

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 18042776
ANITA ORTEGA)
) Date Issued: April 25, 2019
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)

OPINION

Representing the Parties:

For Appellant: Anita Ortega

For Respondent: Gi Nam, Tax Counsel

J. ANGEJA, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, Anita Ortega (appellant) appeals an action by respondent Franchise Tax Board (FTB) denying appellant’s claim for refund in the amount of \$3,071.50 for the 2014 tax year.

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

ISSUE

Whether appellant is entitled to abatement of the proposed demand penalty of \$3,071.50 for the 2014 tax year.

FACTUAL FINDINGS

1. Appellant did not file a timely California return for the 2014 tax year. FTB received information from the Internal Revenue Service and the Employment Development Department indicating that appellant received sufficient income to require the filing of a 2014 return. FTB issued a “Demand for Tax Return” (Demand) to appellant dated April 19, 2016, requesting that, by May 25, 2016, appellant file a 2014 return, provide FTB with a copy of her return if already filed, or explain why she was not required to file a

2014 return. The Demand warned that, if appellant did not timely respond, FTB would impose a demand penalty based on 25 percent of appellant's total tax without taking into consideration any timely payments.

2. Appellant failed to timely respond to the Demand, so FTB issued a Notice of Proposed Assessment (NPA) dated June 30, 2016, in which FTB proposed an additional liability for tax, penalties (including the demand penalty at issue herein), and interest, totaling \$6,446.73.
3. Appellant also failed to timely file a return for 2013. On January 22, 2015, FTB issued a Demand for appellant to file a 2013 return by February 25, 2015. Appellant did not timely respond to that Demand, so FTB issued an NPA to appellant for that year on May 11, 2015.¹
4. By letter dated August 20, 2016, appellant stated that she filed her 2014 tax return on April 18, 2016, and enclosed what she stated was a copy of that return.² The return reported tax of \$12,286, payments totaling \$13,592, and claimed a refund of \$1,306. FTB accepted the tax liability as reported on the return, and sent a Notice of Tax Return Change on September 26, 2016, which, as herein relevant, imposed a demand penalty of \$3,071.50,³ resulting in a balance due of \$1,778.13, which appellant paid on October 15, 2016.
5. Appellant filed a timely claim for refund in which she stated that she mailed her 2014 tax return by first class mail with a postmark date of April 18, 2016 from a post office in Rohnert Park, California. Appellant asserts that the demand penalty should be abated because she filed her 2014 tax return by the reply due date specified in the Demand. FTB denied appellant's claim for refund, and this timely appeal followed.

¹ FTB's records show that appellant failed to file tax returns for the 2005, 2006, and 2008 – 2016 tax years. FTB issued Demand Notices for 2010, 2011, and 2012 tax years, but did not issue NPA's for any of those years.

² The parties dispute whether appellant actually mailed her tax return on April 18, 2016. We need not resolve this factual dispute because, based on our analysis and conclusion below, FTB improperly applied the penalty even if appellant had not previously filed the return.

³ The revised demand penalty was calculated based upon 25 percent of the couple's total reported tax liability of \$12,286.

DISCUSSION

California imposes a penalty for the failure to file a return or to provide information upon FTB's demand to do so, unless reasonable cause prevented the taxpayer from responding to the demand. (R&TC, § 19133.) For individual taxpayers, FTB may only impose a demand penalty if a taxpayer fails to respond to a current Demand, and FTB issues an NPA under the authority of R&TC section 19087(a), after the taxpayer failed to timely respond to a Demand at any time during the four taxable years preceding the year for which the current Demand is being issued. (Cal. Code Regs., tit. 18 (Regulation), § 19133(b).) The demand penalty is designed to penalize the failure of a taxpayer to respond to a Demand, and not a taxpayer's failure to pay the proper tax. (*Appeal of Bryant* (83-SBE-180) 2019 WL 1187161; *Appeal of Hublou* (77-SBE-102) 1977 WL 4093.)

Pursuant to R&TC section 19503, FTB has the authority to prescribe rules and regulations necessary to enforce the Personal Income Tax Law. FTB exercised that authority in promulgating Regulation section 19133, which states how FTB will exercise the discretion granted in the demand penalty statute. (See R&TC, 19133 [FTB "may" add a penalty].) That regulation provides that for individuals, the 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. the FTB has proposed an assessment of tax under the authority of Revenue and Taxation Code section 19087, subdivision (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.)

