OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18053180
C. GIORDANO	)
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OPINION

Representing the Parties:

For Appellant: C. Giordano[1]

For Respondent: Joel M. Smith, Tax Counsel

For Office of Tax Appeals: Neha Garner, Tax Counsel III

J. JOHNSON, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, appellant C. Giordano appeals an action by respondent Franchise Tax Board (FTB) denying appellant's claim for refund of $608, plus interest, for the 2014 tax year.

Office of Tax Appeals (OTA) Administrative Law Judges John O. Johnson, Suzanne B. Brown, and Elliott Scott Ewing held an oral hearing for this matter in Sacramento, California, on February 25, 2020. At the conclusion of the hearing, the record was closed and this matter was submitted for decision.

ISSUE

Whether the demand penalty was properly imposed, and, if so, whether appellant has shown reasonable cause for his failure to respond to the Demand for Tax Return (Demand) for the 2014 tax year.

[1] The Tax Appeals Assistance Program (TAAP) previously represented appellant by filing a reply brief, filed by Maneesha Birdee, and a supplemental brief (without signature or representative name). TAAP did not attend the prehearing conferences held in preparation for this hearing and did not attend the hearing. Appellant represented himself at the hearing, after confirming with the Office of Tax Appeals that TAAP had not contacted him regarding the upcoming hearing. On March 18, 2020, several weeks after the February 25, 2020 hearing, TAAP emailed OTA to indicate that it no longer represented appellant.

FACTUAL FINDINGS

1. Appellant did not file a timely 2014 California tax return.
2. FTB obtained information indicating that appellant received income sufficient to prompt a filing requirement for the 2014 tax year.[2] On March 1, 2016, FTB issued a Demand, requiring that appellant reply no later than April 6, 2016, by either filing his tax return for 2014, providing evidence showing he already filed his return, or explaining why he was not required to file a return.
3. When appellant did not timely reply to the Demand, FTB issued a Notice of Proposed Assessment (NPA) on May 2, 2016. The NPA estimated appellant's income based on the previously mentioned income information and proposed a tax liability of $7,660, a late filing penalty of $1,915, a demand penalty of $2,648.25, and a filing enforcement fee of $79.
4. Subsequently, appellant filed his 2014 return on September 8, 2016, reporting lower California taxable income than reflected on the NPA, and a tax liability of $2,432. FTB accepted appellant's return as filed and issued a Notice of State Income Tax Due on September 28, 2016, which reduced the demand penalty to $608 and abated the late filing penalty.
5. Appellant submitted a claim for refund stating that he disagreed with the assessment of the demand penalty because he had timely responded to FTB's Demand and requested a six-month extension to file. Appellant stated that he did not receive a response from FTB denying his request and that he filed his 2014 return within the six-month extension period he requested. FTB denied his claim for refund on October 18, 2017. This timely appeal followed.
6. On appeal, FTB provided a copy of a Request for Tax Return for the 2013 tax year, issued to appellant in April 2015, and an NPA for the 2013 tax year, issued to appellant in June 2015. In response to a request for additional briefing, FTB affirmed that it did not issue an NPA to appellant in 2010, 2011, 2012, or 2013.

[2] FTB received information from the State of California Controller's Office reporting appellant received wage income, and information from the Board of Equalization indicating appellant had sales income operating as a self-employed individual.

DISCUSSION

California law provides for the imposition of a penalty for the failure to file a return or provide information upon FTB's demand to do so, unless the failure to respond was due to reasonable cause and not willful neglect. (R&TC, § 19133.) According to California Code of Regulations, title 18, section 19133 (Regulation 19133), FTB will only impose a demand penalty if the taxpayer also failed to timely respond to a Request or a Demand for Tax Return for a prior year, and that failure resulted in FTB issuing an NPA 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 at issue is for the 2014 tax year. Therefore, to satisfy the requirements of Regulation 19133(b), FTB must have issued an NPA to appellant at any time during 2010, 2011, 2012, or 2013. FTB affirmed that it did not issue an NPA to appellant during those years. Accordingly, the requirements of Regulation 19133, as explicitly detailed in subdivision (b),[3] have not been met, and the demand penalty is not properly imposed.

