OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18042634
	)
JACOB A. ELY	) Date Issued: March 18, 2019
	)
	)
	)

OPINION

Representing the Parties:

For Appellant: Jacob A. Ely

For Respondent: Joel M. Smith, Tax Counsel

T. STANLEY, Administrative Law Judge: Pursuant to Revenue and Taxation Code section 19045,[1] Jacob A. Ely (appellant) appeals an action by the Franchise Tax Board (FTB or respondent) proposing a demand-to-file penalty of $702 for taxable year 2015.[2]

Appellant waived his right to an oral hearing; therefore, we decide the matter based on the written record.

ISSUE

Is appellant entitled to abatement of the proposed demand-to-file penalty of $702 for taxable year 2015?

FACTUAL FINDINGS

1. Respondent obtained information showing that appellant had earned income for 2015. Respondent, therefore, sent a Demand for Tax Return (Demand) to appellant, on April 25, 2017, indicating that appellant must either file a 2015 California income tax return, provide evidence that appellant already filed that return, or provide information showing

[1] Unless otherwise indicated, all statutory references are to sections ("section" or §) of the Revenue and Taxation Code.

[2] Respondent's Notice of Action (NOA) proposes $1,295 of additional tax, a late-filing penalty of $323.75, a demand-to-file penalty of $702, and a filing enforcement fee of $81, plus interest; however, appellant has only appealed the demand-to-file penalty of $702, and therefore we address only that portion of the proposed assessment.

that appellant had no requirement to file. Appellant's response was due no later than May 31, 2017.

2. The Demand was mailed to an Oakland address that matched the address on appellant's 2014 tax return. The address was the same one to which other relevant notices were mailed by respondent. It was also the same address appellant used to file this appeal.
3. Respondent received no response to its Demand from appellant, and on June 26, 2017, it issued a Notice of Proposed Assessment (NPA). As relevant to this appeal, the NPA included a demand-to-file penalty (Demand Penalty) of $702, plus interest.
4. Appellant protested the NPA on or about August 24, 2017, asserting that he "did not receive such a demand," and requesting a new NPA that excluded the Demand Penalty.
5. Respondent sent a NOA to appellant on October 27, 2017. The NOA included the disputed Demand Penalty.
6. Appellant timely appealed the NOA.
7. Appellant filed his 2015 California Resident Income Tax Return (Form 540EZ) on or about February 28, 2018, and respondent accepted the return. Respondent did not abate or reduce the Demand Penalty.
8. Respondent previously issued a Request for Tax Return (Request) on July 28, 2015, requesting that appellant file a 2013 tax return no later than September 2, 2015.[3]
9. Thereafter, on November 13, 2015, respondent granted appellant's request for additional time to file his 2013 tax return. The due date was extended to January 15, 2016.[4] Appellant did not respond.
10. Respondent issued an NPA for 2013 on February 22, 2016, which NPA did not include a Demand Penalty.

DISCUSSION

When a taxpayer fails or refuses to make and file a return required after FTB issues a Demand, FTB has the discretion to add a penalty of 25 percent of the deficiency in tax assessed

[3] Although respondent's proposed assessment is for the 2015 taxable year, facts related to appellant's 2013 taxable year are relevant to our analysis of whether the FTB properly imposed the Demand Penalty for the 2015 taxable year.

[4] Appellant's request for additional time was not included in respondent's exhibits; therefore, we have no evidence of the date of his request.

or the tax proposed to be assessed pursuant to section 19087. (§ 19133.) FTB established a regulation which provides that in the case of an individual taxpayer, the penalty will only be imposed if "(1) the taxpayer fails to timely respond to a current Demand for Tax Return in the manner prescribed, and (2) the FTB has proposed an assessment of tax . . . after the taxpayer failed to timely respond to a Request for Tax Return or a Demand for Tax Return in the manner prescribed, at any time during the four-taxable-year period preceding the taxable year for which the current Demand for Tax Return is issued." (Cal. Code Regs., tit. 18, § 19133(b).)[5] 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 Bryant*, 83-SBE-180, Aug. 17, 1983; *Appeal of Hublou*, 77-SBE-102, July 26, 1977.)[6] The Demand Penalty may be abated if a taxpayer shows there was reasonable cause (and not willful neglect) for failing to timely respond to a Demand. (§ 19133.)

As a preliminary matter, we note that appellant claims he never received the Demand at issue. Respondent's only obligation in sending notices to taxpayers is to show a notice was sent to the taxpayer's last known address and was not returned by the U.S. Postal Service. (§ 18416(b).) The Demand was sent to the same Oakland address shown on appellant's 2014 tax return. Moreover, all other notices that appellant acknowledges receiving were sent to the same address. Lastly, appellant filed this appeal using the address to which respondent sent its Demand. Therefore, we conclude that appellant has not shown that the demand was mailed to an incorrect address. However, in light of our decision below, appellant's receipt of the Demand is not relevant to this decision.

Pursuant to section 19503, respondent has the authority to prescribe rules and regulations necessary to enforce the Personal Income Tax Law. Respondent exercised that authority in establishing a regulation that states how FTB will apply the discretion granted in the notice and Demand Penalty statute. (Regulation, § 19133(b); see § 19133 [FTB "may" add a penalty].)

