

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:

JOSEPH REITER

) OTA Case No. 18011180
)
) Date Issued: May 15, 2019
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)
)

OPINION

Representing the Parties:

For Appellant: Joseph Reiter¹
For Respondent: Mira Patel, Tax Counsel

D. CHO, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, Joseph Reiter (appellant) appeals an action by respondent Franchise Tax Board (FTB) in denying appellant’s protest of a proposed assessment of \$1,742 of additional tax, a late-filing penalty of \$435.50, a demand penalty of \$435.50, a filing enforcement fee of \$79, and applicable interest, for the 2014 tax year.

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

ISSUES

1. Whether appellant has demonstrated error in FTB’s proposed assessment of additional tax.
2. Whether appellant has demonstrated reasonable cause for his failure to file a timely return.
3. Whether FTB properly imposed a notice and demand penalty.
4. Whether appellant has established that the filing enforcement cost recovery fee should be abated.

¹ Although appellant submitted the appeal letter, the Tax Appeals Assistance Program (TAAP) subsequently represented appellant during the appeal; however, on or about April 12, 2017, TAAP informed the Office of Tax Appeals that it no longer represented appellant. TAAP did not file any briefs in this appeal.

FACTUAL FINDINGS

1. At all relevant times, appellant was a California resident. However, appellant did not file a California return for the 2014 tax year on or before the filing deadline of April 15, 2015.
2. Subsequently, FTB received information reported by First American Title Company showing that appellant received gross proceeds of \$100,000 from a sale of real property located in Covelo, California (Covelo Property) during the 2014 tax year. Based on this information, FTB issued a Demand for Tax Return (Demand) dated December 16, 2015, which required appellant to do one of the following on or before January 20, 2016: file a 2014 tax return, provide a copy of his 2014 tax return if it was already filed, or provide an explanation as to why he did not have to file a 2014 tax return.
3. Appellant requested additional time to respond to the Demand, and FTB granted appellant's request, allowing appellant until February 19, 2016, to file a return for the 2014 tax year. However, appellant did not file a 2014 tax return or provide an explanation as to why he did not have an obligation to file a return.
4. Consequently, FTB issued a Notice of Proposed Assessment (NPA) dated March 14, 2016, that proposed a tax liability of \$1,742 based on an estimated taxable income amount of \$50,000. FTB calculated appellant's income by taking one-half of the gross proceeds of the \$100,000 that was reported from the sale of the Covelo Property. FTB also imposed a late-filing penalty of \$435.50, a demand penalty of \$435.50,² and a filing enforcement cost recovery fee of \$79, plus applicable interest.
5. By letter dated March 23, 2016, appellant protested the NPA, stating that he did not have a filing obligation for the 2014 tax year. Appellant asserted that he purchased the Covelo Property for \$60,727.85 and subsequently sold the real property for \$64,648.33. As a result, it was appellant's understanding that any gain from the sale of the real property would be reduced to zero after applying the standard deduction, and he would therefore owe no tax. In support of this argument, appellant provided a copy of a "Buyer's Final Settlement Statement" (Buyer's Statement) and a copy of a "Seller's Final Settlement

² On June 9, 2015, FTB issued a Demand to appellant for the 2013 tax year. Appellant did not respond to the 2013 Demand, so FTB issued an NPA for the 2013 tax year dated September 28, 2015.

Statement” (Seller’s Statement) from First American Title Company that purported to be for the purchase and sale of the Covelo Property.

6. In response, FTB issued a letter dated May 26, 2016, informing appellant that he had a filing obligation based on the sale of the Covelo Property as well as any other gross income from all other sources. Accordingly, FTB requested that appellant file a 2014 tax return.
7. Appellant did not file a 2014 tax return, and FTB issued a Notice of Action (NOA) dated August 3, 2016, that affirmed the NPA.
8. This timely appeal followed.³

DISCUSSION

Issue 1 – Whether appellant has demonstrated error in FTB’s proposed assessment of additional tax.

Generally, California conforms to section 61 of the Internal Revenue Code (IRC) (see R&TC, § 17071), which defines gross income as all income from whatever source derived, unless specifically excluded. (IRC, § 61(a).)⁴ California also conforms to the general provisions of the IRC relating to the treatment of gain or loss from the disposition of property. (R&TC, § 18031.) IRC section 1001(a) computes the gain from the disposition of property as the excess of the amount realized over the adjusted basis in the property.

R&TC section 18501(a) requires every individual subject to the PITL to make and file a return with FTB “stating specifically the items of the individual’s gross income from all sources and the deductions and credits allowable”⁵ If any taxpayer fails to file a return, FTB may make an estimate of their net income, from any available information, and may propose to assess the amount of tax, interest, and penalties due. (R&TC, § 19087(a).) If FTB makes a tax

³ Subsequently, FTB requested a copy of appellant’s federal Wage and Income Transcript for the 2014 tax year in which it was reported that appellant received gambling winnings totaling \$301,204, in addition to the proceeds from the sale of the Covelo Property. FTB did not determine that appellant had net income from gambling during 2014 or issue a new NPA that included appellant’s gambling winnings in his income.

