OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **K. HAJIKHANI AND** **J. SHEPARD**	) OTA Case No. 18093815)))))

OPINION

Representing the Parties:

For Appellants: Kevin Bratcher, CPA

For Respondent: David Kowalczyk, Tax Counsel

For Office of Tax Appeals: Matthew D. Miller, Tax Counsel III[1]

A. VASSIGH, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, K. Hajikhani and J. Shepard (appellants) appeal an action by respondent Franchise Tax Board (FTB) denying appellants' claim for refund of $21,767 for the 2016 tax year.

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

ISSUES[2]

1. Whether FTB properly imposed the demand penalty for the 2016 tax year.
2. Whether appellants have shown reasonable cause for failing to timely respond to FTB's Demand for Tax Return (Demand) for the 2016 tax year.
3. Whether appellants have shown reasonable cause for failing to timely file their 2016 tax return.

[1] At the time of writing this Opinion, Mr. Miller was a Tax Counsel III at Office of Tax Appeals (OTA).

[2] Appellants included interest in the amount of their claim for refund, but have not separately argued for the abatement of interest on appeal; therefore, it will not be addressed as a separate issue and will only be revised in accordance with the underlying penalties should they be revised by this Opinion.

FACTUAL FINDINGS

1. FTB issued the Demand to appellants on March 30, 2018, for the 2016 tax year. The Demand stated that if appellant, J. Shepard, did not respond to the notice by April 25, 2018, a demand penalty would be assessed. Appellants failed to timely respond to the Demand, which required appellant, J. Shepard, to either file a California tax return, send a copy of a filed California tax return, or explain why she was not required to file a California tax return for that year.
2. Therefore, FTB issued a Notice of Proposed Assessment (NPA) on May 21, 2018, for the 2016 tax year. The NPA included a proposed assessment of tax, late-filing penalty, demand penalty and filing enforcement fee.
3. In 2017, FTB had issued an NPA for the 2015 tax year, after appellants failed to timely respond to a Request for Tax Return.
4. Appellants filed their 2016 California tax return on July 13, 2018, reporting tax due. FTB issued a Notice of Tax Return Change, revising the proposed assessment of tax, the late-filing penalty and the demand penalty. FTB removed the filing enforcement fee.
5. Appellants filed a claim for refund, which FTB denied. This timely appeal followed.
6. Appellant, J. Shepard, worked long hours during the period between February 2017 to December 2018. During part of this time, she was out of state due to her elderly mother's health condition (December 2017 through April 2018). Appellant, K. Hajikhani, supervised two remodeling projects out of town from February 2017 to August 2017. Appellants did not begin gathering their documents to file their 2016 California tax return until May 2018.

DISCUSSION

Issue 1: Whether the FTB properly imposed the demand penalty for the 2016 tax year.

R&TC section 19133 imposes a penalty on a taxpayer who fails to furnish a tax return or any information requested in writing by FTB. This penalty is commonly known as the demand penalty. The penalty is 25 percent of the amount of the tax deficiency determined by FTB unless the taxpayer establishes the failure to respond to the Demand was due to reasonable cause and not willful neglect. (R&TC, § 19133.) For individuals subject to tax under the California Personal Income Tax Law, FTB will only impose the demand penalty if: (1) the taxpayer fails to

respond to a current Demand in the manner prescribed; and (2) FTB previously proposed an assessment of tax under the authority of R&TC section 19087(a), after the taxpayer failed to timely respond to a Request for Tax Return (Request) or a Demand in the manner prescribed, at any time during the four-taxable-year period preceding the tax year for which the current Demand is issued. (Cal. Code Regs., tit. 18, § 19133(b)(1)-(2).)

Here, FTB issued the Demand for appellant J. Shepard's 2016 California tax return on March 30, 2018, and then on May 21, 2018, FTB issued an NPA for the 2016 tax year. FTB contends that the demand penalty was properly imposed under California Code of Regulations, title 18, section (Regulation) 19133 because in 2017 it issued a Request and an NPA for tax year 2015. Specifically, FTB contends that Regulation 19133 should be interpreted consistently with Example 2 of subdivision (d), which indicates that the prior Request or Demand and NPA must have been issued for one of the four tax years preceding the tax year of the current Demand. We refer to FTB's interpretation of the regulatory provision as the "agency interpretation" or the "subdivision (d) interpretation."

On the other hand, the use of the term "during" as used in subdivision (b)(2) could possibly be interpreted as requiring that the previous NPA be issued on a date falling within the four-taxable-year period, i.e., 48-month time period, preceding the tax year for which the current Demand is issued. We refer to this interpretation as the "non-agency interpretation" or the "subdivision (b) interpretation." Applying this interpretation to the instant facts would mean that FTB did not properly impose the demand penalty for the 2016 tax year because FTB issued the prior NPA for the 2015 tax year in 2017, which is not within one of the four calendar years preceding the tax year for which the current Demand was issued (i.e., 2016). Therefore, as a preliminary matter, we must determine the correct interpretation of Regulation 19133 in order to determine whether FTB properly imposed the demand penalty under R&TC section 19133.

The rules of statutory construction govern the interpretation of regulations. (*Butts v. Bd. of Trustees of Cal. State Univ.* (2014) 225 Cal.App.4th 825, 835 (*Butts*).) Accordingly, we must give regulatory language its plain, commonsense meaning. At the same time, if possible, we must "accord meaning to every word and phrase in the regulation, and we must read regulations

as a whole so that all of the parts are given effect [citation]."[3] (*Ibid.*, citing *Price v. Starbucks* (2011) 192 Cal.App.4th 1136, 1145.) Regulation 19133 is made up of four subdivisions, and the examples provided in subdivision (d) are as much a part of the regulation as subdivisions (a) through (c). Accordingly, when interpreting Regulation 19133, we must examine all subdivisions of the regulation, including the examples set forth in subdivision (d). Subdivision (d) provides:

> Example 1
>
> Assume Taxpayer X has not filed a California personal income tax return for the 1999 taxable year. This is the first time that X has not filed a timely California personal income tax return. As a result of X's non-filing, the FTB mails a Request for Tax Return to X on January 15, 2001. When X does not timely respond to the Request for Tax Return, the FTB issues a Notice of Proposed Assessment (NPA) on March 20, 2001, assessing tax, a late filing penalty, and interest, but the NPA does not include a notice and demand penalty under Revenue and Taxation Code section 19133.
>
> Example 2.
>
> Assume the same facts as in Example 1, and X does not file a California personal income tax return for the 2001 taxable year. 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. If X fails to timely respond to the Demand for Tax Return, the FTB will issue an NPA that includes tax, a late filing penalty, interest, and a notice and demand penalty under Revenue and Taxation Code section 19133.

(Cal. Code Regs., tit. 18, § 19133(d).)

In Example 1, the taxpayer failed to file a tax return for the 1999 tax year and failed to respond to the FTB's January 15, 2001 Request. As a result, FTB issued an NPA on March 20, 2001, for the 1999 tax year. We note that if the non-agency interpretation is applied to Example 1, FTB would only be able to assess a demand penalty for tax years 2002, 2003, 2004 or 2005, because the NPA must have been issued on a date *within any one of the four calendar years preceding the year* for which the current Demand was issued.

