

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:

ADAM M. BERMAN AND
ALEJANDRO SCOTTA) OTA Case No. 18043054
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)**OPINION**

Representing the Parties:

For Appellants:

Nicholas Wagener, Tax Appeals Assistance
Program (TAAP)¹

For Respondent:

Joel M. Smith, Tax Counsel
Nancy E. Parker, Tax Counsel IV

J. MARGOLIS, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, appellants Adam M. Berman and Alejandro Scotta appeal an action by respondent Franchise Tax Board (FTB) denying appellants' claim for refund of a notice and demand penalty of \$10,364.25 imposed under R&TC section 19133 for the 2015 tax year.

Administrative Law Judges Jeffrey I. Margolis, Josh Lambert, and Jeffrey G. Angeja held an oral hearing for this matter in Sacramento, California, on September 25, 2019. At the conclusion of the hearing, the record was closed and this matter was submitted for decision.

ISSUE

Whether appellants are liable for the demand penalty imposed against them under R&TC section 19133 for tax year 2015.

FACTUAL FINDINGS

1. For the 2014 tax year, Mr. Berman failed to timely respond to a Request for Tax Return (Request) dated April 20, 2016. As a result, an NPA for 2014 was issued to him on July 1, 2016.

¹ Appellants filed their opening brief. Jessica Covarrubias of TAAP filed appellants' reply brief.

2. For the 2015 tax year, Mr. Berman did not timely file a return. However, FTB obtained information indicating that Mr. Berman received income totaling \$777,064 and determined that he appeared to have a filing requirement.
3. Accordingly, FTB mailed a Demand for Tax Return (Demand) dated June 13, 2017, to Mr. Berman. The Demand required Mr. Berman to respond by July 19, 2017, by either filing a return, providing a copy of a return if already filed, or replying with information indicating why he did not have a filing requirement.
4. Documentary evidence (airplane tickets, passport stamps, and several sworn declarations) establishes that appellants were out of the country from April 4, 2017, through September 21, 2017, dealing with a complicated international adoption situation. They arranged with a neighbor to open, scan, and e-mail them any mail deemed important. However, the neighbor did not open the Demand.²
5. Because Mr. Berman did not respond by the due date, FTB issued a Notice of Proposed Assessment (NPA) on August 14, 2017. In the NPA, FTB estimated Mr. Berman's taxable income to be \$773,020.60 and proposed to assess tax of \$52,130, a late-filing penalty of \$13,032.50, a demand penalty of \$20,375.75, a filing enforcement fee of \$84, plus interest.
6. Appellants returned to their home in the United States on September 22, 2017, and opened the Demand. The same day, appellants contacted FTB by phone and advised FTB that they would promptly file their 2015 return. Approximately two weeks later, on October 8, 2017, appellants filed that return.
7. Appellants' 2015 return reported a taxable income of \$500,045 and total tax of \$41,457. Appellants also reported timely payments of \$66,952, resulting in overpaid tax of \$25,495, some of which appellants asked to have applied to their 2016 tax year and some of which they requested be refunded to them.
8. FTB processed appellant's late-filed 2015 return, accepted the tax liability reported on the return, abated the late-filing penalty and reduced the demand penalty to \$10,364.25.
9. Appellants paid the demand penalty (by FTB offset from appellants' requested refund) and filed a claim for refund requesting that the demand penalty be abated.

² Appellants' neighbor submitted a sworn declaration stating that he only opened mail he "deemed important," and that he did not open the letter containing the Demand from FTB.

10. FTB denied appellant's claim, and this timely appeal followed.

DISCUSSION

R&TC section 19133 provides, in pertinent part, that if any taxpayer fails or refuses to make and file a return required by this part upon notice and demand by FTB, then unless the failure is due to reasonable cause, FTB may add a penalty of 25 percent of the amount of any tax assessment pursuant to R&TC section 19087 for the year for which the return was demanded.

