OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18093783
MATTHEW GOLDMAN	) Date Issued: November 8, 2019

OPINION

Representing the Parties:

For Appellant: Martin Belak-Berger, CPA

For Respondent: David Kowalczyk, Tax Counsel

T. LEUNG, Administrative Law Judge: Pursuant to California Revenue and Taxation Code section 19324,[1] Matthew Goldman (appellant) appeals an action by the Franchise Tax Board (FTB or respondent) in denying his claim for refund in the amount of $3,171.25[2] for the 2015 taxable year.

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

ISSUE

Whether the notice and demand penalty (demand penalty) should be abated.

FACTUAL FINDINGS

1. Appellant did not file his 2015 California Resident tax return until July 11, 2017, reporting a federal adjusted gross income of $168,546, taxable income of $164,700, tax of $12,685, payments of $11,677, tax due of $1,008, and penalties of $273.
2. Respondent's Integrated Non-Filer Compliance Program (INC) annually matches income records obtained from various reporting sources against filed tax returns to identify

[1] All section references are to the Revenue and Taxation Code operative for the 2015 taxable year.

[2] This amount consists of the notice and demand penalty. Appellant is not contesting the $252 late-filing penalty or the $287 collection cost recovery fee.

individuals who may not have fulfilled their legal requirement to file a California income tax return. As part of the program, respondent received income information from the Employment Development Department and the Internal Revenue Service indicating that appellant received sufficient income to prompt a filing requirement.

3. On April 5, 2017, respondent issued a Demand for Tax Return (Demand) to appellant because respondent did not have a record of receiving appellant's 2015 tax return.[3] The Demand stated respondent had information that appellant received California source income in 2015. The Demand required appellant, by May 10, 2017, to file a tax return, send a copy of the tax return, or explain why appellant was not required to file a tax return. The Demand stated that if appellant did not respond by May 10, 2017, then respondent would assess a demand penalty totaling 25 percent of appellant's total tax without regard for any payment(s).
4. On June 5, 2017, respondent issued a Notice of Proposed Assessment (NPA) because respondent did not receive any response to the Demand.
5. On July 18, 2017, respondent issued a Notice of Tax Return Change - Revised Balance after it reviewed appellant's 2015 tax return. Respondent adjusted the demand penalty to $3,171.25 based on the tax reported on appellant's 2015 tax return.
6. On August 30, 2017, respondent issued an Income Tax Due Notice.
7. By letter dated February 7, 2018, appellant's tax preparer requested penalty relief for the demand penalty plus associated interest. The tax preparer stated it overlooked the fact that respondent rejected appellant's attempted e-filed 2015 tax return on December 15, 2016.[4] Appellant then filed a tax return seven months later and paid his balance due, but not the demand penalty. Appellant's tax preparer stated it established reasonable cause to abate the penalties because appellant retained a tax preparer to file his tax return before the due date, and filed his tax return before a notice was purportedly issued to him on August 2, 2017,[5] and appellant failed to file a timely tax return because

[3] Respondent stated that it mailed the Demand to appellant's last-known address in Los Angeles, California, and that the Demand was not returned to respondent. Appellant does not dispute receiving the Demand.

[4] Respondent stated that it does not have a record of appellant's attempt to e-file his tax return before July 11, 2017. Appellant's e-file transaction does not reflect an attempt by appellant to e-file his tax return before July 11, 2017.

[5] Respondent noted that it did not issue a notice on August 2, 2017.

of an oversight. Appellant attached a copy of his e-filing history showing he e-filed his tax return on July 11, 2017.

8. On March 1, 2018, respondent denied appellant's request for penalty abatement stating that appellant did not establish reasonable cause. On March 16, 2018, appellant made a $3,554.31 payment.

9. On April 15, 2018, respondent received appellant's claim for refund.

10. Respondent denied appellant's claim for refund stating he did not establish reasonable cause.

11. Appellant did not file a timely 2014 California Resident tax return. On March 1, 2016, respondent issued a Request for Tax Return (Request) to appellant for the 2014 taxable year, and when appellant did not timely respond in the manner prescribed, an NPA was issued on May 1, 2016.

DISCUSSION

Generally, personal income tax returns are due by April 15th of the year following the close of the taxable year. (Rev. & Tax. Code, § 18566.) A demand penalty may be imposed when a taxpayer fails to provide requested information or file a return upon notice and demand by respondent, unless it is shown that such failure was due to reasonable cause and not willful neglect. (Rev. & Tax. Code, § 19133.) The amount of the penalty is 25 percent of the amount of tax determined pursuant to section 19087 or of any tax deficiency assessed by the FTB. (*Ibid*.) The penalty is proper where the taxpayer does not respond within the time period set forth by the Demand. (*Appeal of Irma E. Bazan* (82-SBE-259) 1982 WL 11915.) The penalty imposed by this section is properly computed on the amount of the total correct tax liability as of the return due date before deduction of credits (including withholding credits). (*Appeal of Robert Scott* (83-SBE-094) 1983 WL 15480.)

Pursuant to section 19503, respondent has the authority to prescribe rules and regulations necessary to enforce the Personal Income Tax Law. Respondent exercised that authority in establishing a regulation that states how FTB will apply the discretion granted in the demand penalty statute.

