

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:)	OTA Case No. 18032523
)	
ANDREJ MAIHORN AND ANGELITA)	Date Issued: September 24, 2019
BILLMAN MAIHORN)	
)	
)	

OPINION

Representing the Parties:

For Appellants: Andrej Maihorn and Angelita Billman Maihorn

For Respondent: David Kowalcyk, Tax Counsel
Marguerite Mosnier, Tax Counsel IV

L. CHENG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, Andrej Maihorn and Angelita Billman Maihorn (appellants) appeal an action by respondent Franchise Tax Board (FTB) denying their claim for refund of \$2,525.75 for the 2015 tax year.

Office of Tax Appeals (OTA) Administrative Law Judges Linda C. Cheng, Daniel K. Cho, and Nguyen Dang, held an oral hearing for this matter in Los Angeles, California, on February 20, 2019. After the conclusion of the hearing, the parties were asked to provide additional briefing, and the record was closed on June 20, 2019.

ISSUES

1. Whether the R&TC section 19133 penalty (demand penalty) for the 2015 tax year was properly imposed.
2. Whether appellants have established that abatement of the demand penalty is warranted based on reasonable cause and the absence of willful neglect.

FACTUAL FINDINGS

1. Appellants failed to file timely California income tax returns for the 2010 through 2015 tax years.

2. FTB issued a request for tax return to Mr. Maihorn for each tax year from 2010 through 2014, requesting that he file a return for those years or explain why he was not required to file.
3. Mr. Maihorn did not respond to the request for tax return for the 2014 tax year, and on July 6, 2016, FTB issued a Notice of Proposed Assessment (NPA) to him for \$3,232 additional tax, a delinquent filing penalty of \$808, and interest.
4. With respect to the 2015 tax year, FTB issued to Mr. Maihorn a demand for tax return (Demand) on April 4, 2017, which required him to file a return for that year or explain why he was not required to file. Mr. Maihorn failed to timely respond to the Demand, and FTB issued an NPA to Mr. Maihorn for \$2,340 additional tax, a \$585 delinquent filing penalty, a \$3,800.75 demand penalty, an \$81 filing enforcement fee and interest.
5. On October 16, 2017, appellants late-filed their joint 2015 California Resident Income Tax Return, claiming an overpayment of \$2,941. FTB accepted the return as filed, reduced the total tax due, and withdrew the delinquent filing penalty and filing enforcement fee. FTB also reduced the demand penalty to \$2,525.75. FTB applied appellants' overpayment of \$2,941 to the demand penalty liability of \$2,525.75 and refunded the balance of \$415.25 to appellants on October 24, 2017.
6. Thereafter, appellants filed a timely claim for refund requesting abatement of the demand penalty.
7. FTB issued a Notice of Action denying appellants' claim, and this timely appeal followed.

DISCUSSION

Issue 1 – Whether the demand penalty was properly imposed.

If any taxpayer fails or refuses to furnish any information requested in writing by FTB, or fails or refuses to make and file a return as required upon notice and demand by FTB, then unless the failure is due to reasonable cause and not willful neglect, FTB may add a penalty of 25 percent to the amount of tax determined by FTB based upon its estimate of the taxpayer's net income. (R&TC, § 19133.)

California Code of Regulations, title 18, section (Regulation) 19133(b)(2), provides that the demand penalty may only be imposed upon an individual taxpayer where two conditions

have been met: (1) the taxpayer fails to respond to a current demand for tax return in the manner prescribed; and (2) FTB has proposed an assessment of tax after the taxpayer failed to respond to a request or demand for tax return at any time during the four-taxable-year period preceding the taxable year for which the current demand for tax return is issued. This second condition plainly requires that a prior request or demand for tax return be issued by FTB during one of the four preceding tax years.

Illustrating this rule are two examples contained in Regulation 19133(d). Example 1 assumes that a taxpayer has failed to file for the 1999 tax year, and that FTB mails to the taxpayer a request for tax return for the 1999 tax year on January 15, 2001. The taxpayer failed to respond to this request, and FTB issued an NPA on March 20, 2001, assessing tax, a late-filing penalty, and interest, but no demand penalty. Example 2 continues under the same facts as example 1, except that the taxpayer has also failed to file a return for the 2001 tax year. FTB issues a demand for tax return for the 2001 tax year, but will impose the demand penalty should the taxpayer fail to respond because the taxpayer received an NPA for not filing a return within the previous four years.

