

**OFFICE OF TAX APPEALS**  
**STATE OF CALIFORNIA**

In the Matter of the Appeal of:  
**GLENN J. MORO**

) OTA Case No. 18011757  
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) Date Issued: November 6, 2019  
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**OPINION**

Representing the Parties:

For Appellant: Bette Kiser, CPA

For Respondent: Meghan McEvilly, Tax Counsel III

For Office of Tax Appeals: Andrea Long, Tax Counsel

P. KUSIAK, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, Glenn J. Moro (appellant) appeals an action by respondent Franchise Tax Board (FTB) proposing additional tax of \$6,296, imposing a late filing penalty of \$1,574, a demand penalty of \$1,574, a filing enforcement fee of \$84, and applicable interest, for the 2015 tax year. After the completion of briefing in this case, FTB stated that it will abate the demand penalty.

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

**ISSUES**

1. The amount of California-source income nonresident appellant received from a California business.
2. Whether appellant timely filed his California tax return for 2015.
3. Whether appellant has established reasonable cause for failing to timely file a 2015 return.
4. Whether appellant is entitled to the abatement of the filing enforcement fee.

FACTUAL FINDINGS

1. Appellant asserts he mailed his 2015 Nonresident Return (Form 540NR) to FTB on October 8, 2016. FTB asserts it has no record of receiving appellant's 2015 return prior to the filing of this appeal.
2. Appellant separately mailed a check to FTB for \$272, dated October 8, 2016, with a notation in the memo line, "2015 Tax Return." Because FTB's records did not reflect receipt of a 2015 return, FTB did not apply the payment to appellant's 2015 account. However, FTB's records indicated appellant had an unpaid tax liability for 2014. FTB applied appellant's payment of \$272 to this 2014 liability.
3. FTB received information that during 2015 appellant received non-employee income of \$99,996 from NovaBay Pharmaceuticals, Inc. (NovaBay), as reported on a Form 1099-MISC. According to public records provided by FTB, NovaBay is registered and has a location in California.
4. FTB sent appellant a Demand dated April 19, 2017, stating that it had no record of receiving appellant's 2015 return. The Demand required appellant to file a 2015 return, provide evidence that he already filed a 2015 return, or explain why he was not required to file a 2015 return.
5. Appellant's timely response to the Demand consisted of copies of the following: the Demand, a letter from appellant to FTB dated October 8, 2016, and a check from appellant for \$272, also dated October 8, 2016. Appellant's October 8, 2016 letter states, "[p]lease find my check for \$272.00 for the tax year 2015. This goes with the return 540NR long form[.]" Appellant's response to the Demand provided no other information.
6. FTB determined that, because NovaBay was a California business and appellant performed services for NovaBay, appellant had California-source income. On August 7, 2017, FTB sent appellant a Notice of Proposed Assessment (NPA), with estimated income of \$99,996, a standard deduction of \$4,044,<sup>1</sup> and taxable income of \$95,952. The NPA proposed a total tax liability of \$6,296, imposed a late filing penalty

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<sup>1</sup> FTB applied the standard deduction for a single individual with no dependents. For the 2015 tax year, a single individual under age 65 with no dependents realizing a California gross income of \$16,256 or a California adjusted gross income (AGI) of \$13,005 was required to file a California income tax return.

- of \$1,574, a demand penalty of \$1,574<sup>2</sup>, and a filing enforcement fee of \$84, plus interest.
7. On August 14, 2017, appellant protested the NPA but did not provide any facts or documentation to explain and support his position.
  8. On October 5, 2017, FTB issued a Notice of Action (NOA) affirming the NPA.
  9. On November 1, 2017, FTB received from appellant a corrected Form 1099-MISC, that showed Texas in box 17, “State/Payer’s state no.” with a handwritten notation stating, “This 1099 Form is corrected to reflect payee’s State of TX instead of CA.”
  10. Appellant filed a timely appeal.
  11. On June 18, 2018, FTB received appellant’s 2015 Form 540NR, signed on May 15, 2018, as well as a letter from appellant dated June 1, 2018, indicating the return is a copy of appellant’s 2014 return that he originally mailed to FTB on October 8, 2015. The 2015 return reported federal adjusted gross income (AGI) of \$256,438, a California adjustment of \$1,587, and itemized deductions of \$16,655 for a total taxable income of \$241,370. Schedule CA (540NR) reported a California AGI of \$3,531. Appellant’s return reported business income of \$99,996, but reported only \$4,700 as taxable by California. Appellant asserts the amount of \$4,700 was allocated based upon the number of days working in California.<sup>3</sup> Appellant reported California taxable income of \$3,303.
  12. FTB automatically processed appellant’s 2015 return, which resulted in the issuance of a Notice of Tax Change – Revised Balance (Notice) dated June 25, 2018. The Notice states that FTB made changes to appellant’s 2015 return, which resulted in a balance of \$441.16, consisting of tax of \$272, a late filing penalty of \$135, and interest of \$34.16. On July 7, 2018, FTB received from appellant a credit card payment of \$441.16.<sup>4</sup> On July 13, 2018, FTB sent appellant and his representative a copy of FTB’s opening letter-

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<sup>2</sup> As indicated above, FTB has abated the demand penalty.

