

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 18032524
CHRISTOPHER HICKS) Date Issued: July 8, 2019
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OPINION

Representing the Parties:

For Appellant: Christopher Hicks
For Respondent: Mira Patel, Tax Counsel
Marguerite Mosnier, Tax Counsel IV

D. CHO, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, Christopher Hicks (appellant) appeals an action by respondent Franchise Tax Board (FTB) proposing \$1,740 of additional tax, a late-filing penalty of \$435, a notice and demand penalty of \$913.50, a filing enforcement cost recovery fee of \$84, and applicable interest, for the 2015 taxable year. Appellant did not appear at the scheduled oral hearing in Torrance, California, on Thursday, December 13, 2018. Therefore, this 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 the notice and demand penalty.
4. Whether appellant has established that the filing enforcement cost recovery fee should be abated.

FACTUAL FINDINGS

1. Appellant did not file a California return for the 2015 taxable year.
2. Subsequently, FTB received information from third parties (Stonegate Mortgage Corporation, Paramount Equity Mortgage, Inc., and InterCap Lending Inc.) indicating that appellant received California wages for the 2015 taxable year totaling \$56,736. FTB also received information from Scottrade Inc. that appellant received gross proceeds from the sale of stock, dividend income, and miscellaneous income during the 2015 taxable year. Based on this information, FTB issued a Demand for Tax Return (Demand) dated May 16, 2017, which required appellant to do one of the following on or before June 21, 2017: file a 2015 tax return, provide a copy of his 2015 tax return if it was already filed, or provide an explanation as to why he did not have to file a 2015 tax return.
3. Appellant did not respond to the May 16, 2017 Demand, and FTB issued a Notice of Proposed Assessment (NPA) dated July 17, 2017, which estimated appellant's California income based on the information provided by the third-parties. Specifically, FTB determined that appellant had California wages of \$56,736, dividend income of \$140, miscellaneous income of \$21, and income from the sale of stock of \$14,748.20, which resulted in an additional tax due of \$1,740 after applying exemption and withholding credits. The NPA also proposed a late-filing penalty of \$435, a notice and demand penalty of \$913.50,¹ a filing enforcement cost recovery fee of \$84, and applicable interest.
4. Appellant timely protested the NPA by filing a copy of the July 17, 2017 NPA, with handwritten notations arguing that he was homeless, only owed tax of \$84.68, and recognized a loss in the sale of his stocks in the 2015 taxable year.
5. FTB rejected appellant's arguments and issued a Notice of Action affirming the NPA.
6. This timely appeal followed.
7. Subsequently, FTB received appellant's Internal Revenue Service (IRS) Wage and Income Transcript on April 24, 2018.

¹ On January 27, 2015, FTB issued a Demand for the 2013 taxable year. Appellant did not respond to the January 27, 2015 Demand, and FTB issued an NPA for the 2013 taxable year dated April 27, 2015.

8. In addition, appellant provided a copy of his Scottrade Inc. tax statement for the 2015 taxable year to demonstrate that he had a net loss. Appellant also stated that he was not a California resident during the 2015 taxable year.

DISCUSSION

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

California residents are taxed upon their entire taxable income, regardless of source. (R&TC, § 17041(a).) 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. 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.”

When FTB proposes a tax assessment based on an estimate of income, FTB’s initial burden is to show that its assessment is reasonable and rational. (*Appeal of Myers* (2001-SBE-100) 2019 WL 1187160.) 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 Bailey* (92-SBE-001) 1992 WL 44503 [estimate based on third-party information reporting]; *Appeals of Tonsberg* (85-SBE-034) 1985 WL 15812 [use of third-party information reporting].) “[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) 1982 WL 11759.)

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 proposed 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) 1982 WL 11930.) California Code of Regulations, title 18, section (Regulation) 30219(c), states that except as otherwise provided by law, “the burden of proof requires proof by a preponderance of the evidence.”

Here, FTB received information from Stonegate Mortgage Corporation, Paramount Equity Mortgage, Inc., and InterCap Lending Inc. that appellant received California wages of \$56,736 during the 2015 taxable year. These entities also listed appellant's address to be located within California. In addition, FTB received information from Scottrade Inc. that appellant received income from the sales of stock as well as dividend income and miscellaneous income. FTB estimated appellant's gain on the stock sales to be 20 percent² of the gross proceeds that was reported by Scottrade Inc. FTB determined that appellant had a filing requirement and estimated appellant's income using these third-party sources. Based on the foregoing, we find that FTB's estimate was both reasonable and rational. Accordingly, the burden of proof shifts to appellant.

Appellant has set forth a number of arguments disputing FTB's proposed assessment. For example, appellant argued that he was homeless, only owed tax of \$84.68, and sustained a loss on the sale of his stocks in the 2015 taxable year. Appellant also argued that he was not a California resident during the taxable year at issue and explained that the address listed with FTB and the third parties was not appellant's actual address. Instead, appellant claims that this address belonged to an acquaintance who collected appellant's mail and forwarded it to him because he resided outside of California during the 2015 taxable year. In support of these arguments, appellant has only provided his Scottrade tax statement for the 2015 taxable year.

