OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18010692
	)
WILLIAM A. LLANOS	) Date Issued: June 26, 2019
	)
	)
	)

OPINION

Representing the Parties:

For Appellant: David William Polk, a.k.a. David William & David Polk[1]

For Respondent: Andrew Amara, Tax Counsel

J. MARGOLIS, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, William A. Llanos (appellant) appeals an action by the respondent Franchise Tax Board (FTB) proposing additional taxes and penalties for the 2012 tax year.

Office of Tax Appeals Administrative Law Judges Jeffrey I. Margolis, Andrew J. Kwee, and Neil Robinson held an oral hearing in this matter in Sacramento, California, on March 26, 2019. At the conclusion of the hearing, the record was closed and this matter was submitted for decision.

ISSUES

1. Has appellant demonstrated error in FTB's proposed assessment?
2. Is appellant liable for the late-filing penalty imposed under R&TC section 19131?
3. Is appellant liable for the notice and demand penalty imposed under R&TC section 19133?
4. Should a frivolous appeal penalty be imposed under R&TC section 19714 and, if so, in

[1] Appellant submitted a power of attorney form authorizing a "David William" to represent him. At the prehearing telephonic conference in this matter, appellant was represented by an individual who identified himself as "David William." At the appeals hearing, however, it became clear to the panel that "Mr. William" had recently appeared before the Office of Tax Appeals in another matter using a different name, "David Polk." In response to a panel question about his legal name, the representative stated that his legal name is David William Polk, but that he also uses the names David William and David Polk. Appellant's representative is not an attorney.

what amount?

FACTUAL FINDINGS

1. Appellant did not file California income tax returns for many years, despite living and working in California and earning taxable income that far exceeded the applicable filing threshold amount. According to FTB's records, appellant failed to file California returns for at least the years 2001-2014.

2. This appeal concerns appellant's 2012 tax year. Because appellant did not file a California income tax return for that year, FTB issued him a "Demand to File California Personal Income Tax Return" (Demand) on April 20, 2015. The Demand indicated that FTB had received information reported on federal Forms 1099 and W-2 showing that appellant had received income during 2012. The Demand stated: "This is a formal legal demand that you file the required 2012 tax return within 30 days ....."[2]

3. Appellant did not comply with the Demand. Instead, on May 5, 2015, Appellant sent a certified letter to FTB attached to which was a document titled "Request for Determination and California State Tax Return for 2012" (the "Response"). The Response stated, in pertinent part:

> I have been unable to determine whether I have received sufficient federal gross income to require me to file a return with the California FTB. [¶ Nevertheless,] I have attached what I intend to be my return, if I am obliged to file one. . . . [¶] ..... [F]or lack of understanding of the Internal Revenue Code and the many ambiguously defined "terms" that are used throughout that body of law, I am unable to self-determine my liability or whether I have one. I am unwilling to accept any unsworn, anonymous, third party assertions of liability. For lack of knowledge I hereby dispute any such allegations unless and until I may confront the witnesses against me and cross-examine their testimony.[3]

The Response also contained the following notable admissions by appellant:

> "My home and legal domicile are ..... in California."
>
> "The IRS received reports from Space Systems Loral, Inc., ...that I received taxable payments totalling $102,570.25, and from Morgan

[2] FTB's Demand did *not* give appellant the option of explaining why he believed there was no obligation to file; it unambiguously demanded that he file his 2012 California income return by May 23, 2015.

[3] Appellant's Response also purported to impose various demands upon FTB. Those demands are irrelevant to the issues before us.

> Stanley Smith Barney LLC . . . that I had a taxable distribution totaling $30,000.00."
>
> "For the year 2012, I received a TOTAL of $30,000.00 in a distribution from Morgan Stanley, and I received a TOTAL of $102,570.25 in personal payments for which I contracted as a matter of right to support myself and my family."

