

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 18011045
)
MARK MORGAN) Date Issued: September 19, 2018
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_____)

OPINION

Representing the Parties:

For Appellant: Mark Morgan
For Respondent: Gi Nam, Tax Counsel

L. CHENG, Administrative Law Judge: Pursuant to California Revenue and Taxation Code section 19045,¹ Mark Morgan (appellant) appeals an action by the Franchise Tax Board (FTB or respondent) on appellant’s protest against a proposed assessment in the amount of \$505 in tax, a late-filing penalty of \$135, a demand penalty of \$261.25, and a filing enforcement cost recovery fee of \$79, plus applicable interest, for the 2013 tax year.

Administrative Law Judges Linda C. Cheng, Michael F. Geary, and Daniel K. Cho held an oral hearing for this matter in Los Angeles, California, on June 19, 2018. At the conclusion of the hearing, the record was closed and this matter was submitted for decision.

ISSUES

1. Has appellant established error in FTB’s proposed assessment of additional tax for the 2013 tax year?
2. Has appellant established reasonable cause to support abatement of the delinquent filing penalty?
3. Has appellant established reasonable cause to support abatement of the demand penalty?
4. Was the filing enforcement cost recovery fee properly imposed?

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

5. Should a frivolous appeal penalty pursuant to section 19714 be imposed, and if so, in what amount?

FACTUAL FINDINGS

1. Appellant has not filed a California income tax return for the 2013 tax year.
2. Through its Integrated Non-Filer Compliance (INC) Program, FTB obtained information from reporting sources that appellant received wages of \$39,821 from Valleycrest Landscape Maintenance, Inc. (Valleycrest), and interest income of \$22 from JP Morgan Chase Bank, N.A. (Chase), for the 2013 tax year. Based on this information, FTB determined that appellant, a California resident, had a California income tax filing requirement.
3. Because appellant had not filed a California income tax return for the 2013 tax year, on January 21, 2015, FTB issued a Demand for Tax Return (Demand #1) to appellant requiring that he file a return, provide a copy of the return if already filed, or explain why no return was required. Demand #1 also stated that FTB received information that appellant earned wages from Valleycrest as well as interest income from Chase, which led FTB to believe appellant had a filing requirement for the 2013 tax year.
4. By letter dated February 15, 2015, appellant submitted a timely response to Demand #1, asserting that FTB should provide appellant with evidence that he is required to file a tax return.
5. By Determination of Filing Requirement —Tax Return Demand dated June 22, 2015 (Demand #2), FTB notified appellant that it had reviewed his response to Demand #1 and determined that he was required to file a 2013 tax return. Demand #2 required appellant to file his 2013 tax return by July 24, 2015.
6. By letter dated July 10, 2015, appellant responded by arguing that his income is not subject to the income tax laws and that FTB's actions violated his constitutional rights. Appellant did not file a 2013 tax return.
7. Because appellant did not file a 2013 tax return by the July 24, 2015 deadline, FTB issued a Notice of Proposed Assessment (NPA) on February 22, 2016. Based on third-party payor information received through the INC program, the NPA estimated taxable income of \$35,937, after allowing a \$3,906 standard deduction, and proposed a tax liability of \$505 after applying withholding credits of \$540. The NPA also imposed a

- delinquent filing penalty of \$135, a demand penalty of \$261.25, and a filing enforcement cost recovery fee of \$79, plus applicable interest.
8. Appellant filed a written protest dated April 3, 2016, requesting a protest hearing, which was held on October 17, 2016.
 9. Following the protest hearing, FTB issued a Notice of Action (NOA) on January 26, 2017, denying the protest, affirming the NPA, and warning appellant that the filing of a frivolous appeal may result in the imposition of a frivolous appeal penalty of up to \$5,000. The FTB also provided appellant a copy of a law summary regarding frivolous appeals.
 10. Appellant then filed this timely appeal.
 11. Appellant also has not filed his tax returns for the 1999, 2002, 2003, 2004, 2005, 2009, 2011, 2012, 2014, and 2015 tax years, resulting in demands and NPAs issued for each of the years.²

DISCUSSION

Issue 1 - Has appellant demonstrated error in FTB's proposed assessment for the 2013 tax year?

Section 17041 imposes a tax “upon the entire taxable income of every resident of this state.” Section 18501 requires every individual subject to the Personal Income Tax Law to make and file a return with FTB “stating specifically the items of the individual’s gross income from all sources and the deductions and credits allowable” Section 17071 defines “gross income” by referring to and incorporating Internal Revenue Code (IRC) section 61, which provides that gross income means “all income from whatever source derived.” (IRC, § 61(a).) As relevant here, gross income specifically includes compensation for services and interest income. (IRC, § 61(a)(1), (4).)