California Code of Regulations, title 18 (Regulation), section 19133 provides two conditions for the imposition of the demand penalty. Regulation section 19133 states that in the case of an individual taxpayer, the penalty will only be imposed if "(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 . . . 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).) In Example 2 of the regulation, an NPA was issued in March 2001 after the taxpayer failed to respond to a Request for a 1999 return that was issued on January 15, 2001. (See Regulation § 19133(d).) Subsequently, a Demand and NPA were issued for 2001, and the example states that the demand penalty would apply. (*Ibid*.) Example 2 goes on to explain: "Because X received an NPA for not filing a return *within* the previous four years, the FTB issues a Demand for Tax Return for the 2001 taxable year." (*Ibid*., emphasis added.) However, we conclude that the illustrative example conflicts with the plain language of the regulation because under the facts of Example 2, the NPA was issued *in* 2001, not "during" the four-taxable-year period *prior to* 2001. Moreover, Example 2 is inconsistent because the explanation that the 1999 NPA was issued "*within* the previous four years" clashes with the regulatory language prescribing that the NPA be issued during "the four-taxable-year period preceding" 2001 (i.e., prior to 2001).

When assessing the validity of an interpretation of a regulation, such as in Example 2 of Regulation section 19133, the scope of review does not require the same level of deference as would a quasi-legislative rule. (*Yamaha Corp. of America v. State Board of Equalization* (1988) 19 Cal.4th 1, 11 (*Yamaha*).) 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.)

In *Kisor v. Wilkie* (2019)__U.S.__[139 S.Ct. 2400], the U.S. Supreme Court held that an agency's interpretation of its own regulations should be given deference only as a last resort. The Court placed the following limits on *Auer* deference:[6]

[6] In *Kisor*, Justice Kagan describes *Auer* deference as follows: "This Court has often deferred to agencies' reasonable readings of genuinely ambiguous regulations. We call that practice *Auer* deference. . . . " (*Kisor, supra,* 139 S.Ct. at p. 2408.)

> • *Auer* deference is applied only if a regulation is genuinely ambiguous. (139 S.Ct. at pp. 2408, 2414.)
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> • Traditional tools of construction must be exhausted before concluding a rule is genuinely ambiguous. (139 S.Ct. at pp. 2414.) "[O]nly when that legal toolkit is empty and the interpretive question still has no single right answer" can a judge conclude a regulation is ambiguous. (*Ibid.*)
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> • If there is a genuine ambiguity, the agency interpretation must be reasonable. (139 S.Ct. at p. 2415.)
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> • An "independent inquiry into whether the character and context of the agency interpretation entitles it to controlling weight" should be made by the judge. (139 S.Ct. at p. 2416.) The interpretation must be the official position of the agency, and the interpretation must implicate the agency's substantive expertise.[7] (139 S.Ct. at p. 2417.)

Kisor informs us that an agency's interpretation of its regulations is not entitled to unfettered deference.

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*).) In this appeal, we need go no further than the "plain language" rule. 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 respondent's interpretation of it.[8] (See *Barnhart v. Sigmon Coal Co.* (2002) 534 U.S. 438, 450 ["The inquiry ceases if the statutory language is unambiguous and the statutory scheme is coherent and consistent," internal quotations omitted]; *Desert Palace, Inc. v. Costa* (2003) 539 U.S. 90 ["[W]here, as here, the words of the statute are unambiguous, the judicial inquiry is complete," [internal quotations omitted].)

The plain words of Regulation section 19133 state that a specified NPA issued following an individual's failure in a prior year to timely respond to a Request or Demand must have

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[7] After the limitations placed on *Auer* deference by the majority opinion, Justice Gorsuch, in his concurrence, referred to the state of the doctrine as "zombified." (139 S.Ct. at p. 2425.)

[8] We note that it has been stated that "examples set forth in regulations remain persuasive authority *so long as they do not conflict with the regulations themselves*." (*Cook v. Commissioner* (7th Cir. 2001) 269 F.3d 854, 858, emphasis added.) This at least suggests that conflicts between regulatory language and illustrative examples should be resolved in favor of the regulatory language.

occurred *during* the four taxable years preceding the taxable year for which the demand penalty is imposed. (Regulation § 19133(b)(2).) Respondent's interpretation of the regulation appears to substitute the word "for" in place of the word "during." However, 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 the NPA for a taxpayer's failure to respond must have been issued during the four-taxable-year period preceding the taxable year for which the demand penalty is at issue. Furthermore, the "*within* the previous four years" language in Example 2 would require us to delete "the four-taxable-year period preceding" from the regulation. In other words, Example 2 is wrong because such an interpretation would allow the 1999 NPA to be issued in 2001 instead of 2000, unless the phrase "the four-taxable-year period preceding" is deleted from the regulation.

Here, the taxable year for which respondent desired to impose the demand penalty is 2015. The taxable year during which appellant previously failed to timely respond to a Request was 2014. In order to apply the demand penalty under Regulation section 19133, respondent must have issued a prior NPA, after the taxpayer failed to respond to a Request or Demand, during 2011, 2012, 2013, or 2014 (the four taxable years preceding 2015). However, in this case, appellant's failure to timely respond to a "prior" FTB demand (for 2014) did not occur until 2016, during a year *subsequent to* the taxable year at issue.

Respondent issued a Demand for the 2015 taxable year, and appellant did not timely respond in the manner prescribed, satisfying the first condition of Regulation section 19133. Respondent also issued a Demand to appellant for the 2014 taxable year which went unheeded, followed by an NPA, but this did not occur "during" the four previous taxable years (or "within" the previous four years), thus failing to satisfy the second condition of Regulation section 19133(b). Because appellant's failure to respond to FTB's notice and demand for taxable year 2014 did not occur during any of the four taxable years prior to 2015, the demand penalty was improperly imposed.

HOLDING

Respondent failed to satisfy the conditions prescribed in Regulation section 19133 for imposing the demand penalty.

DISPOSITION

Respondent's action regarding the demand penalty is reversed. In all other respects, respondent's action is sustained.

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Tommy Leung
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Tommy Leung
Administrative Law Judge

We concur:

DocuSigned by:
Jeffrey I Margolis
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Jeffrey Margolis
Administrative Law Judge

DocuSigned by:
Michael Geary
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