4. On June 22, 2015, FTB replied to the Response by issuing a "Determination of Filing Requirement/Tax Return Demand." In this notice, FTB reiterated its demand that appellant file a valid California tax return and gave him until July 24, 2015, to do so.
5. On July 2, 2015, Appellant responded by letter to FTB's "Determination of Filing Requirement/Tax Return Demand." In his letter, appellant accused FTB of violating California law and of improperly failing to treat his May 5, 2015 Response as a valid return. Appellant also made several demands of his own upon FTB that are not relevant to the issues before us.
6. On February 4, 2016, FTB issued a Notice of Proposed Assessment (NPA) to appellant for 2012. The NPA was based upon the federal Forms W-2 and 1099 information FTB had received showing that appellant earned wage income of $102,571 and received a taxable distribution of $30,000. The NPA computed a total tax liability for appellant of $9,471, and allowed appellant the tax withholding credits reported on these forms ($3,714), leaving a tax amount due of $5,757. The NPA also proposed a late-filing penalty ($1,439.25), a demand penalty ($2,367.15), and interest.
7. Appellant timely filed an administrative protest from the NPA with FTB.
8. On August 15, 2016, FTB issued a Notice of Action denying appellant's protest and affirming the NPA. In addition to affirming the tax and penalty amounts determined in the NPA, the Notice of Action included the following warning to appellant:

> The State Board of Equalization has regularly imposed up to a $5,000 penalty under Personal Income Tax Law Section 19714 on frivolous appeals after stating, "We take this opportunity to advise all individuals who proceed with frivolous cases that serious consideration will be given to the imposition of damages under Section 19714. The cost of processing an appeal is significant, and we will not condone repeated appeals where the arguments have been considered and rejected previously." Appeals of Fred Dauberger. et al., March 31, 1982.

9. On September 14, 2016, appellant filed this appeal from the Notice of Action with our

predecessor, the State Board of Equalization (SBE). Appellant's appeal letter contains a California return address, below which is the notation, "Without the United States."[4] In his appeal letter, appellant contended that FTB's determination was "based on erroneous information" and that he had zero gross income and zero tax liability for 2012. Appellant attached to his appeal letter self-prepared "corrected" Forms W-2 and 1099 for 2012. The "corrected" forms asserted that appellant received zero income during 2012 from the payors instead of the amounts previously reported by the payors themselves.[5] Appellant also attached a 2012 IRS Form 1040NR, "U.S. Nonresident Alien Income Tax Return," to his appeal. The form was signed by appellant and dated April 12, 2016.[6]

10. Appellant's appeal was acknowledged by the SBE by letter dated October 14, 2016. The acknowledgement letter advised appellant that the SBE may impose up to a $5,000 penalty pursuant to R&TC section 19714 if it determines that appellant's appeal was instituted or maintained primarily for delay, or that appellant's position on appeal was frivolous or groundless.

11. As noted above, appellant has not filed California tax returns for many years. FTB provided evidence showing that for the four taxable years preceding the 2012 year at issue in this appeal (that is, for 2008, 2009, 2010 and 2011), FTB issued Demands to appellant on March 17, 2010, February 16, 2011, December 27, 2011, and January 9, 2013, respectively.[7] NPAs were issued to appellant for those years on June 1, 2010, April 18, 2011, February 29, 2012, and September 16, 2013, respectively.

12. Appellant filed an appeal with the SBE from an FTB Notice of Action issued to him for 2010 determining that he had earned taxable income that year of $100,315 from his employment at Space Systems Loral, Inc. The SBE upheld FTB's position in its entirety and imposed a penalty against appellant under R&TC section 19714 in the amount of

[4] Appellant's reply brief and supplemental reply brief also asserted that appellant's California address was "Without the United States."

[5] Appellant claimed that the previously issued Forms W-2 and 1099 were "incorrect and fraudulent."

[6] Although appellant asserted in his appeal letter that he earned no income in 2012, in the federal Form 1040NR attached to his appeal, he reported $500 of "miscellaneous" income. The nature and source of this income is unclear.

[7] These Demands all were based on information FTB received indicating that appellant earned income from his employer, Space Systems Loral, Inc., during those years.

$750 after determining that the arguments he raised were baseless and frivolous. (*Appeal of William A. Llanos*, Case No. 67177, adopted Feb. 25, 2014.) According to the SBE's Summary Decision, those arguments were that "[appellant] and all single individuals are not subject to tax" and that California cannot tax his income because the federal income tax is an indirect tax on certain activities or privileges and he is not engaged in any activity that is taxable for revenue purposes." (*Id.* at pp. 7-8.) The SBE explained that it was only imposing a $750 penalty (instead of the maximum amount of $5,000) because "this is his first appeal before this Board." (*Id*. at p. 8.) The opinion noted, however, that "**we will not hesitate to impose a higher penalty, up to the statutory maximum of $5,000 per appeal, if he pursues further frivolous appeals.**" (*Ibid*., emphasis in original.)

13. Appellant filed a 2015 California tax return in which he reported the payments he received from Space Systems Loral, Inc., as taxable income. Appellant subsequently filed a claim for refund for 2015 (on Form 540X) claiming that the income he reported for that year was nontaxable.

