

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:
JOHN A. BYERLY

) OTA Case No. 18063364
)
) Date Issued: September 25, 2019
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)
)

OPINION

Representing the Parties:

For Appellant: John A. Byerly

For Respondent: Andrew Amara, Tax Counsel

For Office of Tax Appeals: Josh Lambert, Tax Counsel

J. ANGEJA, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, John A. Byerly (appellant) appeals an action by respondent Franchise Tax Board (FTB) in proposing an assessment of additional tax of \$6,463.00, a late filing penalty of \$1,615.75, a notice and demand penalty of \$1,615.75, and a filing enforcement fee of \$84.00, plus applicable interest, for the 2015 tax year.

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

ISSUES

1. Whether appellant has shown error in FTB’s proposed assessment of tax.
2. Whether appellant has shown that the late filing penalty should be abated.
3. Whether appellant has shown that the notice and demand penalty should be abated.
4. Whether appellant has shown that the filing enforcement fee should be abated.

FACTUAL FINDINGS

1. FTB’s Integrated Non-Filer Compliance program annually matches income records obtained from various reporting sources against filed tax returns to identify individuals who may not have fulfilled their legal obligation to file a California tax return. FTB

- obtains mortgage interest payment information reported on federal information returns (Form 1098) through the program. In this case, FTB received information indicating appellant paid mortgage interest on two mortgages to Wells Fargo Bank, N.A. during the 2015 tax year.
2. FTB issued appellant a Demand for Tax Return (Demand) on June 20, 2017, seeking a 2015 California tax return, or proof from appellant that he lacked a filing obligation. 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. Appellant failed to respond to the Demand within the time provided.
 3. Accordingly, FTB issued a Notice of Proposed Assessment (NPA) on August 21, 2017, which proposed to assess a tax of \$6,463.00, a late filing penalty of \$1,615.75, a notice and demand penalty of \$1,615.75, and a filing enforcement fee of \$84.00, plus interest. FTB estimated appellant’s income at six times the mortgage interest paid, or \$117,300.
 4. Appellant timely protested the NPA on October 15, 2017, contending that he was not a California resident and received only a fraction of the estimated income contained in the NPA. Further, he noted that he was in the process of completing a nonresident return.
 5. FTB issued a Notice of Action on May 8, 2018, which affirmed the NPA. This timely appeal followed.
 6. According to FTB’s most recent brief, filed on July 3, 2019, appellant has not filed a nonresident return.
 7. As relevant to the notice and demand penalty, appellant also failed to timely file a return for 2013. On February 25, 2015, FTB issued a Demand for appellant to file a 2013 return by April 1, 2015. Appellant did not timely respond to that Demand, so FTB issued an NPA to appellant for that year on April 27, 2015.

DISCUSSION

R&TC section 17041 imposes a tax “. . . upon the entire taxable income of every resident of this state. . . .” R&TC section 18501 requires every individual subject to the Personal Income Tax Law 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” But when a taxpayer fails to file such a return, FTB “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.” (R&TC, § 19087(a).)

If FTB makes a tax assessment based on an estimate of income, FTB’s initial burden is to show why its assessment is reasonable and rational. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Myers* (2001-SBE-001) 2001 WL 37126924.) Federal courts have held that the taxing agency need only introduce some evidence linking the taxpayer with the unreported income. (See *Rapp v. Commissioner* (9th Cir. 1985) 774 F.2d 932.) When a taxpayer fails to file a valid return, FTB’s use of income information from various sources to estimate a taxpayer’s taxable income is a reasonable and rational method of estimating taxable income. (See *Palmer v. Internal Revenue Service* (9th Cir. 1997) 116 F.3d 1309, 1313.)

The federal Forms 1098 reporting the mortgage interest paid by appellant constitute substantive evidence linking appellant to unreported California income. FTB used that information to reasonably and rationally reconstruct appellant’s income based on analysis of tax returns filed by California residents. Therefore, FTB met its initial burden and established the presumption of correctness in the proposed assessment.

Once FTB has met its initial burden, the assessment is presumed correct and the taxpayer has the burden of proving it to be wrong. (*Todd v. McColgan, supra; Appeal of Myers, supra.*) Unsupported assertions are not sufficient to satisfy a taxpayer’s burden of proof. (*Appeal of Magidow* (82-SBE-274) 1982 WL 11930.)

Appellant contends that he is not a California resident as he was working and living out of state in 2015. Appellant contends that he only worked in California for a few weeks in which he earned \$7,962.55. Appellant asserts that he is in the process of completing a Non-Resident California Tax Return for those wages. Appellant provides no evidence in support of its contentions that he is a nonresident or that FTB’s assessment is in error. As such, there is no basis to rule in its favor. Therefore, appellant has failed to overcome the presumption of correctness and, thus, failed to satisfy its burden to show error in FTB’s proposed 2015 assessment.