An inconsistency develops, however, in concurrently applying the second condition above and example 2 to the facts of this appeal. Here, FTB issued the request for tax return for the 2014 tax year to Mr. Maihorn on April 26, 2016, *after* the 2015 tax year. Mr. Maihorn's failure to respond to that request, therefore, could not have occurred during one of the four preceding tax years (i.e., 2010 through 2014). Thus, the second condition of the regulation has not been met. Nevertheless, according to example 2 and consistent with the intent of the regulation, imposition of the demand penalty is warranted because Mr. Maihorn received an NPA for previously failing to timely file his 2014 tax year return.

“Wherever possible, potentially conflicting provisions should be reconciled in order to carry out the overriding legislative purpose as gleaned from a reading of the entire act. [Citation.] A construction which makes sense of an apparent inconsistency is to be preferred to one which renders statutory language useless or meaningless.” (*Hartford Fire Ins. Co. v. Macri* (1992) 4 Cal.4th 318, 326.) Further, in construing a regulation, the primary purpose is to “ascertain the intent of the administrative agency that issued the regulation.” (*Hoitt v. Department of Rehabilitation* (2012) 207 Cal.App.4th 513, 523.) The most reliable indicator of that intent, is the words of the regulation themselves, given their usual and ordinary meaning.

(*People v. Lawrence* (2000) 24 Cal.4th 219, 230.) Every word, phrase, sentence, and part of a regulation should be given significant consideration in discerning its purpose. (*Curle v. Superior Court* (2001) 24 Cal.4th 1057, 1063.) However, that language is not examined in isolation, but in the context of the regulatory framework as a whole to determine the scope and purpose of the regulation and to harmonize its various parts. (*Sierra Club v. Superior Court* (2013) 57 Cal.4th 157, 165.) Where the application of a regulation is unclear, courts may look to extrinsic sources for guidance. (*Sierra Club v. Superior Court* (2013) 57 Cal.4th 157, 166.)

The most pertinent source for determining FTB's intent as to the proper application of Regulation 19133 is the rulemaking file containing FTB's Initial Statement of Reasons, which explains the purpose for why this regulation was promulgated.¹ The Initial Statement of Reasons states that:

It has been the practice of the Franchise Tax Board to assess the notice and demand penalty against all taxpayers who fail to respond to the notice and demand letter, without consideration of their past filing history. Many of these nonfilers are first-time nonfilers Their failure to file their tax return was an isolated incident.

Because of the manner in which the penalty is calculated . . . and because of its application to all nonfilers (irrespective of prior filing history), some have viewed the Franchise Tax Board's policy of assessing a notice and demand penalty as unduly harsh

Under this proposed regulation, the Franchise Tax Board defines a repeat nonfiler as an individual who has received a proposed assessment of tax after receiving and failing to respond to either a request for tax return or a demand for tax return within the previous four years. The Franchise Tax Board has also determined that four years is a reasonable period of time to look back in making a determination as to whether a taxpayer is a repeat nonfiler.

Therefore, the Franchise Tax Board will issue a demand for tax return to those taxpayers who are repeat nonfilers. The failure by the repeat nonfiler to respond to a demand for tax return in the manner and within the time period specified in the demand for tax return will trigger the assessment of the notice and demand penalty on a proposed assessment of tax. On the other hand, the Franchise Tax Board will not assess the notice and demand penalty against those individual taxpayers who are not identified as repeat nonfilers.

(Cal. Reg. Notice Register 2004, No. 17-Z, p. 504.)

¹ The rulemaking file is currently available at FTB's website at: www.ftb.ca.gov/Law/Final_Regulations.shtml

It is apparent from the above language that the purpose of Regulation 19133 is to impose the demand penalty only upon individual taxpayers who are repeat non-filers; that is, those taxpayers who received an NPA for previously failing to timely file within any one of the preceding four taxable years. In keeping with the intent of the drafters, the language set forth in example 2 should control.

To do otherwise would lead to a demonstrably absurd result. Mr. Maihorn's return for the 2014 tax year was due in 2015, making it impossible for FTB to issue the requisite NPA for the 2014 tax year any earlier than 2015. However, a literal application of Regulation 19133(b)(2) would require FTB to do the impossible by issuing the NPA for the 2014 tax year *during* one of the four taxable years prior to 2015.