14. Appellant filed a reply brief dated May 16, 2018. In his reply brief, appellant stated that FTB's "assertion [that appellant had not filed a 2012 California return] is no longer correct," and attached a copy of a Form 540NR for 2012 dated May 14, 2018, reflecting zero wages, $500 of gross income and zero tax liability. Appellant also asserted that he is not contesting that he received the funds reflected in the Forms W-2 and 1099 that were originally issued to him for 2012; instead, he contends that the Form W-2 payments were not payments of wages and that the taxable distribution reflected on the Form 1099 was not gross income. Appellant stated: "[FTB] has arbitrarily attributed veracity to the stated beliefs and opinions of a third party claiming the payments are taxable . . . but has provided no substantive evidence indicating that [they are]." Appellant (referring to himself as "we"), also stated: "We have not disputed the amounts of money we were paid. [However, t]he amounts of money we were paid is not relevant to our dispute." According to appellant, "[m]erely establishing that we received money is not sufficient basis for concluding we had taxable income."

15. In his reply brief, appellant also alleged that the IRS had accepted his federal Form 1040NR for 2012 "as filed." Attached to appellant's reply brief was a copy of an IRS

transcript of his federal tax account for 2012, which indicated that the IRS had processed the Form 1040NR and reduced appellant's 2012 federal income tax liability to zero.

16. Appellant filed a supplemental reply brief dated November 15, 2018, that reiterated the arguments he previously made in this matter.

DISCUSSION

Issue 1 - Has appellant demonstrated error in the proposed assessment?

California residents are taxed upon their entire taxable income, regardless of source. (R&TC, § 17041(a).) R&TC section 17071 incorporates Internal Revenue Code (IRC) section 61, which defines gross income generally as all income from whatever source derived "subject only to the exclusions specifically enumerated elsewhere in the Code." (*United States v. Burke* (1992) 504 U.S. 229, 233.) The sweeping definition of gross income in IRC section 61 specifically includes, among other things, compensation for services, income derived from business, gains derived from dealings in property, interest, rents, royalties, dividends, annuities, and pensions. Income includes any "accessions to wealth." (*Commissioner v. Glenshaw Glass Co.* (1955) 348 U.S. 426, 431; *Appeals of Wesley et al.* (2005-SBE-002) 2005 WL 3106917.) A taxpayer recognizes income if he or she realizes an economic gain, and that gain primarily benefits him or her personally. (*United States v. Gotcher* (5th Cir. 1968) 401 F.2d 118.)

R&TC section 18501(a) requires every individual subject to the California Personal Income Tax Law to file a return with FTB specifically stating the items of gross income from all sources and the deductions and credits allowable if their income exceeds the applicable filing thresholds. R&TC section 19087(a) provides that if a taxpayer fails to file a return, FTB at any time "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."

Where, as here, FTB proposes a tax assessment based on an estimate of a taxpayer's income, FTB's initial burden is to show that its determination is reasonable and rational. (*Appeal of Myers* (2001-SBE-001) 2001 WL 37126924.) The Forms W-2 and 1099 information FTB received from third parties, as well as appellant's own admission that he received the payments at issue, satisfies that burden. (*Appeals of Bailey* (92-SBE-001) 1992 WL 44503 [estimate based on third-party information reporting]; *Appeal of Tonsberg* (85-SBE-034) 1985 WL 15812 [use of third-party information reporting].)

Appellant nevertheless contends that "[FTB] has arbitrarily attributed veracity to the stated beliefs and opinions of a third party claiming the payments are taxable . . . but has provided no substantive evidence indicating that [they are]." Here, however, FTB's determination is amply supported by the evidence (the Forms W-2 and 1099 and appellant's admissions); it is not an arbitrary determination. And where, as here, there is no dispute that a taxpayer received the funds at issue, the burden is on the taxpayer to prove that the amounts received were nontaxable in nature. (*Tokarski v. Commissioner* (1986) 87 T.C. 74, 76-77.) In short, it is not FTB's burden to prove that the amounts appellant received constituted taxable income; it is appellant's burden to prove that they were not. And because FTB has shown a rational basis for its unreported income determination, and the amount of unreported income determined is reasonably based on that evidentiary foundation, FTB's determination is presumed correct, and appellant has the burden of proving error. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Myers, supra*.)

