellant waived his right to an oral hearing and therefore the matter is being decided based on the written record.²

ISSUES

1. Whether appellant has demonstrated any error in the proposed assessments of additional tax.
2. Whether appellant has established that the late-filing penalties should be abated.
3. Whether appellant has established that the demand penalties should be abated.
4. Whether appellant has established that the filing enforcement cost recovery fee should be abated.

¹ Unless otherwise indicated, all “Section” references are to sections of the California Revenue and Taxation Code.

² Pursuant to Assembly Bill 102, The Taxpayer Transparency and Fairness Act of 2017, as amended by Assembly Bill 131 (2017-18 Reg. Sess.), the duty of processing administrative appeals for corporate franchise and income taxes was transferred from the Board of Equalization (Board) to the newly created Office of Tax Appeals.

FACTUAL FINDINGS

1. Appellant has not filed a California income tax return for the 2007, 2008, 2009, 2010, 2011, 2012 or 2013 tax years.
2. Through its Integrated Non-Filer Compliance (INC) program, FTB received an electronic notice from the Internal Revenue Service (IRS) that Wells Fargo Bank N.A. (Wells Fargo) had reported on a federal Form 1098 that appellant paid mortgage interest in tax years 2007 through 2013, as follows:
 - a. Appellant paid mortgage interest of \$40,886 in the 2007 tax year, which indicated income sufficient to trigger the 2007 California filing requirement. For the 2007 tax year, FTB estimated appellant's income to be \$163,544 by multiplying the amount of mortgage interest by four ($\$40,886 \times 4$).
 - b. Appellant paid mortgage interest of \$37,740 in the 2008 tax year, which indicated income sufficient to trigger the 2008 California filing requirement. For the 2008 tax year, FTB estimated appellant's income to be \$226,440 by multiplying the amount of mortgage interest by six ($\$37,740 \times 6$).
 - c. Appellant paid mortgage interest of \$37,542 in the 2009 tax year, which indicated income sufficient to trigger the 2009 California filing requirement. For the 2009 tax year, FTB estimated appellant's income to be \$225,252 by multiplying the amount of mortgage interest by six ($\$37,542 \times 6$).
 - d. Appellant paid mortgage interest of \$32,743 in the 2010 tax year, which indicated income sufficient to trigger the 2010 California filing requirement. For the 2010 tax year, FTB estimated appellant's income to be \$196,458 by multiplying the amount of mortgage interest by six ($\$32,743 \times 6$).
 - e. Appellant paid mortgage interest of \$32,921 in the 2011 tax year, which indicated income sufficient to trigger the 2011 California filing requirement. For the 2011 tax year, FTB estimated appellant's income to be \$197,526 by multiplying the amount of mortgage interest by six ($\$32,921 \times 6$).
 - f. Appellant paid mortgage interest of \$9,276 in the 2012 tax year, which indicated income sufficient to trigger the 2012 California filing requirement. For the 2012 tax year, FTB estimated appellant's income to be \$55,656 by multiplying the amount of mortgage interest by six ($\$9,276 \times 6$).

- g. Appellant paid mortgage interest of \$7,800 in the 2013 tax year, which indicated income sufficient to trigger the 2013 California filing requirement. For the 2013 tax year, FTB estimated appellant's income to be \$46,800 by multiplying the amount of mortgage interest by six (\$7,800 x 6).
3. FTB issued various notices that requested appellant file California returns for tax years 2007 through 2013 or demonstrate why no return was required.³
4. In response to the notices, appellant sent letters to FTB asserting that he did not pay any mortgage interest and that he did not make payments on a Wells Fargo loan. For some of the years, appellant also questioned FTB's contention that he had to file a California income tax return and asserted that he had insufficient income to obligate him to file a return.
5. Based on the Form 1098 information from the IRS, FTB issued several Notices of Proposed Assessment (NPAs):
 - a. NPA for 2007 dated May 9, 2011, determining additional tax of \$9,143, a late-filing penalty of \$2,285.75, plus applicable interest;
 - b. NPA for 2008 dated December 24, 2012, determining additional tax of \$15,245 a late-filing penalty of \$3,811.25, plus applicable interest;
 - c. NPA for 2009 dated July 16, 2012, determining additional tax of \$15,657, a late-filing penalty of \$3,914.25, a demand penalty of \$3,914.25, a filing enforcement fee of \$82, plus applicable interest;
 - d. NPA for 2010 dated September 3, 2013, determining additional tax of \$13,330, a late-filing penalty of \$3,332.50, a demand penalty of \$3,332.50, a filing enforcement fee of \$78, plus applicable interest;
 - e. NPA for 2011 dated April 8, 2013, determining additional tax of \$12,932, a late-filing penalty of \$3,233, a demand penalty of \$3,233, a filing enforcement fee of \$82, plus applicable interest;

