

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 18042896
)
M. CHANDRA SHEKARAN AND) Date Issued: April 24, 2019
JENNIFER M. SHEKARAN)
)
_____)

OPINION

Representing the Parties:

For Appellants: M. Chandra Shekaran

For Respondent: David Kowalczyk, Tax Counsel

K. GAST, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC) section 19324(a), M. Chandra Shekaran and Jennifer M. Shekaran (appellants) appeal an action by respondent Franchise Tax Board (FTB) in denying their claim for refund of \$5,811 for the notice and demand penalty (the demand penalty) for the 2015 tax year. Appellants waived their right to an oral hearing. Therefore, this matter is being decided based on the written record.

ISSUE

Are appellants liable for the demand penalty imposed under R&TC section 19133?

FACTUAL FINDINGS

1. On May 30, 2017, FTB issued to appellants a Demand for Tax Return (Demand) because its records indicated their 2015 California resident income tax return had not been filed and they had received sufficient income to trigger a filing obligation. The Demand required appellants to respond by a certain date, by either filing a 2015 tax return, sending a copy of the return if one had been filed, or explaining why they were not required to file a return. Appellants did not respond.

2. Subsequently, FTB issued a Notice of Proposed Assessment (NPA), which assessed tax—based on income reported by third-party sources—and, among other things, the demand penalty.
3. Appellants ultimately filed—and subsequently amended—their joint 2015 California resident income tax return. On both these returns, they reported a tax due of \$23,244, which FTB accepted.
4. After processing appellants’ 2015 tax return, FTB issued a Notice of Tax Return Change, reducing the originally-assessed demand penalty to \$5,811.¹ Appellants paid it.
5. Appellants timely filed a claim for refund, requesting the demand penalty be abated based on reasonable cause grounds.
6. FTB denied the refund claim, asserting appellants did not establish reasonable cause for abatement. This timely appeal followed.
7. As relevant here, FTB had previously issued an NPA dated March 21, 2016, for appellants’ failure to file a 2014 tax return. This NPA was issued after appellants did not respond to FTB’s Request for Tax Return (Request) dated January 19, 2016, for their 2014 tax return.

DISCUSSION

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, unless the failure is due to reasonable cause and not willful neglect. California Code of Regulations, title 18, (Regulation) section 19133 further provides that for individuals, the demand penalty will only be imposed if the follow 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

¹ FTB’s NPA originally assessed tax of \$26,344 and the demand penalty of \$6,586, which was computed at 25 percent of the tax due, without regard to timely payments and withholding credits. When appellants filed their 2015 tax return, they self-reported tax of \$23,244, which FTB accepted. Thus, the demand penalty was reduced to \$5,811.

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.)

Under the plain and unambiguous language of subsection (b)(2) above, we find, contrary to FTB's interpretation and application to the facts here, that this subsection requires the NPA for a prior tax year to have been issued at any time "*during the four-taxable-year period preceding*" the current tax year for which FTB seeks to impose the demand penalty. Here, to properly impose the demand penalty for the 2015 tax year, FTB's regulation requires that FTB have issued an NPA for a prior tax year on a date anytime between January 1, 2011, through December 31, 2014. This threshold requirement has not been met in this case.²

Specifically, rather than being issued "*during the four-taxable-year period preceding the taxable year for which the current [Demand] is issued,*" FTB's NPA for the 2014 tax year was not issued until March 21, 2016, which is *after* the 2015 tax year "*for which the current [Demand] is issued.*" Therefore, FTB improperly imposed the demand penalty.

We also note that Example 2 of the regulation appears to apply the regulation as if it stated that the demand penalty could be issued if an NPA were issued "*within the previous four years.*" On this ground, the example contemplates imposition of the demand penalty for the 2001 tax year where the prior NPA for the 1999 tax year was issued on a date during the 2001 tax year. Thus, the example imposes the demand penalty when the prior NPA was issued during the *same* tax year for which the current Demand is issued.

However, this example is directly contrary to the operative language of the regulation that requires that the prior NPA have been issued "*during the four-taxable-year period preceding the taxable year for which the current [Demand] is issued.*" (Emphasis added.) Thus, FTB's regulation is internally inconsistent. However, the operative language of the regulation is unambiguous. It carefully and precisely references "*the four-taxable-year period preceding*" the tax year for which the current Demand is issued. Rather than interpreting the operative language of the regulation, the example appears to overlook or disregard that language. In this circumstance, we see no reason to place greater weight on the implication of the example than on

²Note that we do not address whether, during the four tax years preceding the current year, appellants must have failed to respond to the prior year's Request (dated January 19, 2016) and/or the prior year's NPA (dated March 21, 2016) must have been issued, since neither occurred here.

the clear and precise operative language. We therefore resolve the internal conflict in FTB's regulation by finding that FTB is bound by the ordinary and unambiguous meaning of the words used in the governing language of its regulation.

HOLDING

Appellants are not liable for the demand penalty.

DISPOSITION

FTB's action is reversed, and appellants are due a refund of \$5,811, plus applicable interest.

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Kenneth Gast
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Kenneth Gast
Administrative Law Judge

We concur:

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Sara A. Hosey
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Sara A. Hosey
Administrative Law Judge

DocuSigned by:
Alberto T. Rosas
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Alberto T. Rosas
Administrative Law Judge