FTB carries the initial burden of establishing that its proposed assessment is both reasonable and rational. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Michael E.*

² None of these tax years are currently on appeal before the Office of Tax Appeals (OTA). Appellant filed appeals for the 2004 and 2005 tax years with OTA’s predecessor, the Board of Equalization (BOE), which sustained FTB’s proposed assessment for the 2004 tax year. The appeal for the 2005 tax year was withdrawn prior to the issuance of a decision. As relevant to the demand penalty discussion below, FTB issued a Demand for Return dated January 24, 2014, requiring appellant to file a return for the 2012 tax year, provide a copy of the return if already filed, or explain why no return was required. Appellant did not respond to the January 24, 2014 Demand for Return, and FTB issued an NPA dated August 18, 2014, for the 2012 tax year.

Myers, 2001-SBE-001, May 31, 2001.)³ Thereafter, FTB’s proposed assessment is presumed correct, and the burden of proof shifts to the taxpayer to demonstrate error. (*Todd v. McColgan*, *supra*; *Appeal of Michal E. Myers*, *supra*.) The failure to provide any evidence contradicting the proposed assessment means the taxpayer has failed to carry his or her burden of proof. (*Appeal of Don A. Cookston*, 83-SBE-048, Jan. 3, 1983.)

FTB’s use of the Internal Revenue Service (IRS) Wage and Income Transcript and federal Form 1099-INT showing that appellant had total income of \$39,843 for the 2013 tax year is both reasonable and rational. (*Appeals of Walter R. Bailey*, 92-SBE-001, Feb. 20, 1992 [estimate based on third-party information reporting]; *Appeals 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.) Instead of providing evidence demonstrating FTB erred in the calculation of its proposed assessment, appellant raises metaphysical questions about the definition of “income” and asserts that an income tax is not a direct tax but an indirect excise tax imposed upon the sale of goods and thus not applicable to his income. Appellant’s argument is one of many commonly repudiated frivolous arguments and is thus meritless.

Furthermore, appellant’s reliance on case law and BOE decisions to suggest that income tax laws do not apply to his income is also misplaced. For instance, appellant incorrectly cites the *Appeals of Fred R. Dauberger, et al.*, *supra*, for the proposition that because income tax is not a tax on property, there is no subject upon which to impose the tax. However, appellant’s interpretation misses the mark, since the *Dauberger* decision goes on to state that “California income tax is . . . a tax on income.” (*Ibid.*) Similarly, appellant disingenuously cites *United States v. Ballard*, 535 F.2d 400 (8th Cir. 1976) to support his argument that his income is not subject to tax because “[t]he general term ‘income’ is not defined in the Internal Revenue Code”; however, the court, in the very next sentence, goes on to state that gross income means all income from whatever source derived, citing IRC section 61. In short, appellant has not

³ Pursuant California Code of Regulations, title 18, section 30501(d)(3), precedential opinions of the BOE that were adopted prior to January 1, 2018, may be cited as precedential authority to the OTA unless a panel removes, in whole or in part, the precedential status of the opinion. BOE’s formal opinions are generally available for viewing on the BOE’s website at <http://www.boe.ca.gov/legal/legalopcont.htm>.

demonstrated that the wages he received from Valleycrest and interest income from Chase are exempt from taxation.

Appellant also argues that FTB did not afford him a fair hearing process because: 1) the hearing officer is a paid employee of the FTB; 2) he or she cannot consider any legal evidence, case law, etc., in making a decision; and 3) he or she cannot possibly be fair and unbiased in the decisions made based on items 1 and 2. As this appears to be an argument regarding due process, we note that 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; *Appeals of Walter R. Bailey, supra.*) Moreover, 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 constitutional due process arguments in this forum.

Based on the evidence, we find that appellant has not met his burden of demonstrating error in FTB's proposed assessment of additional tax.

Issue 2 – Has appellant established reasonable cause to support abatement of the delinquent filing penalty?

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 was 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).)

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.) Each taxpayer has a personal, non-delegable obligation to file a tax return by the due date.

(*United States v. Boyle* (1985) 469 U.S. 241.) Ignorance of the law is not an excuse for failing to file a timely return. (*Appeal of Diebold, Inc.*, 83-SBE-002, Jan. 3, 1983.)