³ FTB's notices to appellant included the following: notice for 2007 dated March 7, 2011, requesting a response by April 6, 2011; notice for 2008 dated May 9, 2011, requesting a response by June 8, 2011; notice for 2009 dated May 16, 2012, requesting a response by June 20, 2012; notice for 2010 dated June 11, 2013, requesting a response by July 7, 2013; notice for 2011 dated January 31, 2013, requesting a response by March 6, 2013; notice for 2012 dated February 4, 2014, requesting a response by March 12, 2014; and notice for 2013 dated December 23, 2014, requesting a response by January 28, 2015.

- f. NPA for 2012 dated May 12, 2014, determining additional tax of \$1,847, a late-filing penalty of \$461.75, a demand penalty of \$461.75, a filing enforcement fee of \$78, plus applicable interest; and
 - g. NPA for 2013 dated February 24, 2015, determining additional tax of \$1,231, a late-filing penalty of \$307.75, a demand penalty of \$307.75, a filing enforcement fee of \$76, plus applicable interest.
6. Appellant timely protested each of the NPAs in writing and requested that FTB provide copies of “all information” used to prepare the NPAs.
 7. Telephonic protest hearings before FTB were held on December 18, 2014, for tax years 2007, 2008, 2009, 2011, and 2012.
 8. FTB later affirmed each of its proposed assessments. Pursuant to its memorandum dated August 23, 2016, FTB abated the demand penalties for tax years 2011, 2012, and 2013.
 9. Appellant timely filed a combined appeal for tax years 2007, 2008, 2009, 2011, 2012, and 2013. Appellant separately filed a timely appeal for the 2010 tax year. The Board consolidated the appeals as they pertain to the same substantive issues.
 10. Appellant’s main arguments are that FTB has not offered any evidence in support of the NPAs and has violated appellant’s constitutional and other rights. Appellant contends FTB’s actions are contrary to law and are unenforceable and have deprived appellant of his property without due process of law, and that FTB did not properly respond to appellant’s Information Practices Act and Public Records Act requests.

DISCUSSION

Issue 1 – Whether appellant has demonstrated any error in the proposed assessment.

Section 19087(a) provides:

If any taxpayer fails to file a return, or files a false or fraudulent return with intent to evade the tax, for any taxable year, the Franchise Tax Board, at any time, may require a return or an amended return under penalties of perjury or may make an estimate of the net income, from any available information, and may propose to assess the amount of tax, interest, and penalties due.

When FTB makes a tax assessment based on an estimate of income, FTB’s initial burden is to show why its assessment is reasonable and rational. (*Appeal of Michael E. Myers*, 2001-

SBE-001, May 31, 2001.)⁴ When a taxpayer fails to file a valid return, and refuses to cooperate in the ascertainment of his or her income, FTB is given “great latitude” in estimating income. (*Appeals of Walter R. Bailey*, 92-SBE-001, Feb. 20, 1992 [estimate based on third-party information reporting]; *Appeal of R. and Sonja J. Tonsberg*, 85-SBE-034, Apr. 9, 1985 [use of third-party information reporting].) “A taxpayer is not in a good position to criticize respondent’s estimate of his or her liability when he or she fails to file a required return and, in addition, subsequently refuses to submit information upon request.” (*Appeals of Fred R. Dauberger et al.*, 82-SBE-082, Mar. 31, 1982.)

