

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 19125598
B. McCUTCHEON AND)
M. WINTHAGEN)
_____)

OPINION

Representing the Parties:

For Appellants: Melissa Chung, Attorney

For Franchise Tax Board: Christopher T. Tuttle, Tax Counsel

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

T. LEUNG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, B. McCutcheon and M. Winthagen (appellants) appeal an action by respondent Franchise Tax Board (FTB) in denying appellants’ claims for refund of: (1) a late filing penalty of \$1,524.50¹ and a notice and demand (demand) penalty of \$681.00 for the 2015 taxable year; (2) a late filing penalty of \$1,355.25 and a demand penalty of \$1,355.25 for the 2016 taxable year; and (3) a late payment penalty of \$397.98 for the 2017 taxable year.²

Appellants waived their right to an oral hearing; therefore, this matter is being decided based on the written record.

ISSUES

1. Whether appellants have established reasonable cause for the late filing of their 2015 and 2016 tax returns.

¹ This is the amount reflected in appellants’ refund claim and appeal letter.

² Although appellants’ 2017 refund claim included a claim for the \$68.00 underpayment of estimated tax penalty, their appeal letter does not include this penalty. Moreover, since the entirety of appellants’ appeal is based on the reasonable cause exception, which is not available for the underpayment of estimated tax penalty under these circumstances, we will not address this penalty any further herein.

2. Whether appellants have shown that the demand penalty should be abated for the 2015 and 2016 taxable years.
3. Whether appellants have established reasonable cause for the late payment of tax for the 2017 taxable year.

FACTUAL FINDINGS

1. Appellants did not file their 2015 and 2016 California tax returns (Forms 540) until August 9, 2018. FTB received information through its Integrated Non-Filer Compliance (INC) program indicating that appellants paid mortgage interest in 2015 and 2016, which prompted FTB to issue a Demand for Tax Return (Demand) for the 2015 taxable year on May 18, 2017, and a Demand for the 2016 taxable year on March 15, 2018, that required a response by June 21, 2017, and April 18, 2018, respectively. When FTB did not receive responses to the 2015 and 2016 Demands, it issued Notices of Proposed Assessment (NPAs) for the 2015 and 2016 taxable years together with late filing penalties, demand penalties and interest for both years. The NPAs were not timely protested and the tax deficiencies and penalties proposed in the NPAs were affirmed.
2. After appellants filed their 2015 and 2016 tax returns, FTB accepted the tax liabilities reported in the returns as correct and adjusted the penalties accordingly.
3. Appellants filed their 2017 California tax return on August 27, 2018, showing a total amount due of \$2,948. FTB imposed a late payment penalty of \$397.98.
4. Because FTB had no record of their 2012 tax return, appellants were sent a Demand³; when they failed to timely respond to the Demand, FTB sent appellants an NPA for the 2012 taxable year in 2014.
5. After appellants paid all outstanding liabilities for the 2015, 2016, and 2017 taxable years on September 5, 2019, they filed claims for refund for the penalties applied to those taxable years, which FTB denied.

³ Although the Demand is not in the record, the NPA refers to such a document, and appellants have not contested this.

DISCUSSION

Issue 1: Whether appellants have established reasonable cause for the late filing of their tax returns for the 2015 and 2016 taxable years.

California imposes a penalty for the failure to file a tax return on or before its due date, unless it is shown that the late filing is due to reasonable cause and not due to willful neglect. (R&TC, § 19131.) The penalty is computed at 5 percent of the amount of tax required to be shown on the return for every month that the return is late, up to a maximum of 25 percent. (R&TC, § 19131(a).) For purposes of calculating this penalty, the amount of tax required to be shown on the return is reduced by any timely paid tax amounts, and any credits against the tax which may be claimed on the return. (R&TC, § 19131(c).) FTB properly imposed the late filing penalties for the 2015 and 2016 taxable years because appellants filed their 2015 and 2016 tax returns on August 9, 2018, after the respective extended deadlines had passed.

The late filing penalty may be abated if a taxpayer shows that the failure to timely file was due to reasonable cause and not due to willful neglect. (R&TC, § 19131(a).) To establish reasonable cause, taxpayers must show that they filed their tax return late despite the exercise of ordinary business care and prudence. (*Appeal of Quality Tax & Financial Services, Inc.*, 2018-OTA-130P; *Appeal of Curry* (86-SBE-048) 1986 WL 22783; *Appeal of Sleight* (83-SBE-244) 1983 WL 15615.)

Appellants argue that they have reasonable cause due to difficult circumstances stemming from appellant-husband's depression. While illness or other personal difficulties that prevent a taxpayer from filing a timely return or paying tax can be considered reasonable cause in some cases, the taxpayer must present credible and competent evidence that the circumstances continuously prevented the taxpayer from filing a timely return or paying tax. (*Appeal of Xie*, 2019-OTA-025P; *Appeal of Halaburka* (85-SBE-025) 1985 WL 15809.) Although FTB does not dispute appellants' assertion, this alone does not demonstrate how appellants were continuously prevented from filing their tax returns on time. Even if appellant-husband could show that he was continuously prevented from timely filing appellants' tax returns due to his depression, appellant-wife also had an obligation to timely file their tax returns, and there is insufficient evidence indicating she was continuously prevented from doing so.