Late Filing Penalty

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 burden is on the

taxpayer to establish reasonable cause for the untimely filing. Reasonable cause exists if it can be shown that the taxpayer acted as an ordinarily intelligent and prudent businessperson would have acted under similar circumstances. (*Appeal of Tons* (79-SBE-027) 1979 WL 4068.)

Appellant has not provided any evidence to show reasonable cause for the late filing of his return. Appellant has not presented any evidence that he exercised ordinary business care and prudence. Accordingly, we find that appellant has not shown reasonable cause for failing to file its return by the due date.

Notice and Demand Penalty

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 Request for Tax Return (Request) or 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, § 19133(b).) The demand penalty is designed to penalize the failure of a taxpayer to respond to a notice and demand, and not a taxpayer's failure to pay the proper tax. (*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 California Code of Regulations, title 18, (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. 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.)

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., Inc.* (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, 98 [“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 “during.” Based upon the plain meaning of the regulation above, we find, contrary to FTB’s interpretation and application to the facts here, that this subsection requires that an NPA (following a Request or Demand) for a prior taxable year to have been issued (and therefore dated) 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 Request or Demand must have occurred at any time within or in the course of 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 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 2015. In order to apply the demand penalty under the regulation, appellant’s failure to respond to a prior Demand that resulted in an NPA having been issued, must have occurred in either 2011, 2012, 2013, or 2014 (during the four tax years preceding 2015). However, in this case, appellant’s failure to respond to FTB’s prior Request (for tax year 2013) occurred in 2015. Appellant’s

failure occurred on or after April 1, 2015, which was not during one of the four taxable years preceding 2015.¹

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 section 19133 is inconsistent with the result herein, we decline to defer to Example 2’s illustration of the regulation. (See Cal. Code Regs., tit. 18, § 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 apply. (*Ibid.*) The application in the illustrative example conflicts with the plain language of the regulation.

As stated in Regulation 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. 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 Corp. v Board of Equalization* (1988) 19 Cal.4th 1, 7-8; *Agnew v. State Board of Equalization* (1999) 21 Cal.4th 310, 322.)

Regulation section 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

¹ We note that as applied to this appellant, FTB’s interpretation of Regulation section 19133 operates in a way that was expressly rejected by the FTB’s three-member board. Here, the first NPA was issued (April 27, 2015) after appellant failed to file its 2013 tax return. Thus, the notice to the taxpayer of the need to comply with filing requirements (i.e., the NPA from the prior year) was received *after* the taxpayer already failed to comply with the filing requirement for the current year (2015). The application of the regulation in this manner does not provide the notice to taxpayers intended by the regulation, nor does it effectively “target [] only repeat nonfilers.” Thus, FTB’s application would penalize appellant in a way that it expressly rejected when adopting the regulation. (Cal. Reg. Notice Register 2004, No. 17-Z, p. 504; https://www.ftb.ca.gov/law/regs/19133_isr.pdf.)

plain language of Regulation section 19133(b) states that an NPA following the taxpayer's failure to respond to a prior Request or 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.

Because appellant's failure to respond to the Demand for the 2013 tax return did not occur during any of the four taxable years prior to 2015, the demand penalty may not be imposed for 2015.

Filing Enforcement Fee

R&TC section 19254 authorizes the imposition of a filing enforcement fee when FTB has mailed notice to a taxpayer that the continued failure to file a return may result in the imposition of the fee. Once the fee is properly imposed, there is no language in the statute that permits abatement of the fee for any reason, including reasonable cause. (See *Appeal of Myers, supra.*) The August 21, 2017 NPA notified appellant that its continued failure to file a return would result in the imposition of the fee. Thus, the fee was properly imposed, and the provisions of R&TC section 19254 do not provide us with any basis to abate the filing enforcement fee.

HOLDING

1. Appellant has not shown error in FTB’s proposed assessment of tax.
2. Appellant has not shown that the late filing penalty should be abated.
3. FTB did not properly apply its regulation in assessing the demand penalty; therefore, we abate the proposed penalty.
4. Appellant has not shown that the filing enforcement fee should be abated.

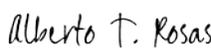
DISPOSITION

FTB’s action in imposing the \$1,615.75 demand penalty is reversed, but otherwise FTB’s action is sustained.

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 Jeffrey G. Angeja
 Administrative Law Judge

We concur:

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 Alberto T. Rosas
 Administrative Law Judge

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 Amanda Vassigh
 Administrative Law Judge