Example 2 does *not* support the non-agency interpretation. In Example 2, the taxpayer failed to file a tax return for the 2001 tax year and failed to respond to FTB's subsequent Demand. In this example, 2001 is the year for which the current Demand was issued. If we use

[3] Our primary aim is to ascertain the intent of the administrative agency that issued the regulation. (*Butts*, *supra*, 225 Cal.App.4th 825, 835.) When that intent cannot be discerned directly from the language of the regulation, we may look to a variety of extrinsic aids, including the purpose of the regulation, the legislative history, public policy, and the regulatory scheme of which the regulation is a part. (*Id.* at p. 836.)

the non-agency interpretation of Regulation 19133, then the first Request would have been required to have been issued within 1997, 1998, 1999 or 2000, because the taxpayer's failure to timely respond to the first Request or Demand must have occurred *in any one of the four calendar years preceding the year* for which the current Demand was issued (i.e., 2001). However, in Example 2, the NPA was issued in 2001. Therefore, it is impossible to reconcile Regulation 19133, subdivision (d), Examples, with the non-agency interpretation of Regulation 19133 and the plain meaning of the word *during*, as used in subdivision (b)(2). Subdivisions (b)(2) and (d), therefore, are in apparent conflict; thus, an ambiguity exists within the regulation's provisions. Consequently, we must determine the proper interpretation of Regulation 19133's provisions.

Administrative Deference – Background

A pillar of modern administrative law is the doctrine of judicial deference to agency interpretations of laws and rules that the agency administers (administrative deference). The federal approach to statutory interpretation is governed by *Chevron v. Natural Resource Defense Council* (1984) 467 U.S. 837 (*Chevron*), which created the principle known as "*Chevron* deference." *Chevron* deference requires a federal court to defer to a federal agency's interpretation of a federal statute that the agency administers, if the underlying statute is unclear, and the agency's interpretation is deemed reasonable. (*Id*. at pp. 842–845.) A companion case to *Chevron* is *Auer v. Robbins* (1997) 519 U.S. 452; this opinion created what is known as "*Auer* deference," which requires federal courts to also uphold a federal agency's interpretation of its own regulation, unless that interpretation is "plainly erroneous or inconsistent with the regulation." (*Id.* at p. 461.) The United States (U.S.) Supreme Court affirmed *Auer* deference in its recent opinion, *Kisor v. Wilkie* (June 26, 2019, No. 18-15)___U.S.___(139 S.Ct. 2400, 2415) (*Kisor*). The Supreme Court, however, limited the application of *Auer* deference to instances where a regulation is "genuinely ambiguous, even after a court has resorted to all the standard tools of interpretation."[4] (*Id.* at p. 2414.)

[4] In addition, if there is a genuine ambiguity, "the agency's reading must still be 'reasonable.'" (*Kisor*, at p. 2416.) Additional factors for analyzing whether *Auer* deference should be provided include: "the regulatory interpretation must be . . . the agency's 'authoritative' or 'official position,' rather than any more ad hoc statement not reflecting the agency's views", "must in some way implicate its substantive expertise", and "must reflect 'fair and considered judgment.'" (*Id.* at pp. 2416-2417.)

California's Approach

The approach of California courts in reviewing this state's agency actions is separate and distinct from the federal approach. One example of such a difference is that the California courts distinguish between quasi-legislative rules and interpretive rules, with the former requiring greater deference than the latter. As stated by the Supreme Court of California in *Yamaha Corp. of America v. State Bd. of Equalization* (1998) 19 Cal.4th 1 (*Yamaha*), a quasi-legislative rule:

> represents an authentic form of substantive lawmaking …. Because agencies granted such substantive rulemaking power are truly "making law," their quasi-legislative rules have the dignity of statutes. When a court assesses the validity of such rules, the scope of its review is narrow. If satisfied that the rule in question lay within the lawmaking authority delegated by the Legislature, and that it is reasonably necessary to implement the purpose of the statute, judicial review is at an end.

(*Id.* at pp. 10–11.)

Pursuant to R&TC section 19503(a), FTB has the authority to prescribe rules and regulations necessary to enforce, as relevant here, the Personal Income Tax Law. When a California statute empowers an administrative agency to adopt regulations implementing legislation, the agency is authorized to conduct rulemaking in a quasi-legislative capacity, having been delegated the California State Legislature's lawmaking power, pursuant to R&TC section 19503(a). Regulations, such as Regulation 19133, constitute quasi-legislative rules because FTB exercised its "delegated legislative power to make law," and courts and administrative tribunals, such as OTA, are bound by these regulations "as firmly as statutes themselves." (*Yamaha*, *supra*, at pp. 7, 11.)

Regulation 19133 is not an "interpretive rule" because it does not merely "interpret the relevant statute" (*Western States Petroleum Assn. v. Board of Equalization* (2013) 57 Cal.4th 401, 414 (*Western States*)) or merely represent the "agency's view of the statute's legal meaning and effect."[5] (*Yamaha, supra*, at p. 6.) Instead, Regulation 19133 is more than an interpretation

[5] Interpretive rules are agency rules which interpret the statute but generally do not receive notice and comment through the rulemaking process. An agency's interpretive rule does "not implicate the exercise of a delegated lawmaking power; instead, it represents the agency's view of the statute's legal meaning and effect." (*Yamaha*, *supra*, 19 Cal.4th at p. 11.) If an agency has adopted a "formal" interpretive rule in accordance with Administrative Procedure Act provisions, which include notice and comment procedures that enhance the accuracy and reliability of the resulting administrative "product," that circumstance weighs in favor of judicial deference. (*Yamaha*, *supra*, at p. 13.) However, even formal interpretive rules do not command the same weight as quasi-legislative rules. (*Ibid*.)

and involved the "exercise of [FTB's] discretion" and "quasi-legislative judgment" in creating a "special rule" as to when the penalty will or will not be imposed, which demonstrates that it is a quasi-legislative regulation. (See *Western States*, *supra*, at p. 414.) This is shown in the language of Regulation 19133, which instead of merely interpreting the statute, adopts language that "fills the gap" to create a new legal standard as to when FTB "may add" the demand penalty.[6] (See *GMRI, Inc. v. Cal. Dept. of Tax and Fee Admin.* (2018) 21 Cal.App.5th 111, 194 (*GMRI*); R&TC, §§ 19503(a), 19133 ["[FTB] may add a penalty"].) Therefore, in adopting this regulation, FTB was "truly 'making law'" pursuant to its "substantive rulemaking power" delegated by the legislature under R&TC section 19503(a). (*Yamaha*, *supra*, at p. 10.) Accordingly, Regulation 19133 is a quasi-legislative rule, and subdivision (d) has the force and effect of law. (See *Yamaha supra*, at pp. 6–7.)