Appellants also assert difficulties with raising their son as preventing them from timely filing their tax returns. If illness or other personal difficulties simply cause taxpayers to sacrifice

the timeliness of one aspect of their affairs to pursue other aspects, the taxpayers must bear the consequences of that choice. (*Appeal of Orr* (68-SBE-010) 1968 WL 1640.) Despite having enough adjusted gross income for the 2015 and 2016 taxable years to necessitate filing their tax returns, appellants failed to file their returns by the respective deadlines and failed to exercise ordinary business care and prudence as required to establish reasonable cause existed.

Therefore, as appellants were able to earn income during the periods at issue, it appears that appellants chose to pursue other aspects of their lives instead of timely filing their returns.

Furthermore, appellants have not shown how the hardships continuously prevented them from being able to file their tax returns for the years at issue. Therefore, appellants have not established reasonable cause for the late filing of their 2015 and 2016 tax returns.

Issue 2: Whether appellants have shown that the demand penalty should be abated for the 2015 and 2016 taxable years.

If a taxpayer fails or refuses to make and file a return upon the receipt of a Demand from FTB, then, unless the failure is due to reasonable cause and not willful neglect, FTB may add a penalty of 25 percent of the amount of tax determined pursuant to R&TC section 19087. (R&TC, § 19133.) FTB will impose a demand penalty if the taxpayer fails to respond to a current Demand and FTB issued an NPA under the authority of R&TC section 19087(a) after the taxpayer failed to timely respond to a Request for Tax Return or a Demand at any time during the preceding four taxable years. (Cal. Code Regs., tit. 18, § 19133(b).)

Here, appellants' 2012 taxable year NPA was issued in 2014, which was during the four taxable year period preceding issuance of the 2015 and 2016 NPAs. Accordingly, FTB properly imposed a demand penalty of \$681.00 for 2015 (i.e., 25 percent of \$2,724) and \$1,355.25 for 2016 (i.e., 25 percent of \$5,421.)

When FTB imposes a demand penalty, the burden of proof is on the taxpayer to show that reasonable cause exists to support an abatement of that penalty. (*Appeal of Findley* (86-SBE-091) 1986 WL 22761.) To establish reasonable cause, a taxpayer must show that the failure to reply to the Demand occurred despite the exercise of ordinary business care and prudence. (*Appeal of Bieneman* (82-SBE-148) 1982 WL 11825.) The taxpayer's reason for failing to respond to the Demand must be such that an ordinary intelligent and prudent businessperson would have acted similarly under the circumstances. (*Appeal of GEF Operating, Inc.*, 2020-OTA-057P; *Appeal of Findley, supra*, 1986 WL 22761.)

For the same reasons stated above, appellants have not presented sufficient evidence of reasonable cause for failing to respond to the Demand or that they exercised ordinary business care and prudence. Thus, appellants have not shown reasonable cause for failing to respond to the Demand.

Issue 3: Whether appellants have established reasonable cause for the late payment of tax for the 2017 taxable year.

A late payment penalty shall be imposed when a taxpayer fails to pay the amount shown as due on the return on or before the due date of the return. (R&TC, § 19132.) The late payment penalty has two parts. The first part is 5 percent of the unpaid tax. (R&TC, § 19132(a)(2)(A).) The second part is 0.5 percent per month, or portion of a month (not to exceed 40 months), calculated on the outstanding balance. (R&TC, § 19132(a)(2)(B).) Here both the computation of the penalty and lateness of the 2017 tax payment are undisputed and, therefore, the penalty was properly imposed.

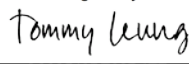
The late payment penalty may be abated if the taxpayer shows that the failure to make a timely payment of tax was due to reasonable cause and not due to willful neglect. (R&TC, § 19132(a).) The issue of whether a taxpayer has demonstrated reasonable cause for failure to timely pay tax asks the same questions and weighs the same evidence as the inquiry of whether reasonable cause exists for failure to timely file a tax return; therefore, decisions analyzing whether reasonable cause existed for failure to timely file a tax return are persuasive authority for determining whether reasonable cause existed for the failure to timely pay the tax. (*Appeal of Triple Crown Baseball LLC*, 2019-OTA-025P; *Appeal of Berolzheimer*, 86-SBE-172.) For the reasons discussed above regarding the late filing penalty, we find that appellants have not shown reasonable cause to abate the late payment penalty.

HOLDINGS

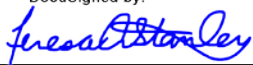
1. Appellants have failed to establish reasonable cause for the late filing of their 2015 and 2016 tax returns.
2. Appellants have failed to show that the demand penalty should be abated for the 2015 and 2016 taxable years.
3. Appellants have failed to establish reasonable cause for the late payment of tax for the 2017 taxable year.


DISPOSITION

FTB’s action is sustained.

DocuSigned by:

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 Tommy Leung
 Administrative Law Judge

We concur:

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 Teresa A. Stanley
 Administrative Law Judge

DocuSigned by:

 67F043D83FF547C...
 Sheriene Anne Ridenour
 Administrative Law Judge

Date Issued: 12/9/2020