OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18093783
M. GOLDMAN	)
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OPINION ON PETITION FOR REHEARING

Representing the Parties:

For Appellant: Martin Belak-Berger, CPA

For Respondent: Marguerite Mosnier, Tax Counsel V

T. LEUNG, Administrative Law Judge: On November 8, 2019, the Office of Tax Appeals issued an opinion in which we found, as relevant here, that respondent Franchise Tax Board (FTB) improperly imposed a notice and demand penalty for the 2015 taxable year pursuant to California Revenue and Taxation Code (R&TC) section 19133[1] and California Code of Regulations, title 18, (Regulation) section 19133(b)(2). Accordingly, we ordered the notice and demand penalty be abated. FTB filed this petition for rehearing (petition) under R&TC section 19334. Upon consideration of FTB's petition, we conclude that the grounds set forth therein do not meet the requirements of Regulation section 30604.

A rehearing may be granted where one of the following five grounds exists, and the substantial rights of the complaining party are materially affected: (a) an irregularity in the appeal proceedings that occurred prior to the issuance of the written opinion and prevented fair consideration of the appeal; (b) an accident or surprise that occurred during the appeal proceedings and prior to the issuance of the written opinion, which ordinary caution could not have prevented; (c) newly discovered, relevant evidence, which the party could not have reasonably discovered and provided prior to the issuance of the written opinion; (d) insufficient

[1] All section references are to laws and regulations operative for the 2015 taxable year.

evidence to justify the written opinion or the opinion is contrary to law; or (e) an error in law. (Cal. Code Regs., tit. 18, § 30604(a)-(e).)

In our opinion, we concluded that the language of Regulation section 19133(b)(2) was unambiguous. As a result, to the extent that Example 2 within Regulation section 19133(d) was inconsistent, we declined to follow the example. Therefore, we concluded that the unambiguous language of the regulation controlled in this situation, and we determined that FTB did not meet the requirements of Regulation section 19133(b)(2) because FTB did not issue a prior notice of proposed assessment at any time during the 2011 through 2014 taxable years, which was the four-taxable-year period preceding the taxable year at issue.

In its petition, FTB argues that our opinion contains an error of law[2] and requests a rehearing pursuant to Regulation section 30604(e). FTB contends that our interpretation of Regulation section 19133(b)(2) is erroneous because we discounted Example 2 in order to find that Regulation section 19133(b)(2) was not ambiguous. FTB explains that had we given Example 2 equal footing, then we would have also concluded that an ambiguity arose between that example and subsection (b)(2) of the same regulation. Specifically, FTB argues that the ambiguity centers on the word "during," which should be interpreted as meaning "for" as demonstrated in Example 2 of Regulation section 19133(d)(2). Thus, FTB continues, because there is ambiguity, its interpretation of the word "during" to mean "for" should be given deference, which would have resulted in a finding that the notice and demand penalty was properly imposed.

FTB did not propose an assessment (NPA) against appellant, after appellant failed to timely respond to a Request or Demand, during 2011, 2012, 2013 or 2014. It issued the prior NPA (for the 2014 taxable year) to appellant in 2016, the year after the taxable year at issue, and, citing Regulation section 19133(d), Example 2, it argues that this was sufficient to allow imposition of the penalty because Example 2 creates an ambiguity within that regulation. FTB contends that the language of Example 2 of the regulation is entitled to weight equal to any other language contained in Regulation section 19133, and that we must resolve the resulting ambiguity by giving great deference to FTB's interpretation and resolution of the ambiguity, which is consistent with the regulatory intent: to look back four years and impose the penalty on

[2] While FTB claims there was an error in law (primarily used for procedural mistakes), it is clear from its arguments that it is instead making a claim that our decision was contrary to law (i.e., contained substantive errors).

repeat non-filers,[3] which are taxpayers to whom FTB has issued an NPA, after such taxpayers had failed to timely reply to a Request or Demand, for any of the previous four taxable years. FTB asserts that focusing on the specific wording of subsection (b)(2), while ignoring subsection (d)'s Example 2, produces an absurd result with repeat non-filers ignoring FTB's Requests or Demands for years without the threat of a penalty because of the time it takes FTB to identify repeat non-filers, determine whether a return was required, send a Demand, and issue an NPA.[4]

Although FTB believes that Example 2 is a rule of general application, as explained in greater detail below, Regulation section 19133(d) states, "The following examples are intended to *illustrate* the provisions of this regulation . . . ." (Emphasis added.) This introductory sentence states the purpose of the examples, including Example 2, in the regulation. Nowhere does it state or allude that the examples are to be considered the general rule of application as FTB argues. Instead, we interpret this introductory sentence to mean what it says, which is that the examples are intended to illustrate the provisions of the regulation. The rule of general application is the language contained in Regulation 19133(b)(2), not the examples. Therefore, we reject FTB's argument.

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* Court 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.)

We agree with FTB's assertion that our interpretation could effectively prevent FTB from imposing the penalty until there have been several years of consecutive failures to file within a four-taxable-year period, and that this result may in some circumstances be contrary to the

[3] As relevant here, according to FTB, a repeat non-filer is a taxpayer who fails to file a return more than once within a four-taxable-year period.