California regulations, including any examples, generally go through a public "notice and comment" process overseen by the Office of Administrative Law's rulemaking process.[7] Regulation 19133, subdivision (d), went through a public notice and comment process. (See Notice of Proposed Rulemaking, Cal. Reg. Notice Register 2004, No. 17-Z, p. 504.) The regulation was published, and the public was invited to submit comments and questions in response. Subdivision (d) is not an agency interpretation of the other subdivisions within the regulation -- it is part of the plain meaning of a quasi-legislative rule.[8]

We note the examples are preceded by the following language: "The following examples are intended to illustrate the provisions of this regulation." As noted above, subdivision (d) cannot be considered separately from the other subdivisions; rather, as stated earlier, we must attempt to accord meaning to every word and phrase in the regulation, and we must read the

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[6] " 'An administrative agency is not limited to the exact provisions of a statute in adopting regulations to enforce its mandate … [The administrative agency] is authorized to " 'fill up the details' " of the statutory scheme." (*GMRI*, *supra*, at p. 125, citing *Batt v. City and County of San Francisco* (2010) 184 Cal.App.4th 163, 171.)

[7] See R&TC section 19503(a), regarding the authority granted by the Legislature to FTB to issue administrative regulations. All California regulations are subject to the Administrative Procedures Act and must go through a public notice and comment process, unless expressly exempted by statute. (See *Englemann v. State Bd. of Ed.* (1991) 2 Cal.App.4th 47; Gov. Code, § 11346.)

[8] See *Yamaha*, *supra*, 19 Cal. 4th at pp. 4-5, where the court discusses the degree of deference to be given by courts to quasi-legislative agency rules, in contrast to mere agency interpretations, such as annotations. This is because, unlike agency interpretations, "quasi-legislative rules are the substantive product of a delegated *legislative* power conferred on the agency." (*Ibid*, italics in original.)

regulation as a whole so that, to the extent possible, all of the parts are given effect. (*Butts*, *supra*, 225 Cal.App.4th at p. 835.) The word "illustrate" is defined as "*to make clear* by giving or by serving as an example or instance*,*"[9] as well as "to show the *meaning or truth* of something *more clearly*, especially by giving examples."[10] (Emphasis added.) Therefore, in according meaning to every word and phrase in the regulation, we find that the word "illustrate" was included to communicate that the examples would provide "meaning or truth" and "make clear" the rest of the regulation's text. Thus, we find that subdivisions (b)(2) and (d) are in conflict and that consequently, an ambiguity exists within the regulation. Accordingly, we must apply an administrative deference analysis to determine the proper interpretation of Regulation 19133.

Administrative Deference Analysis

Having determined that Regulation 19133, in its entirety, is an ambiguous quasi-legislative rule, we turn to the correct standard of review. "The rationale for deference is strongest when the challenged action by the agency results from a rulemaking decision within the authority delegated to the agency [citation], where the agency interprets one of its own regulations [citations] . . . ." (*New Cingular Wireless PCS, LLC v. Pub. Utilities Com.* (2016) 246 Cal.App.4th 784, 807, citing *Yamaha*, *supra*, 19 Cal.4th at pp. 11-12.) The weight given to an agency's construction of a statute or regulation is situational. We consider two broad categories of interrelated factors relevant to the weight due an agency interpretation: those indicating that the agency has a comparative interpretive advantage over courts and tribunals and those indicating that the interpretation in question in probably correct. (*Id.* at p. 812.)

Regarding the comparative advantage criteria, we look to whether the agency has expertise and technical knowledge, "as for example when an agency is interpreting its own regulations, since it is 'likely to be intimately familiar with regulations it authored and sensitive to the practical implications of one interpretation over another.'" (*Id.* at p. 812, quoting *Yamaha*, *supra*, 19 Cal. 4th at p. 12.) The "probably correct" criteria focus on circumstantial evidence surrounding the agency's interpretation, such as whether there are indications of careful consideration by senior agency officials, whether the agency has consistently maintained the interpretation in question, especially if it is long-standing, and whether the rule was adopted in

[9] https://www.merriam-webster.com/dictionary/illustrate

[10] https://dictionary.cambridge.org/us/dictionary/english/illustrate. Also, "intend" is defined as "to have in mind as a purpose or goal" as well as "signify, mean." (https://www.merriam-webster.com/dictionary/intend.)

accordance with the Administrative Procedure Act (i.e., through formal notice-and-comment procedures). (*Ibid.*)

First, it is undeniable that FTB has considerable expertise relevant to its interpretation of its own regulation since it is intimately familiar with its history, authorship, and implementation. Second, the evidence indicates that the regulation was carefully considered by senior agency officials. On appeal, FTB provides contemporaneous documents related to the creation of the regulation, which are described as follows. Before implementation of the regulation, individual taxpayers were subject to the demand penalty after any failure to respond to a demand for a tax return under R&TC section 19133, regardless of the taxpayer's prior filing history. There were concerns in the taxpayer community that this penalty was too harsh. (See Demand Penalty for Nonfilers.)[11] As a result, FTB conducted a study analyzing the extent of the correlation between receiving a demand for a taxable year and taxpayers' filing compliance in the subsequent taxable year. (See *ibid.*; Filing Enforcement's Effects on Subsequent Year Compliance [the above-mentioned study].) Finding that there was strong correlation, FTB staff proposed changing procedures so that only repeat nonfilers would be assessed a demand penalty. (See Demand Penalty for Nonfilers.)

At its September 19, 2000 board meeting, FTB's board considered the proposal. (FTB meeting, September 19, 2000, Transcript of Proceedings.) Upon motion from a board member, the board approved the current procedure which looks back to the four previous tax years because "that's the general statute of limitations." (*Ibid.*) Following implementation of the policy change, FTB's staff were granted permission to proceed with the formal rulemaking process to codify FTB's new procedure. (See Franchise Tax Board Minutes, October 1, 2002.) FTB then engaged in the formal rulemaking process under the Administrative Procedures Act before adopting the regulation in its current form on November 23, 2004. (See Notice of Proposed Rulemaking; Register 2004, No. 48.) Therefore, the evidence indicates careful consideration by senior FTB officials.

Third, FTB has consistently maintained its current interpretation of Regulation 19133. "[A] court may consider whether the agency has consistently maintained the interpretation in

[11] In this document, FTB proposes three alternative recommendations to "address public concerns regarding the perceived harshness of the demand penalty": (1) "[o]nly repeat nonfilers would be assessed the demand penalty"; (2) "[f]irst time nonfilers would receive a reminder letter prior to the demand letter"; or (3) "continue with current policy." FTB selected the first alternative. (FTB minutes, September 19, 2000.)

question, especially if it is long-standing—since '[a] vacillating position ... is entitled to no deference.'" (*Butts*, *supra*, 225 Cal.App.4th at p. 840, quoting *Yamaha*, *supra*, 19 Cal.4th at p. 13).) "When an agency's construction of a statute or regulation contradicts its original interpretation, it is not entitled to significant deference." (*Ibid.,* citing *Murphy v. Kenneth Cole Productions, Inc*. (2007) 40 Cal.4th 1094, 1106, fn. 7.)