The case of *Hendrickson v. Commissioner*, T.C. Memo. 2019-10 (*Hendrickson*), involves a situation much like the one presented here. In *Hendrickson*, the taxpayers—like Mr. Llanos—argued that the burden of proof should be on the taxing agency since the Forms W-2 and 1099 upon which the taxing agency based its income determination were inadmissible hearsay. Also in *Hendrickson*, as here, the taxpayers submitted "corrected" Forms W-2 and 1099, zeroing out their income. The Tax Court nevertheless rejected the taxpayers' arguments, upholding the IRS's tax determinations and stating: "This use of a zero return, zeroing out wages and compensation and reporting zero tax liability, has been repeatedly characterized as frivolous. " (*Hendrickson, supra,* at p. 6, footnote omitted.)

Appellant's argument that the amounts he received are nontaxable is based on snippets of language taken from irrelevant and readily distinguishable authorities. Appellant ignores the numerous authorities that are directly on point and have rejected his position (including the decision in appellant's own prior appeal to the SBE). (See, e.g., *Hendrickson, supra*; *Boyce v. Commissioner*, T.C. Memo. 1996-439, affd. (9th Cir. 1997) 122 F.3d 1069; *Appeal of Balch*, 2018-OTA-159P; *Appeals of Wesley et al.* (2005-SBE-002) 2005 WL 3106917; *Appeal of Myers, supra*.) Accordingly, we reject appellants' arguments, and hold that appellant has failed to satisfy his burden of proving error in FTB's tax determination.

Finally, appellant does not satisfy his burden of proof simply by relying on an IRS transcript of account for 2012, which reveals that the IRS processed appellant's late-filed Form 1040NR and reduced appellant's federal income tax liability to zero. The fact that the IRS may have processed an obviously incorrect and frivolous return (or made an incorrect adjustment to income) does not require FTB to do the same. (*Appeal of Der Weinerschnitzel International, Inc.* (79-SBE-063) 1979 WL 4104 [final federal determination is not controlling upon FTB]; see also *Jibilian v. Franchise Tax Bd.* (2006) 136 Cal.App.4th 862 [court upholds FTB's refusal to refund taxes attributable to a frivolous return for 2002 even though the IRS processed taxpayer's frivolous federal return for that year and refunded all federal income taxes paid].)

Issue 2 - Is appellant liable for the late-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. (R&TC, § 19131.) The penalty is computed at 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. (R&TC, § 19131(a).) Here, the late-filing penalty appears to have been correctly calculated and appellant has neither alleged nor proven any error in the computation.

The burden is on the taxpayer to establish reasonable cause for the failure to timely file. (*Appeal of Scott* (82-SBE-249) 1982 WL 11906.) Appellant, however, has not demonstrated reasonable cause for his failure to file a tax return by the deadline. Appellant's purported beliefs that he lives "without the United States," is a nonresident alien, is not subject to California tax, and has no taxable income, are without a reasonable basis in fact or law. They do not constitute "reasonable cause" that would excuse appellant's failure to timely file a valid 2012 return. Therefore, appellant is liable for the late-filing penalty.

Issue 3 - Is appellant liable for the notice and demand penalty?

California imposes a penalty for the failure to file a return or provide information upon FTB's demand to do so, unless reasonable cause prevented the taxpayer from responding to the demand in a timely manner. (R&TC, § 19133.) To establish reasonable cause, a taxpayer must show that the failure to respond to a demand occurred despite the exercise of ordinary business care. (*Appeal of Bieneman* (82-SBE-148) 1982 WL 11825.) 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 Malakoff* (83-SBE-140) 1983 WL 15525.)

Appellant argues that he is not liable for the penalty because he timely replied to FTB's Demand by submitting his letter entitled "Request for Determination and California State Tax Return for 2012." Appellant contends that his letter constitutes a valid 2012 tax return because it allegedly satisfies the criteria set forth in *Beard v. Commissioner* (1984) 82 T.C. 766, affd (6th Cir. 1986) 793 F.2d 139) (*Beard*) for constituting a valid tax return. Appellant is wrong.

Appellant's letter was not a valid tax return. In addition to the fact that appellant's letter was not on the form required by FTB rules and regulations, appellant's letter does not meet the criteria set forth in *Beard*. In *Beard,* the Tax Court held that for a document to constitute a valid return it must:

- contain "sufficient data to calculate tax liability,"
- "purport to be a return,"
- "be an honest and reasonable attempt to satisfy the requirements of the tax law," and
- be executed under penalties of perjury.