<sup>3</sup> The nonresident return filed by appellant indicated he spent 12 days in CA for any purpose. Although appellant asserts a workday formula was used to allocate NovaBay income, it is unclear from the record how many days in 2015 appellant was working for NovaBay in California, the total number of days in 2015 he was working for NovaBay, or how appellant arrived at \$4,700.

<sup>4</sup> On appeal, FTB indicates that it is holding appellant’s payment of \$441.16 until this appeal is resolved and that the amounts at issue in this appeal remain the same as listed on the NOA.

brief in this matter, explaining its position in this appeal and informing them that FTB inadvertently processed appellant's 2015 tax return, which was not accepted by FTB.

### DISCUSSION

#### Issue 1 – The amount of California-source income nonresident appellant received from a California business.

Every individual subject to the Personal Income Tax Law must 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” in excess of certain filing thresholds. (R&TC, § 18501(a)(1)-(4).) R&TC section 19087(a) provides that if any 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.”

When FTB makes a proposed assessment of additional tax based on an estimate of income, FTB’s initial burden is to show why its proposed assessment is reasonable and rational. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509, 514; *Appeal of Myers* (2001-SBE-001) 2001 WL 37126924.) 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) 1992 WL 44503.)

Once FTB has met its initial burden, the taxpayer has the burden of proving it to be wrong. (*Todd v. McColgan, supra*, 89 Cal.App.2d 509, 514; *Appeal of Myers, supra*.) Unsupported assertions are insufficient to satisfy a taxpayer’s burden of proof. (*Appeal of Magidow* (82-SBE-274) 1982 WL 11930.) In the absence of a preponderance of evidence showing error in FTB’s determination, the assessment must be upheld. (*Appeal of Seltzer* (80-SBE-154) 1980 WL 5068.) A taxpayer’s failure to produce evidence that is within his control gives rise to a presumption that such evidence is unfavorable to his case. (*Appeal of Cookston* (83-SBE-048) 1983 WL 15434.)

Appellant does not dispute that he had a filing requirement for the 2015 tax year. However, appellant argues that only the income he earned while physically present in California is taxable by California. Moreover, appellant asserts that NovaBay corrected its Form 1099-MISC to show that the income appellant received from NovaBay is not taxable by California.

California imposes a tax on the entire taxable income of a nonresident, such as appellant, to the extent it is derived from sources within this state. (R&TC, §§ 17041(b); 17951(a).) Taxable income of nonresidents “shall be allocated and apportioned under rules and regulations prescribed by the [FTB].” (R&TC, § 17954.) California Code of Regulations, title 18, (Regulation) section 17951-4 provides income sourcing provisions for a nonresident’s trade, business, or profession. Under this regulation, if the taxpayer’s business is a sole proprietorship which carries on a unitary business within and without California, then the apportionment rules of the Uniform Division of Income for Tax Purposes Act (UDITPA, codified at R&TC sections 25120-25139) apply. (Cal. Code Regs., tit. 18, § 17951-4(c)(2); see also *Appeal of Bindley* (2019-OTA-179P).)

A taxpayer who has income from business activity that is taxable both within and without the state must apportion business income according to the UDITPA. (R&TC, § 25121; see also Cal. Code Regs., tit. 18, § 25121.) “Notwithstanding [R&TC] section 38006, for taxable years beginning on or after January 1, 2013, all business income of an apportioning trade or business . . . shall be apportioned to this state by multiplying the business income by the sales factor.” (R&TC, § 25128.7.) The sales factor is a fraction, where the numerator is the taxpayer’s total sales in California during the tax year and the denominator is the taxpayer’s total sales everywhere during the tax year. (R&TC, § 25134; see also Cal. Code Regs., tit. 18, § 25134.)

To determine what amount to include in the numerator of the sales factor, R&TC section 25136 governs the assignment of receipts from sales other than sales of tangible personal property, such as receipts from services. R&TC section 25136(a)(1) provides that “[s]ales from services are in [California] to the extent the purchaser of the service received the benefit of the services in [California].” FTB promulgated Regulation section 25136-2, which provides detailed market-based sales factor sourcing provisions that implement and interpret R&TC section 25136.