Federal courts have held that a taxing agency need only introduce “some evidence” linking the taxpayer with the unreported income. (*Rapp v. Commissioner* (9th Cir. 1985) 774 F.2d 932, 935.) In *Rapp*, the Ninth Circuit Court of Appeals stated, “[o]nce the Government has carried its initial burden of introducing some evidence linking the taxpayer with income-producing activity, the burden shifts to the taxpayer to rebut the presumption by establishing by a preponderance of the evidence that the deficiency determination is arbitrary or erroneous.” (*Ibid.*, internal citations omitted.) Essentially, after FTB satisfies its initial burden, its determination is presumed correct and the taxpayer has the burden of proving it wrong. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509.) A taxpayer’s failure to produce evidence that is within his/her control gives rise to a presumption that such evidence is unfavorable to his/her case. (*Appeal of Don S. Cookston*, 83-SBE-048, Jan. 3, 1983.)

FTB’s estimation of appellant’s income is both reasonable and rational. (See *Appeal of Bailey, supra*; *Appeal of Tonsberg, supra*.) FTB reconstructed appellant’s income based on the Form 1098s regarding appellant’s mortgage interest for the tax years at issue. Appellant has not explained nor provided any supporting evidence of why FTB’s reconstruction is incorrect, or how he was paying his mortgage interest payments and other cost of living expenses during these tax years. Appellant had the burden of proving error in FTB’s proposed assessments of additional tax, and he failed to meet that burden of proof.

Appellant argues FTB did not properly respond to his Information Practices Act and Public Records Act requests for the tax years 2007-2013, among other general claims that his constitutional rights have been violated. As to appellant’s arguments regarding the Information

⁴ Published decisions of the Board of Equalization, designated by “SBE” in the citation, are available on that Board’s website at: <http://www.boe.ca.gov/legal/legalopcont.htm>.

Practices Act, they are not within our jurisdiction to consider. In *Appeal of Dauberger, supra*, the Board stated that “the only power that this Board has is to determine the correct amount of an appellant’s California personal income tax liability for the appeal years.” (See also *Appeal of Wesley, et al.*, 2005-SBE-002, Nov. 15, 2005.)⁵ Furthermore, as to appellant’s arguments regarding due process, we are precluded from determining the constitutional validity of California statutes, and have an established policy of declining to consider constitutional issues. (Cal. Const., art III, § 3.5; *Appeal of Aimor Corp.*, 83-SBE-221, Oct. 26, 1983; *Appeal of Bailey, supra.*) In *Bailey, supra*, the Board stated:

[D]ue process is satisfied with respect to tax matters so long as an opportunity is given to question the validity of a tax at some stage of the proceedings. It has long been held that more summary proceedings are permitted in the field of taxation because taxes are the lifeblood of government and their prompt collection is critical.

Therefore, we are unable to address appellant’s IPA and due process violation arguments in this forum.

Issue 2 – Whether appellant has established that the late-filing penalties should be abated.

California imposes a penalty for the failure to file a valid return on or before the due date, unless it is shown that the failure is due to reasonable cause and not due to willful neglect. (§ 19131.) The penalty is computed at five (5) percent of the tax due, after allowing for timely payments, for every month that the return is late, up to a maximum of 25 percent. (§ 19131(a).) Here, the late-filing penalty appears to have been correctly calculated, and appellant has not shown any error in the computation method.

The burden is on the taxpayer to establish reasonable cause for the failure to timely file. (*Appeal of M.B and G.M. Scott*, 82-SBE-249, Oct. 14, 1982.) To establish reasonable cause, the taxpayer “must show that the failure to file timely returns occurred despite the exercise of ordinary business care and prudence, or that cause existed as would prompt an ordinary intelligent and prudent businessman to have so acted under similar circumstances.” (*Appeal of Howard G. and Mary Tons*, 79-SBE-027, Jan. 9, 1979.)

⁵ The jurisdiction for the Office of Tax Appeals also is laid out in the Office of Tax Appeals Rules for Tax Appeals. (See California Code of Regulations, title 18, § 30102.) Specifically, the Office of Tax Appeals cannot consider whether FTB violated the Information Practices Act, the Public Records Act, or any similar provision of the law or whether the appellant is entitled to a remedy for FTB’s actual or alleged violation of any substantive or procedural right unless the violation affects the adequacy of a notice, the validity of an action from which a timely appeal was made, or the amount at issue in the appeal. (Cal. Code Regs., tit. 18, § 30102(b)(4)-(5).)