FTB's discretion to impose the penalty, however, is limited by California Code of Regulations, title 18, (Regulation) section 19133(b). Regulation section 19133(b) states that FTB will only impose the demand penalty upon an individual taxpayer for failing to file a delinquent return upon demand if: (1) the taxpayer fails to respond to a current Demand in the manner prescribed; and (2) "FTB has proposed an assessment of tax under the authority of [R&TC section 19087(a)], after the taxpayer failed to timely respond to a Request or a Demand for a 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."

FTB claims that it properly complied with the requirements of Regulation section 19133(b) because it issued, on April 20, 2016, a request to Mr. Berman that he file his delinquent 2014 return. When Mr. Berman failed to timely comply with that request, FTB issued an NPA to Mr. Berman for 2014 on July 1, 2016. We do not agree that this satisfies the requirements of Regulation section 19133(b). FTB did not send to appellants (or to either of them) a prior Request or Demand and NPA within the four-taxable-year period preceding 2015, the year for which the demand penalty has been proposed. Although FTB did send a prior request to Mr. Berman with respect to his 2014 tax year, that request was sent in 2016, not during the four-taxable-year period that preceded 2015, as is required by Regulation 19133(b). Accordingly, we reverse FTB's imposition of the penalty on the ground that FTB's action violated its own regulation. Hence, we do not reach the issue of whether, if FTB had complied with the requirements of Regulation section 19133(b), appellants' actions would establish reasonable cause for their failure to timely respond to the Demand.

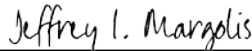
HOLDING

Appellants are not liable for the demand penalty.

DISPOSITION

FTB's action is reversed. Appellants are entitled to a refund of the demand penalty, plus any applicable interest due thereon.

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Jeffrey I. Margolis

Administrative Law Judge

I concur:

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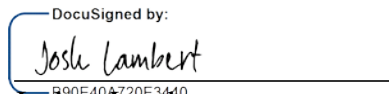
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Jeffrey G. Angeja

Administrative Law Judge

Date Issued: 12/23/2019

J. LAMBERT, dissenting:

I dissent to the majority’s interpretation of Regulation section 19133 requiring that the previous NPA have been issued “during” the 48-month time-period preceding the current tax year. I would defer to FTB’s interpretation, which is that the prior Request or Demand for Tax Return and NPA must have been issued for one of the four tax years preceding the current tax year.³ The regulation’s purpose is to avoid penalizing first-time nonfilers who file “in the following tax year” and to penalize “only repeat nonfilers.” (See Statement of Reasons.)⁴ FTB rejected alternate versions of the regulation that “failed to target repeat nonfilers.” (*Ibid.*) Thus, the purpose of the regulation is to penalize repeat nonfilers, unambiguously defined as taxpayers who fail to file more than once, while allowing only first-time nonfilers to escape the penalty. FTB contemporaneously incorporated procedures to differentiate between first-time nonfilers and repeat nonfilers. FTB sends a Request to a first-time nonfiler, which does not trigger the penalty. If a first-time nonfiler fails to file more than once, a Demand is issued, which triggers the penalty. Therefore, given that tax returns are never due until the following tax year, it would be impossible under the subdivision (b) interpretation to impose the demand penalty on a repeat nonfiler who fails to file in consecutive years, such as appellants, which is clearly contrary to the purpose of the regulation. Here, FTB’s interpretation of its own regulation is the only interpretation consistent with the regulatory intent, and is clearly expressed in FTB’s contemporaneously implemented procedures, which indicate that we should defer to FTB’s interpretation of the regulation. (See *Yamaha Corp. of America v. State Bd. of Equalization* (1998) 19 Cal.4th 1, 12-13; *Butts v. Board of Trustees of California State University* (2014) 225 Cal.App.4th 825, 840.)

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Joshua Lambert
Administrative Law Judge

³ R&TC section 19133, subdivision (d), presents an example where a 2001 demand penalty is properly imposed because the prior Request and NPA were issued for the 1999 tax year, which pertains to one of the four taxable years prior to the example’s current tax year, 2001.

⁴ <https://web.archive.org/web/20190426175829/www.ftb.ca.gov/law/regs/19133_isr.pdf>