Since January 1, 2001, FTB's software has been programed to "differentiate between first time nonfilers and repeat nonfilers." (Staff Request for Permission to Proceed.)[12] FTB sends a Request to a first-time nonfiler, which does not trigger the penalty, whereas a repeat nonfiler is sent a Demand, which triggers the penalty. (*Ibid*.) Accordingly, FTB's software was contemporaneously programmed to penalize "only repeat nonfilers," i.e., those who are sent a Demand and not a Request. (Demand Penalty for Nonfilers.) On the other hand, taxpayers "who fail to file income tax returns for the first time would not be penalized." (Economic and Fiscal Impact Statement.)[13] Thus, the purpose of the regulation is to penalize repeat nonfilers, unambiguously defined as excluding first-time nonfilers. Accordingly, FTB's contemporaneous implementation of the subdivision (d) interpretation is demonstrated by the implementation of a process whereby a single Request is issued, followed by a Demand, which triggers the penalty.

Here, appellants received a Request in the previous tax year, and, for the subsequent tax year, a Demand. Thus, there is no question that appellants are repeat nonfilers, as an examination of their filing history indicates that they failed to file in the previous tax year. (See Demand Penalty for Nonfilers ["the automated system would be programmed to identify the taxpayers that have a history of not filing a return and send demand letters to that group"].) As a result, these circumstances clearly reflect the contemporaneously implemented agency practice, as described above, where a repeat nonfiler is sent a Demand.

In addition, we are not aware of any decision issued by the State Board of Equalization (SBE), the predecessor to the Office of Tax Appeals, where the demand penalty was imposed pursuant to an interpretation inconsistent with the subdivision (d) interpretation. While no

[12] In this document, FTB staff requests permission from FTB to proceed with the formal regulatory process for the proposed regulation.

[13] As part of the rulemaking process, FTB submitted an Economic and Fiscal Impact Statement in which FTB estimated there would be no fiscal impact to the state "because the proposed regulation codifies the Franchise Tax Board's existing policy in effect since January 1, 2001, of not imposing the notice and demand penalty against first-time nonfilers" and the Department of Finance previously "anticipated this change in policy and adjusted baseline state revenues downward."

formal opinions were issued with regard to the demand penalty for tax years where the regulation was in effect, FTB's consistent interpretation is demonstrated by examining previously issued summary decisions. In such non-precedential summary decisions addressing demand penalties for tax years going back to the inception of the regulation, FTB consistently asserted that the taxable year of the prior NPA must be examined, not the date, for purposes of satisfying the requirements of Regulation 19133.[14] In the analyses, the SBE also consistently acknowledged that the regulation uses the term "during," before proceeding to a conclusion that the tax year of the NPA is relevant to satisfying the regulatory prerequisite and sustaining FTB on the matter.[15]

These decisions provide assertions by FTB consistent with the subdivision (d) interpretation examining the tax year of the prior NPA, and which relate to tax years on appeal contemporaneous with the inception of the regulation. These decisions also demonstrate that if FTB had not followed the subdivision (d) interpretation, or, if its software was programmed otherwise, such penalties would not have been imposed and the related appeals would not have reached the SBE. Specifically, the decisions indicate numerous instances where FTB would not have imposed the penalty had it interpreted the regulation inconsistent with subdivision (d).[16] For instance, in *Appeal of Chase* (June 25, 2014) 2014 WL 2945825, with regard to a demand penalty imposed for the 2010 tax year, it was argued by FTB and held by SBE that the regulation prerequisite was satisfied by a Request and NPA issued in 2010 for the 2007 tax year.

We further note the subdivision (b) interpretation would not allow imposition of the penalty in cases where the taxpayer, such as appellant in this case, failed to file two years in a

[14] See, e.g., *Appeal of Buergel* (May 25, 2010) 2010 WL 2640846; *Appeal of Harper* (July 13, 2010) 2010 WL 3912762; *Appeal of Gregoline* (Oct. 24, 2012) 2012 WL 7656652; *Appeal of Barth* (Nov. 14, 2012) 2012 WL 7677804; *Appeal of Ferris* (June 26, 2012) 2012 WL 4049236; *Appeal of Davis* (June 26, 2012) 2012 WL 4049235; *Appeal of Heavens* (July 24, 2012) 2012 WL 5178662; *Appeal of Kennedy* (Oct. 24, 2012) 2012 WL 7656659; *Appeal of Holm* (Oct. 24, 2012) 2012 WL 7656655; *Appeal of Schwab* (May 22, 2013) 2013 WL 6804555; *Appeal of Lei* (July 17, 2013) 2013 WL 7210688; *Appeal of Kindschi* (Feb. 26, 2013) 2013 WL 2371824; *Appeal of Hauber* (May 22, 2014) 2014 WL 4694613; *Appeal of Rivas* (Sep. 23, 2014) 2014 WL 7530115; *Appeal of Sheedy* (Aug. 5, 2014) 2014 WL 7407267.

[15] Some decisions, such as *Appeal of Capriotti* (Dec. 15, 2009) 2009 WL 5849494, even go so far as to acknowledge the requirement to examine the NPA tax year as a "Four-Tax-Year Rule."

[16] See, e.g., *Appeal of Hastings* (July 28, 2015) 2015 WL 13427833; *Appeal of Gibbons* (Aug. 25, 2015) 2015 WL 13439911; *Appeal of Jones* (Feb. 3, 2016) 2016 WL 9526358; *Appeal of Daniels* (Aug. 30, 2016) 2016 WL 9776376; *Appeal of Ghiya* (Nov. 29, 2016) 2016 WL 10005733; *Appeal of Smail* (Aug. 29, 2017) 2017 WL 6419261; *Appeal of Lwanga* (Dec. 11, 2017) 2017 WL 8791035.

row. Because tax returns are never due until the following tax year, it is impossible under the subdivision (b) interpretation to impose the demand penalty on a repeat nonfiler who fails to file in consecutive years, which is an absurd result given that the purpose of the regulation to provide relief for first-time nonfilers only.[17] (Demand Penalty for Nonfilers.) Accordingly, only after failing to file three times in a row would the subdivision (b) interpretation provide for the appellant to be considered here a repeat nonfiler such that the penalty could be imposed.

There is no indication in the regulatory history or in the regulation that a first-time and second-time nonfiler may both escape the penalty. In fact, the regulatory history states that only taxpayers "who fail to file income tax returns for the first time would not be penalized." (Economic and Fiscal Impact Statement.) If FTB had meant for second-time nonfilers to escape the penalty, such a requirement would have been provided in the regulatory history or the regulation. Had FTB contemporaneously implemented the subdivision (b) interpretation in the above-mentioned summary decisions where that interpretation would not have imposed the penalty, two Requests would have been required: one Request for the first-time nonfiling and a second Request for second-time nonfiling, both allowing escape from the penalty.