In FTB's additional brief, it simply stated, "In accordance with Regulation 19133, subdivision (d), [FTB] imposed the demand penalty for the 2014 tax year after issuing a Request for Tax Return and NPA to appellant for the 2013 tax year." However, subdivision (d) only provides examples "intended to illustrate the provisions of this regulation" (i.e., subdivision (b)). Unlike in subdivision (b), nowhere in subdivision (d) are there any rules or guidelines that detail the requirements of Regulation 19133 or when they are satisfied. Instead, subdivision (d) merely provides two related examples with hypothetical fact patterns and states whether the demand penalty would be imposed under either example, but not why.[4] Subdivision (d), by its own explicit language, is only intended to support the rules as set out in subdivision (b). Accordingly, subdivision (d) does not provide any independent legal authority for an application of Regulation 19133 contrary to the rules set forth in subdivision (b).

[3] As only the subdivisions of Regulation 19133 are being analyzed in this Opinion, all references to subdivisions shall refer to subdivisions of that regulation.

[4] For reference, Example 2 of subdivision (d) uses hypothetical facts in which it states that a demand penalty could be imposed for the 2001 tax year if the taxpayer fails to respond to a demand for tax return for that year. The facts, incorporated from Example 1, include an NPA for the 1999 tax year that was issued in 2001, which is described as "an NPA for not filing a return within the previous four years." The example would impose the demand penalty when the prior NPA was issued during the *same* tax year for which the current demand for tax return is issued.

At the hearing, FTB further elaborated on its position, asserting that the plain language in Regulation 19133, subdivisions (b) and (d), create an ambiguity in the regulation, "meaning the courts cannot simply look at the plain meaning of the language." FTB also cited *Yamaha Corp. of America v. State Bd. of Equalization* (1988) 19 Cal.4th 1 (*Yamaha*) as precedent from the California Supreme Court as to when the California courts provide deference to the promulgating agency. FTB asserted that it is not aware of any California authority that suggests subdivision (d) should be ignored if it is inconsistent with subdivision (b).

As FTB noted at the hearing, citing *Butts v. Board of Trustees of California State University* (2014) 225 Cal.App.4th 825 (*Butts*), courts must first give meaning to every word and phrase in the regulation. The same principle applies in this proceeding. (See *Appeal of NASSCO Holdings, Inc.* (2010-SBE-001) 2010 WL 5626976 [regarding statutory interpretation, citing *Appeal of Kishner* (99-SBE-007) 1999 WL 108250].) However, while FTB seems to assert that this rule means we must give the example (subdivision (d)) the same weight, authority, or importance as what we might call the operative language (subdivision (b)) of the regulation, this position is not provided for in *Butts* or any other law cited in this matter. Instead, we read the rule in a more literal manner. FTB's apparent position that the examples be given similar weight or importance as the operative language in subdivision (b) asks that we ignore certain words and phrases in the regulation, principally that we ignore the purpose statement of subdivision (d) wherein it states that its two "examples are *intended* to *illustrate* the provisions of the regulation" (emphasis added). Giving meaning to these words, in accordance with *Butts*, shows that the intent of Regulation 19133 was that the examples are to be given less authority than the remainder of the regulation, which provides the four corners of the rules to follow when implementing the demand penalty for individuals. Accordingly, it would be an incorrect reading of the very words contained in Regulation 19133 to assert that an example that conflicts with the operative language of the regulation supersedes the application of the unambiguous operative language. Rather, such example would merely have failed in its intended purpose. There are no words or phrases in the regulation to insinuate that one of the examples could provide an alternative set of requirements for the imposition of the penalty that would challenge the

requirements set forth in subdivision (b)[5] and, in fact, no example provides any set of requirements.

FTB noted that previous OTA decisions discussing Regulation 19133 have cited to *Cook v. Commissioner* (7th Cir. 2001) 269 F.3d 854 (*Cook*), a Seventh Circuit Court of Appeals decision which FTB notes is not binding authority. FTB also argued that *Cook* did not consider the situation in this appeal, which is where two parts of the regulation are inconsistent. However, *Cook* did contemplate the situation where a regulatory example conflicts with the regulation when it stated, "examples set forth in regulations remain persuasive authority so long as they do not conflict with the regulations themselves." (*Cook*, at p. 858.) The logical reading of this rule of law is to find that in the opposite situation, as we have here, where an example does conflict with the rest of the regulation, the example shall not remain persuasive authority. While *Cook* is not binding authority on this California administrative body, we find it to be convincing as the appellate-level authority that most closely addresses the issue before us, i.e., what weight to give an example that contradicts the otherwise clear operative language of the regulation.[6]

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 is only one of several tools to interpret the regulation, but independent review is required. (*Yamaha, supra,* at pp. 7-8.) While an agency's interpretation "may be helpful, enlightening, even convincing[,] [i]t may sometimes be of little worth." (*Id*. at p. 8.)