With respect to appellant's argument that he was not a California resident, appellant has not provided any supporting documentation to establish this fact. In addition, appellant has not provided any documentation or testimony indicating where appellant resided in the 2015 taxable year. Without such documentation, appellant fails to meet his burden of demonstrating that he was not a California resident.

With respect to appellant's arguments that he was homeless, which we interpret to mean that he is unable to pay the tax, we lack authority to make discretionary adjustments to the amount of proposed tax assessment based on a taxpayer's inability to pay. (See *Appeal of Luebbert* (71-SBE-028) 1971 WL 2708.) In other words, we have no authority to settle or compromise an income tax liability. The Office of Tax Appeal's jurisdiction is limited to

² FTB estimated appellant's gain on the sale of stock by multiplying the total gross proceeds by an average gain rate of 20 percent, which was calculated by FTB's Economic and Statistical Research Bureau. In other words, because it did not have appellant's actual stock basis information, FTB estimated the basis to be 80 percent of the proceeds received for the stock. Based on the foregoing, FTB multiplied appellant's gross proceeds of \$73,741 by 20 percent to arrive at an income amount of \$14,748.20.

determining the correct amount of appellant's California personal income tax liability for the appeal year. (*Appeals of Dauberger, et. al., supra.*) Therefore, we reject appellant's argument.

Lastly, appellant argued that he recognized a loss on the sale of stock during the 2015 taxable year. In support of this argument, appellant provided his 2015 Scottrade tax statement, which indicates that appellant recognized a net gain of \$1,607.81 and not \$14,748.20 as FTB originally estimated in its NPA. Although we found that FTB met its initial burden that its estimate was reasonable and rational, appellant has provided documentary evidence that would demonstrate that FTB's estimate is erroneous and overstated. FTB has not disputed the accuracy or authenticity of appellant's 2015 Scottrade tax statement even though FTB had a copy of appellant's IRS Wage and Income Transcript for the 2015 taxable year. Instead, FTB contends that appellant must file a 2015 tax return before he can be given any basis for his stock transactions. However, FTB has not cited any authority for this proposition. Furthermore, we are unaware of any provision in the Personal Income Tax Law that requires the disallowance of basis in situations where a taxpayer has not filed a tax return. Therefore, appellant has met his burden of proof in demonstrating that FTB's income estimate with respect to the sale of stock for the 2015 taxable year was erroneous and overstated.

In conclusion, appellant has not met his burden of proof demonstrating that the California wages reported by the third-parties was erroneous or overstated; however, appellant has successfully established that FTB's estimate of appellant's gain on the sale of stock for the 2015 taxable year was erroneous and should be reduced to \$1,607.81.

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 the due date unless the taxpayer establishes that the late filing was due to reasonable cause and not willful neglect. The penalty is 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, subds. (a), (c).) Appellant does not dispute the calculation of the penalty, and therefore the only issue is whether he has shown reasonable cause for abatement.

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) 1982 WL 11825; *Appeal of Tons* (79-SBE-027) 1979 WL 4068.) Ignorance of the law does not excuse the failure to file a timely return. (*Appeal of Diebold, Inc.* (83-SBE-002) 1983 WL 15389.) 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 2015 tax return. Appellant has not argued that he had reasonable cause for his failure to timely file his 2015 tax return. Although appellant argued that he was not a California resident for the 2015 taxable year, we rejected this argument above, and appellant's remaining arguments do not establish reasonable cause for appellant's failure to timely file a 2015 tax return. Therefore, appellant has not shown reasonable cause for his failure to file a timely 2015 tax return.

Issue 3 – Whether FTB properly imposed the 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 or of any deficiency tax by the FTB concerning the assessment for which the return was required. The penalty will be waived if the failure is due to reasonable cause and not willful neglect. Regulation 19133 further provides that for individuals, the notice and 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.)³

In this case, the taxable year at issue is the 2015 taxable year. As a result, FTB must have proposed an assessment (i.e., issued an NPA) at any time during the 2011 through 2014 taxable years, which is the four-taxable-year period preceding the taxable year at issue. However, it is undisputed that FTB issued a prior year NPA for not filing a return for the 2013 taxable year on April 27, 2015, which is not within the four-taxable-year period of 2011 through 2014. Accordingly, FTB has not met the second condition imposed by Regulation 19133. Therefore, we find that FTB erred in proposing to assess a notice and 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 2015 tax return within 25 days of the issuance of the Demand dated May 16, 2017. 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 a net gain of \$1,607.81 as stated on the Scottrade tax statement instead of FTB's estimate of \$14,748.20 regarding the sale of stocks during the 2015 taxable year. No other adjustments to FTB's remaining income amounts are warranted. FTB is to recalculate appellant's tax liability for the 2015 taxable year based on the foregoing.
2. Appellant has not demonstrated reasonable cause for his failure to file a timely return. However, to the extent that the tax liability has decreased, FTB is to recalculate this penalty as well.
3. The notice and demand penalty was improperly imposed and shall therefore be deleted from the assessment.