However, such a requirement was not provided, and we note that such a requirement would allow the inconsistent imposition of the penalty, allowing both first-time and second-time nonfilers to escape the penalty, depending on the date of the prior NPA, which varies on a case-by-case basis. For example, if the Demand was issued for the 2013 tax year, the subdivision (b) interpretation *would* impose the penalty if the prior NPA was issued in 2012. However, the subdivision (b) interpretation *would not* impose the penalty if the NPA was issued in 2013. This is an absurd result that is contrary to the stated purpose of the regulation. Given the above, we conclude FTB did not contemporaneously, or at any time, implement the subdivision (b) interpretation.

Fourth and finally, Regulation 19133 was adopted in accordance with the Administrative Procedure Act (i.e., through formal public notice and comment procedures).

In conclusion, while we acknowledge that the plain language of subdivision (b)(2) of Regulation 19133 supports the non-agency interpretation and FTB's use of the term "during" in

[17] "One of the fundamental rules of statutory construction is that a law should not be applied in a manner producing absurd results, because the Legislature is presumed not to intend such results." (*Fireside Bank Cases* (2010) 187 Cal.App.4th 1120, 1129.)

subdivision (b)(2) is, at best, unartful,[18] we must accord meaning to every word and phrase in the regulation, and we must read the regulation as a whole so that all of the parts are given effect. In doing so, we observe that subdivisions (b)(2) and (d) create an ambiguity within the regulation. Accordingly, we apply the administrative deference analysis for a quasi-legislative rule such as Regulation 19133. Here, FTB's interpretation of its own regulation is consistent with the regulatory intent and is expressed in FTB's contemporaneously implemented procedures. Therefore, we will defer to FTB's interpretation.

The dissent acknowledges that reading subdivisions (b)(2) and (d) together results in a regulation that is "internally inconsistent." However, it avoids undertaking the requisite administrative deference analysis by creating an artificial distinction between the regulation's "operative language" in subdivision (b)(2), and the other subdivisions that make up the regulation. In determining whether the regulation is ambiguous, the dissent only considers subdivision (b)(2), and deems "the operative language of the regulation to be unambiguous." The legal authorities cited by the dissent do not support a conclusion that the so-called "operative language" must be followed when it conflicts with a clearly stated regulatory example. According to that reasoning, the so-called "operative language" must be followed without examination of any regulatory intent or purpose, regardless of any contradictions with the intent of the regulation or with other parts of the regulation, as in this case.[19]

The dissent argues that the use of the word "illustrate" implies the examples are to be given less weight than the "rules themselves." The dissent argues that, as a result, any ambiguities or conflicts are, therefore, resolved in favor of the "operative language" of the

[18] We find it problematic that the plain language of subdivision (b)(2) is contradicted by the example in subdivision (d), as the purpose of a regulation is to provide transparent guidance on how an agency is carrying out the purpose or provisions of a statute. Our concerns about transparency and fairness to the public are assuaged, however, by a few considerations. This regulation went through the public notice and comment process, so the public had the opportunity to review and provide any concerns about the language of the regulation when it was proposed. To our knowledge, no concerns about the contradictory language of the regulation were raised at that time, or upon appeal. We undertake this examination of whether the demand penalty was properly imposed as part of our effort to adjudicate tax appeals fairly and to arrive at the correct legal conclusion for each issue before us. Our concerns are also assuaged by the fact that although the plain language of the regulation does not provide clear guidance on when FTB will impose the demand penalty, FTB's practice has been consistent and applied uniformly. Finally, most relevant to appellants is that in the Demand, FTB warned appellants that if they did not respond by April 25, 2018, the demand penalty would be imposed. As a result, appellants were accorded notice of the penalty and were given an opportunity to respond accordingly and avoid the imposition of the penalty.

[19] We note that "[o]ur primary aim is to ascertain the intent of the administrative agency that issued the regulation." (*Butts*, *supra*, at p. 835.)

regulation. The dissent provides no legal authority for this position, and such an argument disregards well-established legal authority on statutory construction. As discussed above, in according meaning to every word and phrase in the regulation, we find that the word "illustrate" was included to communicate that the examples would provide "meaning or truth" and "make clear" any so-called "operative language." Accordingly, the use of the word "illustrate" does not support the argument in the dissent that the plain meaning of the word "illustrate" means the examples should be provided less weight, such that an example or well-established law on statutory construction may be disregarded.

The dissent supports its analysis with cites to *Kisor*, *supra*, and *Cook v. Commissioner* (7th Cir. 2001) 269 F.3d 854, 858, affg. 115 T.C. 15. With regard to *Kisor*, we first note that federal and California case law on agency deference are significantly different. *Auer* and *Kisor* apply to federal regulations, such as "legislative regulations," and provide their own set of distinct factors for analysis, as described above. California, however, does not have legislative regulations, but instead "quasi-legislative regulations," with their own set of distinct factors for examination with regard to agency deference.

The *Auer* standard is more deferential to an agency interpretation than *Yamaha*, as discussed above, and holds that an agency interpretation controls "unless 'plainly erroneous or inconsistent with the regulation.'" *Kisor* did not overrule *Auer*. Instead, *Kisor* provides a framework for when *Auer* deference should apply. For instance, a central holding in *Kisor* was that "before concluding that a rule is genuinely ambiguous, a court must exhaust all the 'traditional tools' of construction" by careful consideration of the "text, structure, history, and purpose of a regulation." (*Kisor*, *supra*, at p. 2415.)

Binding Authority on This Matter

"On a federal question, the decisions of the United States Supreme Court are binding on state courts." (*Forsyth v. Jones* (1997) 57 Cal.App.4th 776, 781 (*Forsyth*), citing *People v. Bradley* (1969) 1 Cal.3d 80, 86.) With respect to the decisions of lower federal courts on federal questions, the California courts have held that such decisions, "while persuasive, are not binding on us."[20] (*Ibid*; *Shaeffer v. Califia Farms, LLC* (2020) 44 Cal.App.5th 1125, 1142.) Here, however, it is important to note that we are not addressing a federal question, such as interpreting

[20] In addition, "[w]here the federal circuits are in conflict, the decisions of the Ninth Circuit [which decides appeals from federal courts in California] are entitled to no greater weight than those of other circuits." (*Forsyth*, *supra*, at p. 783, citing *Irwin v. City of Hemet* (1994) 22 Cal.App.4th 507, 520, fn. 8.)

a federal statute or regulation. Therefore, in this case, a United States Supreme Court decision interpreting a federal regulation, such as *Kisor*, is not binding on OTA. (*Kelly v. Vons Companies, Inc*. (1998) 67 Cal.App.4th 1329, 1337 [U.S. Supreme Court cases that "construe federal law … are not binding in our interpretation of state law"], citing *People v. Guiton* (1993) 4 Cal.4th 1116, 1126.)[21] In addition, "lower federal decisional authority [such as *Cook*] is neither binding nor controlling in matters involving state law." (*People v. Beltran* (2013) 56 Cal.4th 935, 953; see also *Nunez v. Nevell Group, Inc*. (2019) 35 Cal.App.5th 838, 847.)