As noted above, appellant received wages of \$39,821 from Valleycrest and interest income of \$22 from Chase, which triggered a filing requirement for the 2013 tax year. Appellant has not provided any coherent reason for his failure to file his 2013 tax return other than the claim that he requested FTB to help him understand why he had a filing obligation and that FTB did not respond. Based on the lack of information, appellant asserts that he had no filing obligation. Appellant's explanation does not constitute reasonable cause because his mistaken belief about his filing obligation is not an excuse for failing to timely file his return. (See *Appeal of Diebold, Inc.*, *supra*.) Appellant's action in putting the burden on FTB to explain why he had a filing requirement does not reflect the exercise of ordinary business care and prudence. We note that, to date, appellant still has not filed a 2013 tax return. Consequently, we find no basis to abate the delinquent filing penalty.

Issue 3 – Has appellant established reasonable cause to support abatement of the demand penalty?

California imposes a penalty for the failure or refusal to file a return or provide information upon FTB's demand to do so, unless reasonable cause prevented the taxpayer from responding to the request. (§ 19133.) The burden is on the taxpayer to prove that reasonable cause prevented him from complying with the demand. (*Appeal of Kerry and Cheryl James*, 83-SBE-009, Jan. 3, 1983.) Illness or other personal difficulties that prevent a taxpayer from responding to a demand notice or a request for information may be considered reasonable cause. (*Appeal of Michael J. and Diane M. Halaburka*, 85-SBE-025, Apr. 9, 1985.) Appellant's mistaken beliefs concerning his tax obligations, even if held in good faith, do not constitute "reasonable cause" that might excuse appellant's failure or refusal to respond to FTB's notice and demand for a valid tax return. (See *Appeal of W. L. Bryant*, 83-SBE-180, Aug. 17, 1983.)

The demand penalty is 25 percent of the total tax, determined without regard to payments and withholding credits. For individual taxpayers, FTB will only impose the demand penalty for an unfiled return if the taxpayer fails to respond to a current Demand for Tax Return and FTB has proposed an assessment under Section 19087(a) after the taxpayer failed to timely respond to a Request for Tax Return or a Demand for Tax Return at any time during the four taxable years preceding the year for which the current Demand for Tax Return has been issued. (Cal. Code

Regs., tit. 18, § 19133, subd. (b).) The demand penalty is designed to penalize a taxpayer for failing to respond to a notice and demand, not for failing to pay the proper tax. (See *Appeal of W. L. Bryant, supra*; *Appeal of Frank E. and Lilia Z. Hublou*, 77-SBE-102, July 26, 1977.)

Here, the demand penalty was properly imposed because appellant failed to comply with FTB's Demand #1, which clearly stated that FTB received information indicating that appellant earned wage and interest income for the tax year at issue. Instead of filing a return or setting forth reasons why he did not have a filing requirement, appellant responded by asking FTB to provide him with information identifying appellant as someone who is required to file a return. Appellant cannot be said to have complied with the Demand #1 because by putting the burden on FTB to provide evidence, he did not satisfy the demand to either file a return or to articulate reasons why he had no filing requirement. Similarly, in response to FTB's Demand #2, instead of filing a return, appellant asserted meritless arguments similar to those made in his protest and appeal briefs, i.e., income tax is an indirect excise tax, he is not subject to the income tax, there is no activity to support gross income, and the taxes, penalties and fees were imposed without due process. Despite having responded to Demand #2, appellant cannot be said to have complied with FTB's request for the filing of a tax return. His refusal to provide the information demanded by FTB renders the demand penalty properly imposed. Appellant's refusal to comply with the demands does not reflect the exercise of ordinary business care and prudence of an ordinary intelligent and prudent businessperson under similar circumstances.

Furthermore, FTB issued a Demand for Return and a subsequent NPA for the 2012 tax year, which is within the four taxable years preceding the year for which the current demand has been issued. Since appellant has not established reasonable cause for his failure to comply with FTB's Demands, he is liable for the demand penalty determined by FTB.

Based on the facts set forth above, we find no reasonable cause to warrant the abatement of the demand penalty.

Issue 4 – Was the filing enforcement cost recovery fee properly imposed?

Section 19254(a)(2) provides that FTB shall impose a filing enforcement cost recovery fee if a person fails or refuses to make and file a tax return within 25 days after a formal legal demand to file the tax return has been mailed to that person by FTB. Once properly imposed, there is no statutory provision that would relieve the imposition of the filing enforcement cost recovery fee for any circumstance, including reasonable cause. Here, the fee was properly

imposed because appellant failed to file a 2013 tax return within 25 days of the above-referenced Demands issued by FTB. Accordingly, we uphold FTB's imposition of the filing enforcement cost recovery fee.