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 FTB'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."].)

FTB appears to apply the regulation in a manner that would substitute the word "for" in place of the word "during." Based upon the plain meaning of the regulation above, we find, contrary to FTB's assertion in this case, that subsection (b)(2) of the regulation requires that an NPA must have been issued after a request to file a tax return (Request) or Demand for a prior year's return at any time "*during* the four-taxable-year period preceding" the current tax year for which FTB seeks to impose the demand penalty. 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 to a Demand must have occurred at any time during the four-taxable-year period preceding the taxable year for which the demand penalty is at issue. Moreover, giving each phrase its plain, common meaning, as required by *Butts*, the usage of "at any time," followed by the word "during" does not lend itself to an alternate meaning. (See R&TC, § 19133(b)(2).) If "during" is interpreted as "for," the words "at any time" become meaningless surplus words. FTB's proposed application of the regulation would ignore that phrase, while we must give significance to every word, phrase, and sentence. (*Curle v. Superior Court* (2001) 24 Cal.4th 1057, 1063.)

The taxable year for which FTB desires to impose the demand penalty is 2014. In order to apply the demand penalty consistent with the regulation, appellant must have failed to respond to a prior Request or Demand that resulted in an NPA having been issued, in either 2010, 2011, 2012, or 2013 (the four tax-year period preceding 2014). However, appellant's failure to respond to FTB's prior Request occurred in 2015. Thus, FTB cannot apply the penalty in this appeal consistent with its own regulation.

Although the plain meaning of the regulation is clear, an ambiguity exists between the regulation and its Example 2. To the extent that Example 2 of regulation § 19133 is inconsistent with the result herein, 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. (*Ibid.*) Subsequently a Demand and NPA were issued for 2001,

and the example states that the demand penalty would be properly applied. (*Ibid.*) The application in the illustrative example conflicts with the plain language of the regulation.

As stated in section 19133(d), the examples are only “intended to illustrate the provisions of this regulation.” The examples at issue here constitute FTB’s interpretation of its regulation. FTB, in promulgating the regulation, exercised its discretion and determined under what circumstances the statutory penalty would apply. 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 (*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, supra*, at pp. 7-8; *Agnew v. State Board of Equalization* (1999) 21 Cal.4th 310, 322.)

Regulation § 19133 is unambiguous – its plain language says what it means. Deferring to the agency’s interpretation here would permit FTB to “create *de facto* a new regulation.” (See *Christensen v. Harris County* (2000) 529 U.S. 576, 588 [rejecting deference to an agency letter that was intended to interpret the agency’s regulation].) As discussed above, the plain language of Regulation 19133(b) states that a taxpayer’s failure to respond to a Demand must have occurred during one of the four taxable years preceding the taxable year for which the second Demand and NPA were issued. To the extent that Example 2 of Regulation 19133, which is simply an interpretation of the rule, suggests that the first failure must have occurred *for* one of the four preceding taxable years, we hold that it is inconsistent with the unambiguous language of the regulation and is incorrect.⁴

Because appellant’s failure to respond to the Demand for the 2013 tax year did not occur during any of the four taxable years prior to 2014, the demand penalty may not be imposed for 2014.

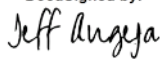
⁴ We note that the concerns of the dissent would be best addressed by the well-vetted regulatory process of proposing or amending regulations (which typically includes opportunity for public input and review by the Office of Administrative Law).

HOLDING

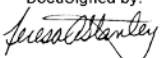
FTB did not properly apply its regulation in assessing the demand penalty; therefore, we abate the proposed penalty.

DISPOSITION

FTB's action in denying the claim for refund is reversed.

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Jeffrey G. Angeja
Administrative Law Judge

I concur:

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Teresa A. Stanley
Administrative Law Judge

DISSENTING OPINION

N. DANG, Administrative Law Judge: I respectfully dissent. The proper interpretation of California Code of Regulations, title 18, section (Regulation) 19133, requires that the regulatory language be examined in its entirety to ascertain and effectuate the true purpose of the regulation. Relying solely upon the ordinary meaning of “during,” without due consideration for the entirety of the regulatory language leads to a demonstrably “absurd result” which is directly contrary to FTB’s expressly stated purpose for promulgating this regulation.