Accordingly, while federal cases interpreting a federal regulation may be persuasive, in this case, they do not constitute binding precedent to OTA on matters solely of state law. (See *Spikener v. Ally Financial, Inc.* (2020) 50 Cal.App.5th 151, 158, citing *Kilroy v. Superior Court* (1997) 54 Cal.App.4th 793, 801 [In applying *Kisor* and *Auer*, the court stated: "Because we are applying a federal [regulation], we follow rules of ... construction enunciated by the United States Supreme Court."].)

When a California statute is substantively identical to a federal statute, we may look to the federal authority interpreting the federal statute as highly persuasive in interpreting the California statute. (*Appeal of Kishner* (99-SBE-007) 1999 WL 1080250, citing *Douglas v. State of California* (1942) 48 Cal.App.2d 835, 838) Here, however, there is no comparable federal statute or regulation, as there is no similar federal demand penalty.

In addition, as previously discussed, the approach of the California courts in interpreting California regulations is separate and distinct from the federal approach. Finally, there is substantial state precedent on the issue of interpreting a California regulation, such as *Yamaha*, *supra*. Therefore, there is no need to address federal cases such as *Kisor* and *Cook*. We will, however, address the dissent's analysis citing to those cases.

The dissent cites to *Kisor, supra,* for the proposition that "because the words 'at any time during' are unambiguous, FTB's interpretation should not be entitled to deference." However, if we applied the holdings of *Kisor* to this appeal, we would conclude that, in fact, the regulation's provisions are ambiguous. As noted above, a central holding of *Kisor* requires careful consideration of the "text, structure, history, and purpose of a regulation." The dissent does not

[21] A U.S. Supreme Court decision which is "based solely on federal law, is not binding on this court in its interpretation of state law. Nevertheless, a decision by the United States Supreme Court, and especially a unanimous one … is entitled to 'respectful consideration'" and may be found "persuasive." (*People. v. Guiton* (1993) 4 Cal.4th 1116, 1126.)

include such an analysis as directed by *Kisor*.[22] However, as discussed above, we found an ambiguity in the regulation, not only by carefully considering the text and structure of the regulation, but the history and purpose of the regulation. Therefore, *Kisor* is consistent with the holding of the majority.

The dissenting opinion cites to *Cook v. Commissioner*, *supra*, 269 F.3d at p. 858, for the proposition that "examples set forth in regulations *remain persuasive authority* so long as they do not conflict with the regulations themselves." (Emphasis added.) The dissent states that it would not consider Example 2 of Regulation 19133(b)(2) as "persuasive authority" because it "does create such a conflict." However, the federal regulation discussed in *Cook,* Treasury Regulation section 25.2702-3, promulgated under IRC section 2702, is a federal "interpretative regulation" as opposed to a federal "legislative regulation." (T.D. 8395, 57 FR 4250-01 ["the regulations … adopted by this Treasury decision are interpretative"].) As noted by *Walton v. Commissioner* (2000) 115 T.C. 589, which was cited by *Cook* and discussed the same regulation, "[t]he regulations at issue here are interpretative regulations..... Hence, while entitled to considerable weight, they are accorded less deference than would be legislative regulations ....." (*Ibid*., citing *Chevron*, *supra*, 467 U.S. at pp. 843-844.)

As noted by the dissent, *Cook* discussed whether the example would "remain persuasive authority." The U.S. Supreme Court has stated that the weight given to a federal interpretative regulation depends on certain factors which give it the "power to persuade."[23] (*Skidmore v. Swift & Co*. (1944) 323 U.S. 134, 140; see also, e.g., *Kisor*, *supra*, at p. 2414 ["courts should not give deference to an agency's reading, except to the extent it has the 'power to persuade'"].) In

[22] The dissent notes that "FTB's regulation is internally inconsistent" and that the example is in "conflict" with and "appears to overlook or disregard" subdivision (b)(2), and therefore states it would disregard subdivision (d). However, when there is such an internal conflict and "it is clear that a word has been erroneously used, a judicial correction will best carry out the intent of the adopting body." (*People v. Skinner* (1985) 39 Cal.3d 765, 775; see also *Szold v. Medical Bd. of California* (2005) 127 Cal.App.4th 591, 670 ["we interpret statutes so as to avoid giving effect to drafting errors"). Whether the use of a word is the result of a drafting error "can only be determined by reference to the purpose of the section and the intent of the electorate in adopting it." (*People v. Skinner, supra* at p. 776; see also *People v. Garcia* (1999) 21 Cal.4th 1.) Therefore, such an internal conflict that cannot be resolved, which is the result of a drafting error or oversight, as it appears here, is interpreted by the court in favor of the agency's intent in adopting the regulation. As discussed above, the agency's intent in adopting the regulation is in line with subdivision (d).

[23] See also, e.g., *Dalheim v. KDFW-TV* (5th Cir. 1990) 918 F.2d 1220, 1228 ["the persuasive authority of a given interpretation obtains only so long as 'all those factors which give it power to persuade' persist"], citing *Skidmore*, at p. 140.

addition, the U.S. Supreme Court held that "a court is not required to give effect to [a federal] interpretative regulation." (*Batterton v. Francis* (1977) 432 U.S. 416, fn 9 (*Batterton*).)

On the other hand, federal legislative regulations have the "force and effect of law." (*Batterton*, *supra*, at p. 844, fn 9.) Accordingly, holding the regulation to be "persuasive authority" in *Cook* demonstrates that the regulation was a persuasive interpretation as opposed to a binding legislative regulation that has the force of law. (See *Dillon Ranch Supply v. U.S.* (1981) 652 F.2d 873, 880 ["Such legislative regulations, if consistent with statutory authorization, adopted pursuant to proper procedure, and are reasonable, have the force of law."].)

Therefore, while the dissent states that it "would not give [Regulation 19133(d), Example 2] persuasive authority," Regulation 19133 is in fact a quasi-legislative regulation that is binding and has the force and effect of law. (See *Yamaha*, *supra*, at pp. 6-7.) On the other hand, an agency interpretation may be considered persuasive authority under California law, depending on such factors as described in *Yamaha* and as examined above. (*Id*. at p. 3 ["the deference due an agency interpretation – including the [California Department of Tax and Fee Administration (CDTFA)] annotations at issue here . . . will depend upon . . . those factors which give it the power to persuade"], citing *Skidmore*, *supra*, at p. 140.) The dissent, therefore, improperly likens the authority that may be given to a subdivision in the regulation to an agency interpretation such as, for example, the annotations of the CDTFA.

Furthermore, because the regulation discussed in *Cook* was an interpretive regulation in its entirety, both the example and non-example portion of such regulation would be persuasive authority. Therefore, there is no distinction drawn in *Cook* between the example and non-example portion of the interpretive regulation, because both parts are, at most, persuasive interpretations. As a result, *Cook* provides no holding that can be read to mean the example portion is given less weight than the non-example portion of the regulation. Thus, *Cook* is inapplicable to this appeal, and Regulation 19133(d)(2) cannot be held to be, or not to be, merely "persuasive authority."