Therefore, because Mr. Maihorn received an NPA for the 2014 tax year after failing to respond to FTB's request for tax return, he is a repeat non-filer within the meaning of Regulation 19133, and thus, I find that the demand penalty was properly imposed.

Issue 2 – Whether appellants have established that abatement of the demand penalty is warranted due to reasonable cause and the absence of willful neglect.

A demand penalty shall be abated if it is established that the failure to timely file or respond as required upon notice and demand by FTB was due to reasonable cause and not due to willful neglect. (R&TC, § 19133.) Appellants bear the burden of proving that their failure to file or respond after notice and demand was due to reasonable cause. (*Appeal of Bryant* (83-SBE-180) 2019 WL 1187161.) To establish reasonable cause, appellants must demonstrate that they exercised ordinary business care and prudence. (*Appeal of Bieneman* (82-SBE-148) 1982 WL 11825.) Appellants' reason for failing to respond to the demand notice must be such that an ordinarily intelligent and prudent businessperson would have acted similarly under the circumstances. (*Appeals of Cummings* (60-SBE-040) 1960 WL 1418.)

Appellants testified that they did not respond to the Demand because they did not receive it due to their unreliable mail delivery service. Specifically, appellants explained that they have experienced inconsistent mail delivery by the United States Postal Service (USPS) at their address of record for as long as they have lived there beginning in 2005. By way of example, Mrs. Maihorn testified that she was contacted by her prior employer inquiring about her uncashed residual checks, which had to be reissued because she did not receive them the first time they were sent via USPS. According to appellants, they obtain tracking numbers or request

alternate delivery service providers for the delivery of packages or important documents due to the unreliability of the USPS. In support of their testimony, appellants provided printouts of emails from USPS showing pending deliveries of mail with addresses not belonging to appellants. Furthermore, appellants stated that they first received correspondence from FTB regarding the 2015 tax year on or about September 20, 2017, when Mr. Maihorn contacted FTB regarding a notice of balance due.

I find appellants' testimony credible in that they did not receive the Demand. The printouts provided by appellants showing that they received mail intended to be delivered to other addresses corroborate their testimony that their postal delivery is unreliable and bolster their contention that they do not receive 100 percent of their mail, such as Mrs. Maihorn's W-2 forms and residual checks. While it is not direct evidence that appellants' mail such as the Demand was actually delivered to someone else's address, it does support appellants' testimony that their mail is often misdelivered and that they did not receive the Demand.

FTB, however, contends that reasonable cause does not exist here because FTB mailed the Demand to appellants' last-known address and it was not returned as undeliverable. Thus, FTB believes that sufficient notice was provided to appellants. This argument is faulty because appellants do not dispute the sufficiency of the Demand or whether it was in fact mailed; instead, appellants merely assert that they did not receive it due to unreliable postal service. As a result, they did not timely respond to the Demand. Nonetheless, assuming the Demand was properly addressed and mailed, the ultimate question comes down to whether a reasonable businessperson can timely respond to a demand notice that he or she did not receive. And the clear answer to that is a resounding no.

FTB's remaining arguments that appellants acted unreasonably by failing to use a different delivery address or a post office (P.O.) box or to contact the FTB because a Demand may have issued are also misplaced. As applied to the demand penalty, reasonable cause refers to whether appellants acted reasonably in their failure to *respond* to the Demand, as opposed to failure to ensure they *receive* the Demand. The statutory language clearly provides, "if any taxpayer fails or refuses to file a return *upon notice and demand*." (R&TC, § 19133, emphasis added.) In other words, the statute does not require appellants to take reasonable steps before receiving the Demand to secure receipt thereof. Hence, what appellants did or did not do prior to receiving the Demand is irrelevant for a reasonable cause analysis.

Finally, we note that FTB does not contend that appellants' failure to respond to the Demand was due to willful neglect, which is defined as a conscious, intentional failure or reckless indifference. (*United States v. Boyle* (1985) 469 U.S. 241, 245-246.) As discussed above, because appellants had reasonable cause for failing to respond to a demand notice they never received, it cannot be said that appellants acted with conscious, intentional failure or reckless disregard.


Accordingly, I find that appellants' failure to respond to the Demand was due to reasonable cause and not due to willful neglect such that abatement of the demand penalty is warranted.

HOLDINGS

1. The demand penalty for the 2015 tax year was properly imposed.
2. Appellants have established that the demand penalty should be abated due to reasonable cause and the absence of willful neglect.