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[5] And, as referenced above, the examples by their very nature do not set forth a complete set of requirements detailing when the penalty should be imposed, let alone a set of requirements that challenges those found in subdivision (b). In other words, subdivision (d) does not provide an alternative interpretation, which would stand on its own if subdivision (b) were found to have been improperly worded and disregarded. Instead, FTB proposes that subdivision (b) should be effectively reworded, based on a conflicting example, to mean something not provided for in the literal words of the regulation.

[6] For comparison, *Yamaha* focuses nearly entirely on distinguishing the level of deference to apply to Board of Equalization annotations (which are concededly not regulations). While *Yamaha* provides a thorough review of the standards of deference applicable to quasi-legislative versus interpretive regulations, it does not address the question of how to handle an internal inconsistency between operative language and an example.

The United States Supreme Court recently examined the rules for the interpretation and construction of an agency's regulations, particularly the circumstances that warrant giving deference to an agency's interpretation of its own regulation, in *Kisor v. Wilkie* (2019) 139 S.Ct. 2400 (*Kisor*). While the *Kisor* opinion declined to overrule *Bowles v. Seminole Rock & Sand Co*. (1945) 325 U.S. 410, or *Auer v. Robbins* (1997) 519 U.S. 452, the seminal decisions that established rules for deferring to an agency's interpretation, it recognized the limited scope of the doctrine. *Kisor* tells us that "the possibility of deference can arise only if a regulation is genuinely ambiguous . . . , even after a court has resorted to all the standard tools of interpretation. (*Kisor, supra,* 139 S.Ct. 2400 at p. 2414.) Based on our analysis above, relying on the words and phrases in Regulation 19133 itself, and giving meaning to every word and phrase (see *Butts, supra*), we find that while Example 2 is inconsistent with the operative language, this internal conflict is resolved by the stated intent of the examples, and the clearly superior and overruling authority the regulation provided to the operative language. Accordingly, Regulation 19133, by its own terms, provides that a conflict between the examples in subdivision (d) and the operative language in subdivision (b) is internally resolved by giving greater weight to subdivision (b), and the regulation is therefore not patently ambiguous because of an inconsistent example.

Even though we have found that Regulation 19133 is not ambiguous by its terms (i.e., patently ambiguous), statutory interpretation also provides for a review of intent "when a literal application of [the law] would frustrate the purpose of the [law] or would produce absurd consequences" (i.e., latent ambiguity). (See *Appeal of NASSCO Holdings, Inc., supra,* at *5 [finding latent ambiguity in a statute's definition of "tax"].) However, "a court should not create a latent ambiguity where none exists . . . ." (*Ibid*.; see also *Coburn v. Sievert* (2005) 133 Cal.App.4th 1483, 1496.) For purposes of this appeal, the discussion of latent ambiguity is a discussion of whether an application of Regulation 19133 consistent with subdivision (b) frustrates the purposes (i.e., intent) of the regulation or produces absurd results.

FTB raised arguments regarding the intent of the regulation for the first time at the oral hearing (e.g., a purpose to "penalize recent repeat non-filers," specific "input from the three-member Franchise Tax Board," and consistent enforcement of the regulation in accordance with the interpretation argued), but did not provide any evidentiary support for those assertions. FTB was on notice that this issue would be a potential topic at the oral hearing and had the

opportunity to provide any documentation to support its assertions regarding the intent behind the regulation.