Issue 5 – Should a frivolous appeal penalty be imposed and, if so, in what amount?

Section 19714 provides that whenever it appears that a proceeding before the OTA⁴ has been instituted or maintained by the taxpayer primarily for delay, that the taxpayer's position in the proceedings is groundless or frivolous, or that the taxpayer unreasonably failed to pursue available administrative remedies, a penalty in the amount of up to \$5,000 shall be imposed. Under the applicable regulations, the following non-exclusive list of factors are considered in determining whether to impose the penalty, and in what amount: (1) whether the taxpayer is making arguments that have been previously rejected by OTA in a precedential opinion, by the BOE in a Formal Opinion, or by the courts; (2) whether the taxpayer is repeating arguments that he advanced unsuccessfully in prior appeals; (3) whether the taxpayer filed the appeal with the intent of delaying legitimate tax proceedings or the legitimate collection of tax owed; and (4) whether the taxpayer has a history of filing frivolous appeals or failing to comply with California's tax laws. (Cal. Code Regs., tit. 18, § 30502, subs. (b)(1-4).)⁵ The cost of processing an appeal is significant, and repeated appeals where the arguments have been previously considered and rejected will not be condoned. (*Appeals of Fred R. Dauberger, et al., supra.*)

Here, throughout the entire administrative protest process with FTB, as well as on appeal before us, appellant has made numerous meritless arguments that previously have been rejected by BOE and the courts, such as his argument that income is not subject to tax. (See, e.g., *Boyce v. Commissioner*, T.C. Memo. 1996-439, affd. (9th Cir. 1997) 122 F.3d 1069; *Appeals of Robert E. Wesley, et al.*, 2005-SBE-002, Nov. 15, 2005; *Appeal of LaVonne A. Hodgson*, 2002-SBE-001, Feb. 6, 2002; *Appeal of Michael E. Myers, supra*; *Appeal of Alfons Castillo*, 92-SBE-020, July 30, 1992; *Appeals of Walter R. Bailey, supra*; *Appeals of Fred R. Dauberger, et al., supra*). Appellant's arguments challenging the administrative process and questioning the definition of

⁴ The Office of Tax Appeals is the successor to, and vested with, all of the duties, powers and responsibilities of the BOE necessary or appropriate to conduct appeals hearings. (Gov. Code, § 15672(a).)

⁵ The Office of Tax Appeals' regulations concerning imposition of the frivolous appeal penalty are virtually identical to its predecessor BOE's regulations on this subject. (See Cal. Code Regs., tit. 18, § 5454.)

words and terms such as “income,” “gross income,” “taxable income,” “subject to,” and “hearing” are the same as or similar to positions that have been specifically identified as frivolous in the Internal Revenue Service Notice 2010-33.⁶ Before appellant filed the instant appeal, the NOA issued by FTB notified him that if he chose to assert frivolous arguments, a penalty of up to \$5,000 under Section 19714 could be imposed. FTB also provided appellant a copy of its Law Summary, Nonfiler – Frivolous Arguments, that identified the argument that wages are not subject to tax as being frivolous. Despite these warnings, appellant has pursued this appeal raising similar if not identical frivolous arguments as stated in the Law Summary.

Additionally, appellant’s history of failing to file California income tax returns for the 1999, 2002, 2003, 2004, 2005, 2009, 2011, 2012, and 2015 tax years and failing to comply with FTB’s demands to file returns reflects a continual noncompliance with California tax laws. This pattern of noncompliance with tax laws places an onus on the resources of this state in processing appellant’s protests and appeals, warranting the imposition of the frivolous appeal penalty.

Based on the circumstances of this case, a frivolous appeal penalty in the amount of \$500 shall be imposed upon appellant.


HOLDINGS

1. Appellant has failed to demonstrate any error in the proposed assessment of additional tax.
2. Appellant has not established reasonable cause to support abatement of the delinquent filing penalty.
3. Appellant has not established reasonable cause to support abatement of the demand penalty.
4. The filing enforcement cost recovery fee was properly imposed.
5. We impose a frivolous appeal penalty against appellant in the amount of \$500 pursuant to Section 19714.

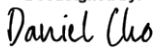
⁶ Pursuant to section 19179(d)(1), this list of frivolous arguments was adopted by the FTB and incorporated into its Law Summary, Nonfiler – Frivolous Arguments.


DISPOSITION

For the reasons set forth above, FTB's action is sustained in full and a frivolous appeal penalty of \$500 is imposed.

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Linda C. Cheng
Administrative Law Judge

We concur:

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Daniel K. Cho
Administrative Law Judge

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Michael F. Geary
Administrative Law Judge