³ 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.

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 2015 taxable year as stated above. Otherwise, FTB’s action is sustained as to the late-filing penalty (subject to a recalculation as stated above) 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

I concur:

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Kenneth Gast
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Kenneth Gast
Administrative Law Judge

L. CHENG, concurring in part and dissenting in part:

I concur with the majority's holding with respect to Issues 1, 2, and 4 above. I respectfully dissent, however, from the majority's holding in Issue 3 regarding the application of the demand penalty. The majority holds that the demand penalty was improperly imposed because the issuance of the 2013 Notice of Proposed Assessment (NPA) was not *during* one of four years preceding 2015, but instead was during 2015. In arriving at this conclusion, the majority implicitly construes the regulatory language (i.e., "during") literally, which leads to an absurd result directly contrary to the Franchise Tax Board's (FTB) expressly stated purpose for promulgating this regulation.

The California Supreme Court has held that, in examining statutory language, courts will first give it a plain and commonsense meaning. However,

[w]e do not examine that language in isolation, but in the context of the statutory framework as a whole in order to determine its scope and purpose and to harmonize the various parts of the enactment. If the language is clear, courts must generally follow its plain meaning unless a literal interpretation would result in absurd consequences the Legislature did not intend. If statutory language permits more than one reasonable interpretation, courts may consider other aids, such as the statute's purpose, legislative history, and public policy. Furthermore, we consider portions of a statute in context of the entire statute and the statutory scheme of which it is a part, giving significance to every word, phrase, sentence, and part of an act in pursuance of the legislative purpose.

(*Sierra Club v. Superior Court* (2013) 57 Cal.4th 157, 165-166, internal citations and quotations omitted.)

Here, the language of California Code of Regulations, title 18, section (Regulation) 19133 is unclear as to the proper application of the demand penalty. Specifically, 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, whereas the regulation itself states that FTB will impose it where the NPA was issued *during* one of the prior four taxable years. Because the example was enacted as part of the text of the regulation itself, it should be given significant consideration in determining the intent of the drafter. And because the application of the example would potentially conflict with the plain meaning of the regulation, as in the instant appeal, we should look to extrinsic sources for guidance. (*Sierra Club v. Superior Court, supra*, 57 Cal.4th at p. 645.)

The Initial Statement of Reasons contained in FTB's rulemaking file for Regulation 19133 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.)

Given the purpose of Regulation 19133 is to mitigate the perceived harshness of the demand penalty by imposing it only upon repeat nonfilers, applying a literal reading of Regulation 19133(b)(2) to the facts would frustrate that intent. In other words, it would prevent FTB from imposing the demand penalty upon a repeat nonfiler where the failure to file occurs in two consecutive years, as here. If appellant had failed to respond to a demand notice and NPA for, say, the 2014 taxable year, a literal application of the regulation would require FTB to do the impossible by issuing the NPA for the 2014 taxable year during one of the four taxable years prior to 2015 (i.e., 2014, 2013, 2012, or 2011). This impossibility stems from the fact that the 2014 tax return would not have been due until April 2015, and hence, no demand notice and corresponding NPA would have issued prior to 2015. This result clearly runs contrary to the intent of the regulation.

Moreover, a literal application of Regulation 19133(b)(2) fails to properly account for the taxpayer’s prior four-year filing history. That is, the NPA issued *during* the prior four years could conceivably be for *any* tax year open to assessment, beyond the immediate four years prior to the current tax year at issue. For instance, where no return is filed, FTB could potentially reach back 20 or more years, as there would be no time limit to issue the requisite NPA, as long as the NPA is issued *during* one of the four prior taxable years. (R&TC, § 19057.) This result would run contrary to the originally contemplated four-year lookback period for evaluating whether a taxpayer was a repeat nonfiler for purposes of imposing the demand penalty. For instance, taxpayers who have been compliant in filing returns for the past four or more years may find themselves subject to the demand penalty for one lone tax year decades ago.

Based on the above language from FTB’s Initial Statement of Reasons, Example 2 of the regulation, and the absurd results that would follow from a literal interpretation of Regulation 19133(b)(2), it is clear that the use of the word “during” was a drafter’s error, because the word “for” was intended to effectuate the stated purpose of the regulation. Moreover, relevant extrinsic sources support substituting “for” in place of “during” in Regulation 19133(b)(2) for the proper imposition of the demand penalty. Therefore, absent showing of reasonable cause, I would sustain FTB’s imposition of the demand penalty.

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Linda C. Cheng
Administrative Law Judge