When assessing the validity of an interpretation, such as in Example 2 of the regulation, the scope of review does not require the same level of deference as would a quasi-legislative rule. (*Yamaha Corp. of America v. State Board of Equalization* (1988) 19 Cal.4th 1, 11

[5] Unless otherwise indicated, all references to "Regulation" or "regulation" are to sections of the California Code of Regulations, Title 18.

[6] Precedential opinions of the State Board of Equalization (BOE) may be found on BOE's website at: <http://www.boe.ca.gov/legal/legalopcont.htm>.

(*Yamaha*).) While courts have held that an agency's interpretation of its own regulation is entitled to deference, that deference is not unlimited. (See *Auer v. Robbins* (1997) 519 U.S. 452; *Stinson v. United States* (1993) 508 U.S. 36.) If the agency's interpretation is plainly erroneous or inconsistent with a regulation that is unambiguous, it is not entitled to deference. (*Stinson v. United States, supra,* at p. 45; *Bowles v. Seminole Rock & Sand Co.* (1945) 325 U.S. 410, 414.) The agency's interpretation becomes only one of several tools to interpret the regulation, but independent review is required. (*Yamaha,* at pp. 7-8; *Agnew v. State Board of Equalization* (1999) 21 Cal.4th 310, 322.) As written, the rule cannot be applied in the manner suggested in respondent's briefing.

The rules of statutory construction apply when interpreting regulations promulgated by administrative agencies. (*Butts v. Board of Trustees of California State University* (2014) 225 Cal.App.4th 825, 835 (*Butts*).) A regulation, and each word and phrase in a regulation, must be given its plain, common sense meaning. (*Ibid.*) Only if the meaning cannot be determined from the plain language of the regulation, do we look to extrinsic aids to ascertain its intent. (*Id.,* at p. 836.) Moreover, when the plain language of a regulation is unambiguous, we need not inquire into respondent's interpretation of it. (See *Barnhart v. Sigmon Coal Co.* (2002) 534 U.S. 438, 450 ["The inquiry ceases "if the statutory language is unambiguous and 'the statutory scheme is coherent and consistent.' "]; *Desert Palace, Inc. v. Costa* (2003) 539 U.S. 90 ["Where, as here, the words of the statute are unambiguous, the judicial inquiry is complete."].)

In this case, the plain words of the relevant regulation state that an individual's prior failure to timely respond to a Request or Demand must have occurred *during* the four taxable years preceding the taxable year for which the Demand Penalty is imposed. (Regulation § 19133(b)(2).) Respondent's interpretation of the regulation appears to substitute the word "for" in place of the word "during." However, the regulation may not be rewritten "to make it conform to a presumed intention which is not expressed." (*Seaboard Acceptance Corp. v. Shay* (1931) 214 Cal. 361 365.) The plain meaning of the word "during" in the regulation must be interpreted to mean that a taxpayer's failure to respond must have occurred within, or during, the four-taxable-year period preceding the taxable year for which the Demand Penalty is at issue.[7]

[7] To the extent that Example 2 of the regulation § 19133 is inconsistent with this result, we decline to defer to Example 2's illustration of the regulation. (See Regulation § 19133(d).) In that example, an NPA was issued in 2001 after the taxpayer failed to respond to a Request for 1999. (*Id.*) Subsequently a Demand and NPA were issued for 2001, and the example states that the demand penalty would apply. (*Id.*) The application in the illustrative example conflicts with the plain language of the regulation.

Here, the taxable year for which respondent desires to impose the Demand Penalty is 2015. The taxable year during which appellant previously failed to timely respond to a Request, for taxable year 2013 was 2016. In order to apply the Demand Penalty under the regulation, respondent must have issued a prior NPA, after the taxpayer failed to respond to a Request or Demand, during 2011, 2012, 2013, or 2014 (the four taxable years preceding 2015). However, in this case, appellant's failure to timely respond to FTB's notice and demand did not occur until 2016, during a year subsequent to the taxable year at issue.

Specifically, on July 28, 2015, respondent sent appellant a Request to file a 2013 tax return by September 2, 2015. In a November 13, 2015 Deferral Letter, respondent extended appellant's time to respond to January 15, 2016. Respondent issued an NPA on February 22, 2016, when appellant failed to file his 2013 tax return by the extended due date of the Demand. Appellant's failure under the Regulation, therefore, occurred in 2016. Accordingly, respondent has not complied with its own regulation in imposing the Demand Penalty at issue, and the Demand Penalty must be abated.

Because appellant's failure to respond to FTB's notice and demand for taxable year 2013 did not occur during any of the four taxable years prior to 2015, the Demand Penalty should not have been imposed.

HOLDING

Respondent did not properly apply its regulation in assessing the Demand Penalty; therefore, we abate the proposed $702 Penalty.

DISPOSITION

Respondent's action in imposing the Demand Penalty is reversed.

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Teresa A. Stanley
Administrative Law Judge

We concur:

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Douglas Bramhall
Administrative Law Judge

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Neil Robinson
Administrative Law Judge