It is well established that the rules of statutory construction apply equally to the interpretation of administrative regulations. (*Hoitt v. Department of Rehabilitation* (2012) 207 Cal.App.4th 513, 523.) In construing a regulation, the primary purpose is to “ascertain the intent of the administrative agency that issued the regulation.” (*Ibid.*) 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.) “If the language is clear, courts must generally follow its plain meaning unless a literal interpretation would result in absurd consequences the [administrative agency] did not intend.” (*Id.* at pp. 164–165.)

When considered in its entirety, the language of Regulation 19133 is unclear as to the proper application of the demand penalty. As stated in the majority opinion, the plain language of subdivision (b)(2) provides that FTB will impose the demand penalty only where the requisite NPA was issued *during* one of the prior four taxable years. However, Example 2 of the regulation, as provided in subdivision (d), indicates that FTB will impose the demand penalty where the requisite NPA was issued *for* one of the prior four taxable years. That example is not a post-enactment interpretation taken by FTB, but part of the text of the enacted regulation itself, and, along with subdivision (b)(2), should be given significant consideration in determining the intent of the drafter. The plain meaning of these two subdivisions of Regulation 19133 are in direct conflict, and call for substantially differing applications of the demand penalty. And

where, as here, the application of a regulation is unclear, courts may look to extrinsic sources for guidance. (*Sierra Club v. Superior Court, supra*, 57 Cal.4th at p. 166.)

FTB's rulemaking file for Regulation 19133 contains 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.)

It is clear from the above language that the purpose of Regulation 19133 is to mitigate the perceived "harshness" of the demand penalty by only imposing it upon repeat nonfilers. However, this purpose is frustrated by applying a literal reading of subdivision (b)(2) to the facts of the instant appeal; that is, it would prevent FTB from imposing the demand penalty upon a repeat nonfiler where the failure to file occurs in two consecutive years.

Here, appellant failed to file returns for the 2013 and 2014 taxable years. Appellant's return for the 2013 tax year was due in 2014, making it impossible for FTB to issue the requisite

¹ As of April 7, 2019, the rulemaking file is currently available at FTB's website at: <www.ftb.ca.gov/Law/Final_Regulations.shtml>

NPA for the 2013 tax year any earlier than 2014. However, a literal application of subdivision (b)(2), would require FTB to do the impossible by issuing the NPA for the 2013 tax year *during* one of the four taxable years prior to 2014 (e.g., 2013, 2012, 2011, or 2010). This would prevent FTB from imposing the demand penalty upon appellant, even though she was a repeat nonfiler. This is an absurd result which is not in keeping with the purpose of Regulation 19133.

A literal application of subdivision (b)(2) also fails to properly account for the taxpayer's prior four-year filing history. By requiring only that FTB issue the requisite NPA *during* the prior four years, that NPA could conceivably be issued *for* any tax year open to assessment. The absurdity of this interpretation is best demonstrated where no return is filed. In this situation, there would be no time limit for FTB to issue the requisite NPA. (§ 19057.) Thus, where the taxpayer fails to file a return, FTB could have issued the requisite NPA for a tax year decades past, so long as it was issued *during* one of the four prior taxable years. This would in effect, eliminate the originally contemplated four-year lookback period for evaluating whether a taxpayer was a repeat non-filer for purposes of imposing the demand penalty. Thus, contrary to the stated purpose of Regulation 19133, taxpayers who previously made timely returns for the prior four years would be subject to the demand penalty.

While the majority is correct that, as a general principle, courts should not seek to rewrite the plain and unambiguous language of a statute, “[t]hat rule is not applied, however, when it appears clear that a word has been erroneously used, and a judicial correction will best carry out the intent of the adopting body.” (*People v. Skinner* (1985) 39 Cal.3d 765, 775.) For example, the inadvertent use of “and” where the clear intent or purpose of a statute requires “or,” is one such situation “which may properly be rectified by judicial construction.” (*Ibid.*) The determination of whether a word was used erroneously, is accomplished by referring to the purpose of the statute and the intent of the adopting body. (*Id.* at p. 776.) Based on the above language from FTB's Initial Statement of Reasons, Example 2 of the regulation, and the demonstrably absurd results which follow a literal interpretation of subdivision (b)(2), it is apparent that the use of the word “during” was the result of a drafter's error. Under these circumstances, substituting the intended “for” in place of “during” in subdivision (b)(2) is necessary to properly effectuate the stated purpose of the regulation. Therefore, I would sustain FTB's imposition of the demand penalty.

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Nguyen Dang
Administrative Law Judge