In addition, by examining whether the regulation conflicts with the statute, *Cook* applies a federal standard on the validity of a federal regulation. (See, e.g., *GHS Health Maintenance Organization, Inc. v. U.S.* (Fed. Cir. 2008) 536 F.3d 1293, 1297 (*GHS*) [the "regulation conflicts

with the statute and is thus invalid"].)[24] In addition, a federal standard for determining the validity of interpretive regulations examines whether the regulation is a reasonable interpretation of the statute. (See, e.g., *United States v. Vogel Fertilizer Co.* (1982) 455 U.S. 16, 24-26 [interpretive regulation held invalid as unreasonable interpretation of statute].) *Cook* cites to cases which examine such a standard on validity, including *Freeport Country Club v. U.S.* (7th Cir. 1970) 430 F.2d 986, 992 (*Freeport*),[25] which states: "example 1 is on point and is persuasive authority . . . since the regulation is not an unreasonable interpretation of the statute, it must be sustained." (*Cook*, at p. 858; see also *Walton*, *supra*, at p. 598 ["a challenged regulation is not considered a . . . reasonable interpretation unless it harmonizes with the statutory language and with the statute's origin and purpose"].)[26] If a federal court finds that a federal interpretive regulation is consistent with its underlying statute and a reasonable interpretation, then the court may conclude that the regulation is "persuasive authority." (*Gerdes v. U.S.* (N.D.Cal. 1980) 498 F.Supp. 385, 388 (*Gerdes*).)[27] Therefore, in relying on *Cook*, the dissent applies a federal standard on the validity of a federal regulation.

Again, such a federal standard on the validity of a federal regulation is inapplicable here, as we are only addressing the interpretation of a California regulation. OTA does not have the jurisdiction to determine the validity of a California regulation. (*Appeal of Talavera*, 2020-OTA-022P.) Accordingly, we may not determine that the subdivision does not have the force and effect of law or, at any rate, that it is not persuasive authority.

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[24] "When a regulation directly contradicts a statute, the regulation must yield." (*GHS*, at p. 1297, citing *Ragsdale v. Wolverine World Wide, Inc.* (1997) 535 U.S. 81, 86.) "A regulation cannot stand if it is arbitrary, capricious, or manifestly contrary to the statute." (*Ibid*.)

[25] In addition, the standard provided by *Freepor*t, *supra*, is based on two cases involving the validity of a federal regulation. (See *Cohen v. U.S.* (1967) 381 F.2d 383, 388 ["As the regulations [and the examples] are not an unreasonable interpretation of the statute, they must be sustained"]; *Maryland Casualty Co. v. U.S.* (1920) 251 U.S. 342, 349 [determination of validity of a regulation involving examination of whether conflict with statute].)

[26] In *Walton*, *supra*, 115 T.C. at p. 604 (*Walton*), the court states: "we hold that Example 5 is an unreasonable interpretation and an invalid extension of [IRC] section 2702 [after examining Congressional intent]."

[27] As stated in *Gerdes, supra*: "The United States Supreme Court has declared on numerous occasions that Treasury regulations must be sustained by the Court unless they are unreasonable and "plainly inconsistent with the revenue statutes . . . the court finds, after a thorough investigation of the statute involved, the legislative history, and the regulation itself, that the regulation is entirely consistent with the interpretation of Section 6651 put forth by the United States. Therefore, this court must conclude that the regulation is persuasive authority." (See also *Smith v. U.S.* (S.D.N.Y. 1983) 571 F.Supp. 664, 667 [noting the regulations discussed in *Gerdes* are interpretive regulations].)

Finally, even if *Cook* was applied to the circumstances of this appeal, the dissent does not provide a discussion that supports its conclusion. The examination in *Cook* involved determining whether the example was invalid with regard to the underlying statute. In doing so, the court in *Cook* analyzed whether the example was consistent with the underlying statute and the intent of Congress in drafting the statute. (*Cook*, at p. 858 ["it is clear that, in drafting [IRC] section 2702, Congress intended to . . ."].)[28] The court, which affirmed a tax court decision, stated that it agreed with the lower court's determination as to Congressional intent that was, according to the tax court decision, based on an examination of "[l]egislative history" and a determination that "congressional purpose is advanced by [the example]" such that to hold otherwise "would be contrary to the intent of [the statute]." (*Cook*, *supra*, 115 T.C. at p. 24.) However, the dissent provides no such examination before making its conclusion. As noted above, we will not address whether, under California law, the regulation is valid because we cannot determine that a subdivision of the regulation is invalid and refuse to follow it on that basis.[29] (*Appeal of Talavera*, *supra*.)

Based on our administrative deference analysis, we must defer to FTB's interpretation of Regulation 19133. As such, the demand penalty was properly imposed in this case because the prior Request and NPA were issued for one of the four taxable years preceding the tax year at issue.

Issue 2: Whether appellants have shown reasonable cause for failing to timely respond to the Demand for Tax Return for the 2016 tax year.

When FTB imposes a demand penalty, the law presumes that the penalty was imposed correctly. (*Appeal of Goodwin* (97-SBE-003) 1997 WL 258474.) The burden is on a taxpayer to prove that reasonable cause prevented a timely response to the Demand. (*Ibid*.) To establish reasonable cause, a taxpayer must show that the failure to respond to a Demand occurred despite the exercise of ordinary business care. (*Appeal of Bieneman* (82-SBE-148) 1982 WL 11825.)

[28] The court in *Walton*, *supra*, at p. 597, stated that "[w]ith respect to interpretative regulations, the appropriate standard is whether the provision "'implement[s] the congressional mandate in some reasonable manner'" and looked to *Chevron*, *supra*, in applying that test.

[29] We note that the statutory test applied by courts in California in evaluating the validity of regulations is similar to the described federal test applicable to federal courts. (See Gov. Code, § 11342.2 ["no regulation adopted is valid or effective unless consistent and not in conflict with the statute and reasonably necessary to effectuate the purpose of the statute"].) However, we are not determining whether a regulation is invalid, but interpreting a regulation.

The taxpayer's reason for failing to respond must be such that an ordinarily intelligent and prudent businessperson would have acted similarly under the circumstances. (*Appeal of GEF Operating*, *Inc.*, 2020-OTA-057P.)

Difficulties suffered by a taxpayer, such as the serious illness of the taxpayer or a member the taxpayer's immediate family, are circumstances which the courts have acknowledged may constitute reasonable cause. (*McMahan v. Commissioner* (2nd Cir. 1997) 114 F.3d 366, 369.) For the difficulties to constitute reasonable cause, they must continuously prevent the taxpayer from timely complying with the statutory requirement. (*Appeal of Halaburka* (85-SBE-025) 1985 WL 15809.)

Appellants assert that they have reasonable cause for the failure to timely file and respond to the Demand because they suffered a series of difficulties that they claim caused them to be unable to timely manage their affairs. Appellants state that these hardships included numerous issues related to, for example, appellant J. Shepard's mother's health, as well as increased hours at work.[30]

While we are sympathetic to what was clearly a stressful and busy time, appellants provide no evidence or documentation establishing that they were continuously prevented from responding to the Demand. Appellants have the burden of proof to provide evidence to support their contentions. We have no information showing how being out of state impacted appellant J. Shepard's ability to handle her affairs, especially since her mother was under professional care at a rehab center. There is no evidence to show that appellant K. Hajikhani was continuously prevented from responding to the Demand during this period. Appellants have not provided us with any information or evidence to show what efforts they took to respond to the Demand in a timely manner or why they were prevented from providing their CPA with their tax information before May 2018. As such, we have no basis to find reasonable cause.