Regulation section 25136-2(c) states that “[s]ales from services are assigned to [California] to the extent the customer of the taxpayer receives the benefit of the service in [California].” “Benefit of a service is received” is defined as “the location where the taxpayer’s customer has either directly or indirectly received value from delivery of that service.” (Cal. Code Regs., tit. 18, § 25136-2(b)(1).) Regulation section 25136-2(c)(2) provides that, where a corporation or other business entity is the taxpayer’s customer, receipt of the benefit of the service shall be determined under the following cascading rules:

- (A) The location of the benefit of the service shall be presumed to be received in this state “to the extent” the contract between the taxpayer [i.e., appellant] and the taxpayer’s customer [i.e., NovaBay] or the taxpayer’s books and records kept in the normal course of business, notwithstanding the billing address of the taxpayer’s customer, indicate the benefit of the service is in this state. This presumption may be overcome by the taxpayer or the [FTB] by showing, based on a preponderance of the evidence, that the location (or locations) indicated by the contract or the taxpayer’s books and records was not the actual location where the benefit of the service was received.
- (B) If neither the contract nor the taxpayer’s books and records provide the location where the benefit of the service is received, or the presumption in subparagraph (A) is overcome, then the location (or locations) where the benefit is received shall be “reasonably approximated.”
- (C) If the location where the benefit of the service is received “cannot be determined” under subparagraph (A) or reasonably approximated under subparagraph (B), then the location where the benefit of the service is received shall be presumed to be in this state if the location from which the taxpayer’s customer placed the order for the service is in this state.
- (D) If the location where the benefit of the service is received cannot be determined pursuant to subparagraphs (A), (B), or (C), then the benefit of the service shall be in this state if the taxpayer’s customer’s billing address is in this state.

Here, we are unable to apply the first cascading rule under subparagraph (A) because there is no evidence in the record of a contract between appellant and NovaBay or where appellant’s books and records indicate the benefit of the services was received. Under subparagraph (B), we can reasonably approximate the location where NovaBay received the benefit of appellant’s services. “Reasonably approximated” means, in relevant part, “considering all sources of information other than the terms of the contract and the taxpayer’s books and records kept in the normal course of business, the location of the market for the benefit of the services . . . is determined in a manner that is consistent with the activities of [NovaBay] to the extent such information is available to [appellant].” (Cal. Code Regs. tit. 18, § 25136-2(b)(7).)

Public records from the California Secretary of State and LexisNexis provided by FTB show that NovaBay is located in California. Appellant also concedes that NovaBay is located and registered in California. Appellant asserts the amount of income received from NovaBay taxable by California should be limited to \$4,700 - an amount allegedly based on the time appellant was present working in the state. However, appellant has offered no evidence to

explain appellant's computation or, more importantly, the terms of the contracts, books and records, or other information to explain where the benefit of appellant's services was received.

Based on the evidence in the appeal record and in the absence of evidence suggesting otherwise, we find that it was both reasonable and rational for FTB to conclude that NovaBay received the benefit of appellant's services entirely within California. Because we have determined that NovaBay received the benefit of appellant's services entirely in California under Regulation section 25136-2(c)(2)(B) there is no need to discuss the remaining cascading rules.

Regarding the corrected Form 1099-MISC changing box 17 from California to Texas, this "correction" does not alter the taxability of that income by California. Internal Revenue Service's (IRS) 2015 Instructions for Form 1099-MISC indicate boxes 16 through 18 are provided for the payer's convenience when state income taxes have been withheld.<sup>5</sup> In this case, the original and corrected Forms 1099-MISC indicate that NovaBay did not withhold any amount of appellant's income for state income tax purposes for California or Texas. The change from California to Texas in box 17 of the corrected Form 1099-MISC is not relevant to the issue of whether the income reported on Form 1099-MISC is subject to California tax.

In sum, pursuant to the UDITPA provisions relating to the sale of services and the regulations thereunder, whether appellant had income from a California source is determined by where the benefits of appellant's services were received and not by appellant's physical presence. Having determined that appellant's income from NovaBay should be sourced entirely to California, FTB reasonably estimated appellant's income as \$99,996 based on the 2014 Schedule 1099-MISC that NovaBay issued appellant. Appellant has not sustained its burden of proving that FTB's determination was erroneous.

#### Issue 2 – Whether appellant timely filed his California tax return for 2015.

Appellant argues that he originally filed his return on October 8, 2016, which was within the extension period. Appellant offers proof of a separately mailed but allegedly contemporaneous letter with payment for the amount reported as owed for the 2015 return, arguing that the return was also received and FTB lost it.