(*Beard, supra,* 82 T.C. at p. 777.) Although appellant's letter was signed under penalty of perjury, it does not meet the remaining *Beard* criteria. Among other deficiencies, it does not reflect the amount of appellant's taxable income. Instead, the letter states that appellant is "unable to self-determine whether payments I've received are taxable," and is "incapable of self-determining [his] liability." It also states that appellant is refusing to sign California's tax return (Form 540), because it "contains terms I do not understand." Although the letter states appellant "intend[s] that this document is my return if I am required to file one," the document, taken as a whole, does not purport to be a return. Instead, it is a statement of appellant's objections to the demands imposed on him by law, and his attempt to impose various demands on the taxing authority (including his demand that FTB determine appellant's taxable income and tax obligation for him). It is abundantly clear that the document is *not* "an honest and reasonable attempt to satisfy the requirements of the tax law."

Finally, we note that the requirements for imposing the notice and demand penalty contained in Regulation 19133(b) of title 18 of the Code of California Regulations have been satisfied. The record shows that appellant is a "repeat offender," in that during the four-taxable-

year period preceding the 2012 taxable year in dispute in this appeal, he failed to timely respond as required to other FTB Demands for prior years' tax returns and, as a result, FTB issued NPAs to him for those years. Accordingly, appellant is liable for the notice and demand penalty as determined by FTB.

Issue 4 - Should a frivolous appeal penalty be imposed and, if so, in what amount?

In accordance with R&TC section 19714, this agency may impose a penalty of up to $5,000 whenever it appears that a proceeding before it has been instituted or maintained primarily for delay or that the taxpayer's position in the proceeding is frivolous or groundless.[8] Under our Rules for Tax Appeals, 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 the Office of Tax Appeals in a precedential opinion, by the Board 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; (4) whether the taxpayer has a history of filing frivolous appeals or failing to comply with California's tax laws; and (5) whether the taxpayer has been notified, in a current or prior appeal, that a frivolous appeal penalty may apply. (Cal. Code Regs., tit. 18, § 30217(b)(1-5).)[9] The taxpayer meets all five of these criteria.[10]

Here, as noted above, appellant's position has consistently been rejected by us, our predecessor agency and the courts.[11] In fact, the SBE previously imposed a frivolous appeal penalty of $750 for appellant's appeal regarding his 2010 tax year. In its decision, the SBE warned appellant that he would face additional frivolous appeal penalties if he filed further appeals raising baseless arguments, and he has received additional warnings of a potential

[8] R&TC section 19714 refers to proceedings before the SBE, however, Section 20(b) explains that this phrase now refers to the Office of Tax Appeals because the SBE's authority to handle income and business tax appeals has been transferred to this agency.

[9] The Office of Tax Appeals' regulation concerning imposition of the frivolous appeal penalty is virtually identical to its predecessor Board's regulation on this subject. (See Cal. Code Regs., tit. 18, § 5454.)

[10] Although we consider all five criteria in making a penalty determination under R&TC section 19714, it should be noted that satisfaction of all five criteria is *not* required in order for the penalty to be imposed.

[11] See also the IRS publication "The Truth about Frivolous Tax Arguments" (<https://www.irs.gov/privacy-disclosure/the-truth-about-frivolous-tax-arguments-introduction>, updated yearly), which lists and elaborates on frivolous tax positions and provides further explanation and authority for why those positions are frivolous.

frivolous appeal penalty being imposed when he first filed this appeal. These warnings have not deterred him from pursuing the discredited, baseless, and frivolous arguments he has raised in this appeal. Accordingly, we find that imposition of the frivolous appeal penalty in the maximum amount of $5,000 is warranted.

HOLDINGS[12]

1. Appellant has failed to demonstrate any error in the proposed assessment.
2. Appellant is liable for the late-filing penalty as determined by FTB.
3. Appellant is liable for the notice and demand penalty as determined by FTB.
4. We impose a frivolous appeal penalty against appellant in the amount of $5,000 pursuant to R&TC section 19714.

DISPOSITION

FTB's action is sustained in full, and a frivolous appeal penalty of $5,000 is imposed pursuant to R&TC section 19714.

DocuSigned by:
Jeffrey I. Margolis
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Jeffrey I. Margolis
Administrative Law Judge

We concur:

DocuSigned by:
3CADA62FB4864CB...
Andrew J. Kwee
Administrative Law Judge

DocuSigned by:
Neil Robinson
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Neil Robinson
Administrative Law Judge

[12] In reaching our holdings herein, we have considered all arguments made by appellant, and to the extent not mentioned above, we find them to be moot, irrelevant, or without merit.