Moreover, appellant, J. Shepard, was able to earn substantial wages during the 2016 tax year. Penalty abatement is inapplicable if the difficulties at issue simply cause taxpayers to sacrifice the timeliness of one aspect their business affairs to pursue other aspects. (*Appeal of Triple Crown Baseball*, 2019-OTA-025P.) Taxpayer's selective inabilities to perform tax obligations, while participating in regular business activities, does not establish reasonable cause.

[30] Appellants argue that the penalties should be abated due to a history of timely payments. We were not provided evidence showing appellants' tax payment history. Regardless, there is no provision in the Revenue and Taxation code that would allow us to abate a penalty based on such circumstances.

(*Appeal of Head and Feliciano*, 2020-OTA-127P.) As such, because appellants both worked, and appellant, J. Shepard, earned wages during the relevant period at issue, they were not prevented from timely responding to the Demand or filing their California tax return. Instead, they sacrificed their filing obligation in order to pursue other aspects of their business affairs, which does not establish reasonable cause.

Additionally, appellants were on notice that they were failing to fulfill their filing requirement and that penalties could be issued if they failed to timely file and respond to the Demand. FTB issued the 2016 Demand on March 30, 2018. The Demand clearly stated that a demand penalty and a late-filing penalty could be issued if appellants failed to comply by April 25, 2018. Appellants, however, failed to either timely file or respond to the Demand. Accordingly, appellants have not shown reasonable cause such that the Demand penalty may be abated.

Issue 3: Whether appellants have shown reasonable cause for failing to timely file their 2016 tax return.

R&TC section 19131 provides that a late-filing penalty shall be imposed when a taxpayer fails to file a tax return on or before its due date, unless the taxpayer establishes that the late-filing was due to reasonable cause and not due to willful neglect. When FTB imposes a late-filing penalty, the law presumes that the penalty was imposed correctly. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; see *Appeal of Goodwin*, *supra*.) To establish reasonable cause, a taxpayer must show that the failure to file a return on time occurred despite the exercise of ordinary business care. (*Appeal of Tons* (79-SBE-027) 1979 WL 4068; *Appeal of Bieneman*, *supra*.) The taxpayer's reason for failing to file timely must be such that an ordinarily intelligent and prudent businessperson would have acted similarly under the circumstances. (*Appeal of Cummings* (60-SBE-040) 1960 WL 1418.)

Appellants' contentions for the late-filing penalty are the same as those for the demand penalty. For the same reasons as described above for the demand penalty, appellants have not shown reasonable cause to abate the late-filing penalty.

HOLDINGS

1. FTB properly imposed the demand penalty for the 2016 tax year.
2. Appellants have not shown reasonable cause for failing to respond to the Demand for the 2016 tax year.
3. Appellants have not shown reasonable cause for failing to timely file their 2016 tax return.

DISPOSITION

FTB's action is sustained.

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Amanda Vassigh
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Amanda Vassigh
Administrative Law Judge

I concur:

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Richard Tay
Administrative Law Judge

K. GAST, concurring in part and dissenting in part:

I concur with majority's opinion in Issues 3 and 4, but I respectfully dissent with respect to Issue 1 and, for that reason, would not have reached Issue 2. As explained below, I would have found Franchise Tax Board (FTB) improperly imposed the demand penalty under Revenue and Taxation (R&TC) section 19133 for the 2016 tax year.

R&TC section 19133 provides that if a taxpayer fails to file a return upon notice and demand by FTB, then FTB may impose a penalty of 25 percent of the amount of tax assessed pursuant to R&TC section 19087, unless the failure is due to reasonable cause and not willful neglect. California Code of Regulations, title 18, section (Regulation) 19133 further provides that for individuals, the demand penalty will only be imposed if the follow two conditions are satisfied:

> (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 under the authority of Revenue and Taxation Code section 19087, subdivision (a), 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*.

(Cal. Code Regs., tit. 18, § 19133(b)(1)-(2), emphasis added.)

Under the plain and unambiguous language of subsection (b)(2) above, I find, contrary to the majority's conclusion, that this subsection requires the Notice of Proposed Assessment (NPA) for a prior tax year to have been issued "*at any time during* the four-taxable-year period preceding" the current tax year for which FTB seeks to impose the demand penalty. Here, to properly impose the demand penalty for the 2016 tax year, FTB's regulation requires that FTB have issued an NPA for a prior tax year on a date anytime between January 1, 2012, through December 31, 2015. This threshold requirement has not been met in this case.

Specifically, rather than being issued "at any time during the four-taxable-year period *preceding* the taxable year for which the current Demand for Tax Return is issued," FTB's NPA for the 2015 tax year was not issued until August 7, 2017, which is *after* the 2016 tax year "for which the current [Demand] is issued." Therefore, FTB improperly imposed the demand penalty.

I note that Example 2 of the regulation appears to interpret subsection (b)(2) as being met if the prior NPA were issued for a tax year "within the previous four years." On this ground, the example contemplates imposition of the demand penalty for the 2001 tax year where the prior NPA for the 1999 tax year was issued on a date during the 2001 tax year. Thus, the example imposes the demand penalty when the prior NPA was issued during the *same* tax year for which the current demand is issued.

However, this example is directly contrary to the operative language of the regulation that requires that the prior NPA have been issued "at any time during the four-taxable-year period *preceding* the taxable year for which the current Demand for Tax Return is issued." (Emphasis added.) Thus, FTB's regulation is internally inconsistent. Contrary to the majority's conclusion, I find the operative language of the regulation to be unambiguous. It carefully and precisely references "the four-taxable-year period preceding" the tax year for which the current demand is issued. Rather than interpreting the operative language of the regulation, the example appears to overlook or disregard that language. In this circumstance, I see no reason to place greater weight on the implication of the example than on the clear and precise operative language. Indeed, Regulation 19133(d), where Example 2 is found, clearly indicates that the "examples are intended to *illustrate* the provisions of this regulation," and thus, in my view, are not intended to be given greater weight than the rules themselves. (Emphasis added.) Therefore, I would resolve the internal conflict in FTB's regulation by finding that FTB is bound by the ordinary and unambiguous meaning of the words used in the governing language of its regulation.

Finally, while "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), here, Example 2 does create such a conflict and I would not give it persuasive authority. Accordingly, because the words "at any time during" are unambiguous, FTB's interpretation should not be entitled to deference. (See *Kisor v. Wilkie* (June 26, 2019, No. 18-15)___U.S.___[139 S.Ct. 2400, 2415].)

For the foregoing reasons, I respectfully dissent with respect to Issue 1 and, for that reason, would not have reached Issue 2.

DocuSigned by:
Kenneth Gast
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Kenneth Gast
Administrative Law Judge

Date Issued: 12/29/2020