⁴ For the 2014 tax year, R&TC section 17024.5(a)(1)(O) provides that for Personal Income Tax Law (PITL) purposes, California conforms to the IRC as of a January 1, 2009 specified date. Thus, references to the IRC are to the version in effect on January 1, 2009.

⁵ For the 2014 tax year, a California resident that was under 65 years of age, with no dependents, and who claimed a single filing status had an obligation to file a return with FTB if he or she had gross income of \$16,047 or more; or if his or her California adjusted gross income was \$12,838 or more.

assessment based on an estimate of income, FTB's initial burden is to show why its assessment is reasonable and rational. (*Appeal of Myers*, 2001-SBE-001, May 31, 2001.) An assessment based on unreported income is presumed correct when the taxing agency introduces a minimal factual foundation to support the assessment. (*In re Olshan* (9th Cir. 2004) 356 F.3d 1078, 1084 (quoting *Palmer v. Internal Revenue Service* (9th Cir. 1997) 116 F.3d 1309, 1312); see also *Appeals of Bailey*, 92-SBE-001, Feb. 20, 1992.) When a taxpayer fails to file a valid return and refuses to cooperate in the ascertainment of his or her income, FTB is given "great latitude" in estimating income. (*Appeals of Tonsberg*, 85-SBE-034, Apr. 9, 1985.) "[A] taxpayer is not in a good position to criticize [FTB's] estimate of his or her liability when he or she fails to file a required return and, in addition, subsequently refuses to submit information upon request." (*Appeals of Dauberger et. al.*, 82-SBE-082, Mar. 31, 1982.)

Once FTB has met its initial burden by linking the taxpayer with an income-producing activity, the taxpayer has the burden of proving that the assessment is arbitrary or erroneous. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509, 514; *Appeal of Myers*, *supra*.) Unsupported assertions are not sufficient to satisfy the taxpayer's burden of proof. (*Appeal of Magidow*, 82-SBE-274, Nov. 17, 1982.) California Code of Regulations, title 18, section (Regulation) 30705(c), states that except as otherwise provided by law, "the burden of proof requires proof by a preponderance of the evidence."⁶

In this instance, FTB estimated appellant's income for the 2014 tax year based on information that it received, which reported that appellant sold the Covelo Property for a total consideration of \$100,000 in 2014. FTB estimated appellant's income by taking one-half of the gross proceeds and concluding that amount to be all of appellant's income for the 2014 tax year. Based on this information, we find that FTB met its initial burden. Accordingly, the burden shifts to appellant to demonstrate an error with the proposed assessment.

At protest, appellant stated that he purchased the Covelo Property for \$60,727.85, and in support of this statement, appellant provided the Buyer's Statement and Seller's Statement and an explanation that these documents represent his purchase and sale of the Covelo Property at issue in this appeal. Although the property description in the Buyer's Statement is listed as vacant land while the Seller's Statement lists a parcel number, the property referenced in both

⁶ A preponderance of evidence means that the taxpayer must establish by documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (*Concrete Pipe & Products of Cal., Inc. v. Construction Laborers Pension Trust for Southern Cal.* (1993) 508 U.S. 602, 622.)

documents is located in Covelo, California and in the same zip code of 95428. Furthermore, FTB has presented no evidence to dispute appellant's statement and supporting documentation. Instead, FTB has repeated its argument that appellant had a filing obligation.⁷ Based on all of the evidence, we conclude that it is more likely than not that appellant purchased the Covelo Property for \$60,717.85, which would establish his initial cost basis as a starting point in computing any gain on the sale of such property.

With respect to appellant's argument that he only received \$64,648.33 cash at the time of the sale, the Seller's Statement indicates that appellant also received a promissory note from the purchaser in the amount of \$30,000. While IRC sections 453 and 1001(d) allow for the deferral of gain for installment payments, appellant has not provided any information to determine when any or all of the \$30,000 loan repayment was received by him. Specifically, appellant has not established that he received a payment after the 2014 tax year as required by IRC section 453(b). Without this information, we are unable to determine whether appellant is eligible to defer the recognition of gain attributable to this promissory note to a later taxable year. Therefore, we conclude that appellant has failed to demonstrate that he did not receive the \$94,648.33 shown on the First American Title Company and the Seller's Statement.

Because appellant established his initial cost basis of \$60,727.85 in the Covelo Property, appellant could not have recognized \$50,000 of gain in the sale of the real property. Therefore, we conclude that FTB must recalculate appellant's gain from the sale of the Covelo Property using an amount realized of \$94,648.33, minus appellant's adjusted basis in the property as determined by the Buyer's Statement, and minus any selling expenses as reported in the Seller's Statement.