DISPOSITION

FTB's action is reversed and appellants' claim for refund for the 2015 tax year is granted in full.

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Linda C. Cheng
Administrative Law Judge

D. CHO, concurring opinion:

I concur with the majority opinion's disposition that FTB's action is reversed and appellants' claim for refund is granted. However, I do not join in on the analysis.

As stated by the majority opinion, R&TC section 19133 provides that if a taxpayer fails to file a return upon notice and demand by FTB, then FTB may impose a penalty of 25 percent of the amount of tax assessed pursuant to R&TC section 19087 or of any deficiency tax by FTB concerning the assessment for which the return was required. The penalty will be waived if the failure is due to reasonable cause and not willful neglect. Regulation 19133 further provides that for individuals, the notice and demand penalty will only be imposed if the following two conditions are satisfied:

- (1) the taxpayer fails to timely respond to a current Demand for Tax Return in the manner prescribed, and
- (2) FTB has proposed an assessment of tax under the authority of Revenue and Taxation Code section 19087(a), 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.*

(Regulation 19133(b)(1)-(2), emphasis added.)

In this case, the tax year at issue is the 2015 tax year. As a result, FTB must have proposed an assessment (i.e., issued an NPA) at any time during the 2011 through 2014 tax years, which is the four-taxable-year period preceding the tax year at issue. However, it is undisputed that FTB issued the prior year NPA for not filing a return for the 2014 taxable year on July 6, 2016, which is not within the four-taxable-year period of 2011 through 2014.¹ Accordingly, FTB has not met the second condition imposed by Regulation 19133.

Although the majority opinion believes that we should follow example 2 rather than the language of the Regulation, that example was intended to be an illustration of the rule and not the rule itself. (See Regulation 19133(d).) Furthermore, while "examples set forth in regulations remain persuasive authority *so long as they do not conflict with the regulations themselves*" (*Cook v. Commissioner* (7th Cir. 2001) 269 F.3d 854, 858, emphasis added), there is no dispute

¹ Although FTB provided numerous prior Requests for Tax Returns for the 2010 through 2013 tax years, FTB has not provided an NPA for any of those years that were issued during the four preceding tax year period of 2010 through 2014. As a result, the only NPA in the evidentiary record for this appeal is the NPA issued on July 6, 2016, for the 2014 tax year.

that example 2 creates such a conflict with the language in the Regulation. As a result, I do not believe that it is entitled to any persuasive authority. Therefore, I believe that the language of the Regulation is controlling and not the example.

Based on the foregoing, FTB's denial of appellants' claim for refund should be reversed because the imposition of the demand penalty was improper.

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Daniel Cho
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Daniel K. Cho
Administrative Law Judge

N. DANG, concurring in part and dissenting in part:

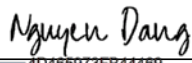
I agree that the demand penalty was properly imposed for the 2015 tax year, but find that there is insufficient evidence warranting abatement of this penalty.

Appellants have not produced sufficient evidence indicating that their mail service was so consistently unreliable as to demonstrate that the Demand, which was properly addressed to their last known address, was likely lost or misdelivered. Evidence that appellants received mail addressed to other individuals, does not necessarily mean that appellants failed to receive their own mail on a regular basis, or that they did not receive the Demand. While I recognize the difficulties inherent in proving non-receipt of the Demand, it is well-established that neither extreme difficulty nor impossibility relieves a taxpayer of his or her burden of proving a material fact upon which the right to relief depends. (*Burnet v. Houston* (1931) 283 U.S. 223, 228.)

Further, I decline to accept appellants' uncorroborated testimony that they did not receive the Demand, as I believe there is another, more likely explanation for their failure to timely respond. Appellants acknowledge that they have a history of late filing and that they did not respond to any of the requests for tax return issued for the 2010 through 2014 tax years.

Appellants explain that these actions were taken based on their mistaken belief that, having substantially overpaid their taxes each year through withholdings, they would incur no penalties for late filing. I believe it is for this reason, that upon receiving yet another similar request from FTB for the 2015 tax year, appellants did not respond to the Demand until after they were informed of the imposition of the demand penalty.

Appellants' ignorance of the law does not constitute reasonable cause warranting abatement of the demand penalty. (See *Appeal of Diebold, Inc.*, (83-SBE-002) 1983 WL 15389.) Accordingly, I would sustain FTB's action denying appellants' refund claim for the 2015 tax year.

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Nguyen Dang
Administrative Law Judge