In this appeal, appellant has not demonstrated any sort of reasonable cause for his failure to file a tax return by the deadline. To date, appellant has not filed returns for the tax years at issue. Appellant did not provide any evidence that his failure to file timely returns was due to reasonable cause. Therefore, this agency has no grounds to abate the late-filing penalties.

Issue 3 – Whether appellant has established that the demand penalties for 2009 and 2010 should be abated.

California imposes a penalty against a taxpayer for failing to file a return or provide information after an FTB demand to do so, unless the failure to do so was attributable to reasonable cause and not to willful neglect. (§ 19133.) To establish reasonable cause, a taxpayer must show that the failure to respond occurred despite the exercise of ordinary business care. (*Appeal of Stephen C. Bieneman*, 82-SBE-148, July 26, 1982.) A taxpayer’s reason for failing to respond must be such that an ordinarily intelligent and prudent businessperson would have acted similarly under the circumstances. (*Appeal of Elmer R. and Barbara Malakoff*, 83-SBE-140, June 21, 1983.) The demand penalty is 25 percent of the total tax, determined without regard to payments and withholding credits. The demand penalty is designed to penalize the failure of a taxpayer to respond to a notice and demand, and not a taxpayer’s failure to pay the proper tax. (*Appeal of W.L. Bryant*, 83-SBE-180, Aug. 17, 1983; *Appeal of Frank E. and Lilia Z. Hublou*, 77-SBE-102, July 26, 1977.)

FTB did not impose demand penalties for tax years 2007 and 2008. In relation to tax years 2011, 2012, and 2013, FTB stated it would abate the demand penalties in full for those tax years. Only the demand penalties for 2009 and 2010 remain in dispute.

As for the 2009 tax year, FTB issued a notice dated May 16, 2012, demanding that appellant file a 2009 California return or demonstrate why no return was required by June 20, 2012. FTB’s demand notice complied with the requirements of California Code of Regulations, title 18, section 19133(b). In response, appellant sent FTB a letter dated June 14, 2012, asserting that he “did not have sufficient income to have a filing requirement for 2009.” However, appellant did not file a 2009 California return by the demand notice deadline of June 20, 2012, and we find that appellant’s letter dated June 14, 2012, did not demonstrate why no return was required.

As for the 2010 tax year, FTB issued a demand notice dated June 11, 2013, as appellant had not yet filed a 2010 tax return. FTB’s demand notice complied with the requirements of

California Code of Regulations, title 18, section 19133(b). Appellant failed to file a tax return and did not demonstrate why no return was required.

Appellant has offered no explanation for his failure to timely provide an adequate response to FTB’s demand notices for 2009 and 2010. Therefore, appellant has failed to establish reasonable cause to abate the notice and demand penalties imposed for those years.

Issue 4 – Whether appellant has established that the filing enforcement cost recovery fee should be abated.

Section 19254(a)(2) provides that when FTB mails a formal legal demand to a taxpayer to file a tax return, a filing enforcement fee is required to be imposed if the taxpayer fails or refuses to file a return within 25 days. The amount of this fee is set by the Legislature in the annual Budget Act. (§ 19254(b).) No provision in California law excuses FTB from imposing the filing enforcement cost recovery fee for any reason, including reasonable cause.

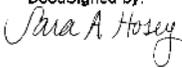
Here, appellant does not appear to dispute the amount of the fee, which is set by statute. Appellant provided no authority for this agency to waive or modify this fee. Accordingly, we sustain its imposition.

HOLDINGS

1. Appellant has failed to demonstrate any error in the proposed assessment.
2. Appellant has failed to establish that the late-filing penalties should be abated.
3. Appellant has failed to establish that the demand penalties for 2009 and 2010 should be abated.
4. Appellant has failed to establish that the filing enforcement cost recovery fees should be abated.

DISPOSITION

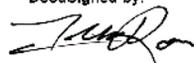
Except for the demand penalties proposed for tax years 2011, 2012, and 2013 that respondent conceded during the appeal, respondent’s action is sustained in full.

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Sara A. Hosey
Administrative Law Judge

We concur:

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Teresa A. Stanley
Administrative Law Judge

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Alberto T. Rosas
Administrative Law Judge