[4] According to Example 2, FTB issued what it calls the "qualifying" NPA for year 1 in March of year 3.

purpose and intent of Regulation section 19133. However, having determined that the language of subsection (b)(2) controls and that this subsection is clear on its face, our job is done. As stated in *Kisor*,

> If uncertainty does not exist, there is no plausible reason for deference. The regulation then just means what it means—and the court must give it effect, as the court would any law. Otherwise said, the core theory of *Auer* deference is that sometimes the law runs out, and policy-laden choice is what is left over. . . . But if the law gives an answer—if there is only one reasonable construction of a regulation—then a court has no business deferring to any other reading, no matter how much the agency insists it would make more sense. Deference in that circumstance would "permit the agency, under the guise of interpreting a regulation, to create *de facto* a new regulation."

(*Kisor*, *supra*, 139 S.Ct. 2400, at p. 2415.)

Clearly, we have a conflict between the language of subsections (b)(2) and (d) of Regulation 19133. That does not necessarily mean the regulation is ambiguous. We must first decide whether illustrative examples are entitled to consideration and weight equal to that afforded to the regulatory language that precedes them. As stated in Regulation section 19133(d), "[t]he .....examples are intended to illustrate the provisions of this regulation." Thus, subsection (d) states that the examples describe FTB's interpretation of the regulation that precedes them. And while we agree with FTB that illustrative examples are part of a regulation and must be considered as such by us, we conclude that there are situations where the language in an illustrative example is not entitled to consideration and weight equal to the regulatory language that precedes the examples.

Regulatory language that "comes from an example contained in a regulation, rather than the body of a regulation, is of no import, as 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 (*Cook*) (emphasis added); see also *United States v. Brown* (10th Cir. 2003) 348 F.3d 1200, 1210-1211 (*Brown*).) This at least suggests that conflicts between regulatory language and illustrative examples should be resolved in favor of the regulatory language. We agree. We are not persuaded that the language in Example 2 should control our interpretation of Regulation section 19133, and we find that there is only one reasonable construction of Regulation section 19133, one based on the clear language of subsection (b)(2).

FTB believes OTA's reliance on *Cook* is misplaced because the *Cook* court cited to *Freeport Country Club*,[5] which in turn cited to *Maryland Casualty Co.*,[6] a 1920 United States Supreme Court decision. "It is settled by many recent decisions of this court that a regulation by a department of government, addressed to and reasonably adapted to the enforcement of an act of Congress, the administration of which is confided to such department, has the force and effect of law if it be not in conflict with express statutory provision. The law is not different with respect to the rules and regulations of a department of a state government." (*Maryland Casualty Co., supra*, 251 U.S. at p. 349, internal citations omitted.) FTB is correct in arguing that *Maryland Casualty* did not involve an example from a regulation; however, the significance of *Brown, Cook* and *Freeport* is the courts' use of a logical approach to reach their conclusion that an example is of no import unless it is in sync with the regulation it is explaining. Thus, just as a regulation needs to be consistent with the statute it is interpreting (see *Maryland Casualty, supra*), an example to a regulation also needs to be consistent with the regulation it is interpreting; otherwise, an inconsistent example is useless. Put another way, the federal appellate courts' analogy of regulation-statute consistency to examples interpreting their adopted regulations is a logical extension of the holding in *Maryland Casualty*, as quoted above, and FTB has cited no case disputing *Cook* or *Brown*.

While FTB noted the purported absurdity of OTA's literal interpretation of the word "during" which allegedly results in favoring individuals who ignore its tax return demand notices for "several years," the real irony is that Example 2 does not help it because of the examples' wording and consecutive taxable years were not illustrated. The examples state that the penalty may be imposed as long as the taxpayer "received an NPA for not filing a return within the previous four years"; replacing "within" with "for" could work in order to effectuate FTB's

[5] *Freeport Country Club v. United* States (7th Cir. 1970) 430 F.2d 986, 992 (*Freeport*).

[6] *Maryland Casualty Co. v. United States* (1920) 251 U.S. 342 (*Maryland Casualty*).

stated policy goal, or deleting the words "the previous."[7] Again, we decline to do this rewrite for FTB.

Although FTB emphasizes that Example 2 supports imposition of the demand penalty on individuals who fail to file their tax returns for consecutive taxable years, the two examples in that regulation do not describe that fact pattern. While we will not speculate as to why FTB chose to illustrate with the 1999 and 2001 taxable years, the use of a consecutive taxable year hypothetical (e.g., either 1999 and 2000, or 2000 and 2001) could have made it more apparent to the drafters that employment of the word "for" would adequately implement said policy as opposed to the use of "during" or "within."

Thus, we continue to find that the words in Regulation section 19133(b)(2) are unambiguous, and FTB's interpretation is not entitled to deference. (See *Kisor v. Wilkie*, *supra*, 139 S.Ct. at 2415.)

For the foregoing reasons, FTB's petition is hereby denied.

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Tommy Leung
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Tommy Leung
Administrative Law Judge

I concur:

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Michael F. Geary
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Date Issued: 6/24/2020

[7] Interestingly, the use of the words "during" and "within" would implement the finding in FTB's study (Exhibit T) that the "qualifying" NPA for year 1 was the catalyst for voluntary filing compliance by two thirds of the non-filers in the "subsequent taxable year." But in order for this causal relationship to occur, the taxpayer must have received the "qualifying" NPA prior to the due date of the subsequent year's tax return. According to FTB's own timelines, this cause and effect cannot occur with respect to consecutive taxable years and, therefore, in order to impose the demand penalty when consecutive taxable years are involved, FTB would need to ignore this part of its study.