Without evidence showing the intent behind the regulation beyond the language of the regulation itself, it is difficult to find the specific intent FTB alleges, such as an intended imposition of the penalty on *recent* repeat non-filers, or whether there was any concern about disadvantaging taxpayers by having their distant filing history expose them to the demand penalty. In fact, when asked whether the word "recent" was defined in any of the legislative language involving Regulation 19133, FTB responded that it was not, but that it was just a term used by FTB for purposes of the hearing. That word specifically, however, seems important to FTB's position, as it places an emphasis on consecutive years satisfying the regulation. Contrarily, a plain reading of subdivision (b) creates a situation that would ensure that a taxpayer would receive notice (in the form of an NPA issued in a prior year) before being subjected to the penalty. That notice would inform the taxpayer, through actions rather than just words, that failing to respond to a request or demand for a tax return would have real consequences. That reading provides taxpayers an opportunity to correct their behavior going forward in future years by either timely filing their return or responding to a demand, while imposing the penalty on taxpayers who repeat noncompliance after receiving this, in effect, warning. The interpretation FTB asks us to apply does not guarantee such notice.[7] Importantly, application of Regulation 19133 in accordance with the unambiguous language of subdivision (b) still imposes the penalty on only repeat non-filers. Accordingly, without evidence to the contrary, we have no basis in which to find that FTB's asserted intent is accurate, or that the application of Regulation 19133 pursuant to the operative language of subdivision (b) produces absurd results or fails to accurately reflect the intent of the regulation.

Similarly, we do not have evidence supporting the assertion that FTB has consistently followed the application of the regulation it endorses in this appeal. However, if we had such evidence, it would not be determinative in FTB's favor. While consistent application can support an agency's interpretation in situations where deference is being given to the agency (see *Yamaha*, *supra*, at p. 13), the simple fact that an agency has been applying the law in a certain

[7] As FTB stated at the hearing, the demand notice itself contains a warning that a penalty may be imposed if a timely response is not received; however, Regulation 19133's requirement that a previous NPA be issued following an earlier failure to respond shows that more than just the warning in the notice itself was required for imposition of the penalty on individuals.

manner is not wholly determinative as to whether that application is the correct application.[8] (See, e.g., *NASSCO Holdings, Inc*., *supra*.) Based on the above, we do not find that a literal application of Regulation 19133 pursuant to the operative language of subdivision (b) either frustrates the purpose of the law or produces absurd results; therefore, we conclude there is no latent ambiguity in Regulation 19133. Finding Regulation 19133 unambiguous as written, we do not find agency deference to be appropriate here, and we cannot reach a conclusion that would allow FTB to apply the regulation inconsistently with the clear operative language found in subdivision (b).

The tax code states that FTB *may* impose a penalty when a taxpayer does not timely respond to a Demand for Tax Return. To provide consistency and certainty as to *when* FTB would impose the penalty, for the benefit of taxpayers and the administrative process as a whole, it drafted a regulation with explicit rules as to when the penalty would be applied to individuals. One section of that regulation provides those explicit rules, which are clear and can only be read one way. A later section of that regulation provides examples intended to show how those explicit rules operate using hypothetical fact patterns. One of those examples does not follow the rules. FTB asserts that because that one example does not follow the otherwise clearly laid-out rules, it can apply the regulation in a manner inconsistent with the plain language of the rules, based on its interpretation of case law. We disagree, finding that case law and the language of the regulation itself support upholding the clear rules as written and made available to the public.

Because we find that the penalty was not properly imposed based on the application of Regulation 19133, we do not need to discuss the arguments regarding whether appellant timely responded to the Demand or whether appellant otherwise had reasonable cause for any failure to respond.

[8] FTB's arguments at the oral hearing appear to suggest that the interpretation of the regulation must follow the way the regulation is being enforced ("If it's to be interpreted another way, it doesn't fit with how the filing enforcement works"). However, the law is clear that the plain reading of a regulation is more significant than the way the regulation is being applied by the promulgating agency. (*Butts*, *supra*, at p. 838 ["If the plain language of a statute or regulation is clear and unambiguous, our task is at an end and there is no need to resort to the canons of construction or extrinsic aids to interpretation"].)

HOLDING

The demand penalty was not properly imposed.

DISPOSITION

FTB's imposition of the demand penalty is reversed, and appellant's claim for refund is granted.

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John O Johnson
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John O. Johnson
Administrative Law Judge

We concur:

DocuSigned by:
Suzanne B. Brown
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Suzanne B. Brown
Administrative Law Judge

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E. L. Ewing
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Date issued: 6/3/2020