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<sup>5</sup> A copy of the 2015 Instructions for Form 1099-MISC may be found at <<https://www.irs.gov/pub/irs-prior/i1099msc--2015.pdf>>

While FTB concedes receipt of the payment, FTB did not credit the amount to 2015 because appellant's return for the 2015 tax year had not been received. Instead, FTB applied the payment to an unpaid liability for 2014.

Appellant posits that FTB lost his 2015 return and he should not be penalized for FTB's negligence. However, appellant has not offered any other proof that he timely filed the 2015 return. If the taxpayer places a return in a United States mailbox before the statutory filing deadline and there is no record of that return being received, the taxpayer must offer convincing evidence, such as a registered or certified mail receipt, that the return was timely filed. (Gov. Code, § 11003; Int.Rev. Code, § 7502; *Appeal of La Salle Hotel Co.* (66-SBE-071) 1966 WL 1412.) Although appellant asserts that he has evidence that showed he timely filed his return, appellant has not provided that evidence.

Issue 3 – Whether appellant has established reasonable cause for failing to timely file a 2015 return.

California imposes a penalty for failing to file a valid return on or before the due date, unless the taxpayer shows that the failure is due to reasonable cause and not due to willful neglect. (R&TC, § 19131.) The late filing penalty is calculated at 5 percent of the tax for each month or a fraction thereof that the return is late, with a maximum penalty of 25 percent of the tax (after reduction for amounts paid on or before the date prescribed for payment and by the amount of any credit against the tax which may be claimed on the return). (R&TC, § 19131(a).) To establish reasonable cause, the taxpayer must show that the failure to timely file a return occurred despite the exercise of ordinary business care and prudence, or that circumstances existed that would cause a prudent businessperson with ordinary intelligence to have acted in the same way under similar circumstances. (*Appeal of Tons* (79-SBE-027) 1979 WL 4068.)

When FTB imposes a penalty, the burden is on the taxpayer to establish reasonable cause for the failure to timely file. (*Appeal of Bieneman* (82-SBE-148) 1982 WL 11825.) To overcome the presumption of correctness attached to the penalty, the taxpayer must provide credible and competent evidence supporting a claim of reasonable cause; otherwise the penalty cannot be abated. (*Appeal of Walsh* (75-SBE-073) 1975 WL 3557.)

Here, FTB did not receive appellant's 2015 return until June 11, 2018, which is more than twenty-five months after the filing due date of April 15, 2016. Therefore, the late filing penalty applies unless appellant can show that he had reasonable cause for filing the return late.



If the taxpayer places a return in a United States mailbox before the statutory filing deadline and there is no record of that return being received, the taxpayer must offer convincing evidence, such as a registered or certified mail receipt, that the return was timely filed. (Gov. Code, § 11003; Int.Rev. Code, § 7502; *Appeal of La Salle Hotel Co., supra.*)

An ordinarily intelligent and prudent businessperson would confirm that FTB received his return, and if there was a delay in filing, he or she would have taken steps to fix the problem. Appellant does not describe what efforts, if any, he took to ensure that the return was in fact filed on or before the due date. Based on the evidence in the record, appellant has not established that he acted with ordinary business care and prudence. Therefore, appellant is not entitled to abatement of the late filing penalty.

Issue 4 – Whether appellant is entitled to the abatement of the filing enforcement fee.


R&TC section 19254(a)(2) requires FTB to impose a filing enforcement fee if a taxpayer fails to file a return within 25 days after FTB mails a demand letter to the taxpayer. Once the fee is properly imposed, there is no language in the statute that would abate or waive the fee under any circumstances, including for reasonable cause. (See *Appeal of Myers, supra.*) Here, FTB mailed the Demand on April 19, 2017, and appellant did not file a return within 25 days of its mailing. Accordingly, FTB properly imposed the filing enforcement fee and we have no legal authority for abating it.

HOLDINGS


1. All of the income that appellant received from NovaBay, a California business, is California-source income.
2. Appellant has not established that the return for 2015 was timely filed.
3. Appellant has not established reasonable cause for failing to timely file a 2015 return.
4. Appellant is not entitled to the abatement of the filing enforcement fee.

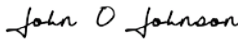
DISPOSITION

FTB’s action in this case, including FTB’s abatement of the demand penalty, is sustained.

DocuSigned by:  
  
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 Patrick J. Kusiak  
 Administrative Law Judge

We concur:

DocuSigned by:  
  
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 Neil Robinson  
 Administrative Law Judge

DocuSigned by:  
  
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 John O. Johnson  
 Administrative Law Judge