Issue 2 – Whether appellant has demonstrated reasonable cause for his failure to file a timely return.

R&TC section 19131 provides that FTB shall impose a late-filing penalty when a taxpayer fails to file a tax return on or before its due date unless the taxpayer establishes that the late filing was due to reasonable cause and was not due to willful neglect. The penalty is

⁷ FTB based this conclusion on the presence of gambling winnings and the sale of the Covelo Property. However, FTB has not asserted that any of the gambling income is at issue in the appeal of the current NPA and NOA. Therefore, the issue of the gambling income is outside of the scope of this appeal, and we do not address it.

computed at five 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).)

A taxpayer has the burden of establishing reasonable cause. (*Appeal of Myers, supra.*) As a general matter, for a taxpayer to establish that a failure to act was due to reasonable cause, the taxpayer must show that the failure occurred despite the exercise of ordinary business care and prudence, or that cause existed as would prompt an ordinarily intelligent and prudent businessman to have so acted under similar circumstances. (*Appeal of Bieneman*, 82-SBE-148, July 26, 1982; *Appeal of Tons*, 79-SBE-027, Jan. 9, 1979.) Ignorance of the law does not excuse the failure to file a timely return. (*Appeal of Diebold, Inc.*, 83-SBE-002, Jan. 3, 1983.) In addition, the United States Supreme Court has found that each taxpayer has a personal, non-delegable obligation to file a tax return by the due date. (*United States v. Boyle* (1985) 469 U.S. 241, 252.)

It is undisputed that appellant did not file a 2014 tax return on or before the filing deadline of April 15, 2015. Appellant appears to argue that he did not need to file a 2014 tax return by the deadline because he did not have a filing requirement. However, as we found above, even with the adjustment to appellant's basis in the Covelo Property, appellant would have gross income of approximately \$33,920.48 (\$94,648.33 - \$60,727.85), which is significantly greater than the minimum threshold amount of \$16,047 for an obligation to file a California return as stated in footnote 5, *supra*. As such, appellant had sufficient income to warrant the filing of a 2014 tax return, and appellant's ignorance of the law does not excuse his failure to file a timely return. (*Appeal of Diebold, Inc., supra.*) Therefore, appellant has not shown reasonable cause for his failure to file a timely 2014 tax return.

Issue 3 – Whether FTB properly imposed a notice and demand penalty.

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. Regulation 19133 further 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.*

(Cal. Code Regs., tit. 18, § 19133(b)(1)-(2), emphasis added.)⁸

In this case, the taxable year at issue is the 2014 tax year. As a result, FTB must have proposed an assessment (i.e., issued an NPA) at any time during the 2010 through 2013 tax years, which is the four-taxable-year period preceding the taxable year at issue. However, it is undisputed that FTB issued the NPA for not filing a return for the 2013 tax year on September 28, 2015, which is after the four-taxable-year period of 2010 through 2013. Accordingly, FTB has not met the second condition imposed by Regulation 19133. Therefore, we find that the FTB erred in proposing to assess a demand penalty.

Issue 4 – Whether appellant has established that the filing enforcement cost recovery fee should be abated.

R&TC section 19254(a)(2) requires FTB to impose a filing enforcement cost recovery fee in the event a taxpayer fails to file a return within 25 days after FTB mails a Demand to the taxpayer. There is no reasonable cause exception or other exception that permits the abatement of this fee. (See *Appeal of Myers, supra.*) Here, the fee was properly imposed after appellant failed to file a 2014 tax return within 25 days of the issuance of the Demand dated December 16, 2015. Accordingly, we find that appellant is liable for the filing enforcement cost recovery fee.

HOLDINGS

1. FTB is to recalculate appellant's taxable gain using an amount realized of \$94,648.33 minus appellant's adjusted basis of \$60,727.85 as stated in the Seller's and Buyer's Statements.
2. Appellant has not demonstrated reasonable cause for his failure to file a timely return.

⁸ Although Example 2 in Regulation 19133 appears to be in conflict with the language in the regulation, we note that the operative language in the regulation is unambiguous. As a result, we find that the language in the regulation to be controlling.

- 3. The notice and demand penalty was improperly imposed and shall therefore be deleted from the assessment.
- 4. Appellant has not established that the filing enforcement cost recovery fee should be abated.

DISPOSITION

FTB shall recalculate appellant’s tax liability for the 2014 tax year as stated above. Otherwise, FTB’s action is sustained as to the late-filing penalty and the filing enforcement cost recovery fee and reversed as to the notice and demand penalty.

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Daniel K. Cho

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 Daniel K. Cho
 Administrative Law Judge

We concur:

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Kenneth Gast

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 Kenneth Gast
 Administrative Law Judge

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Alberto T. Rosas

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 Alberto T. Rosas
 Administrative Law Judge