OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 19064857
E. KUAN	)
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	)
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	)

OPINION

Representing the Parties:

For Appellant: E. Kuan

For Respondent: Ellen L. Swain, Tax Counsel III

S. BROWN, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC) section 19324, E. Kuan (appellant) appeals an action by respondent Franchise Tax Board (FTB) in denying a claim for refund in the amount of $668.50 for the 2014 taxable year.

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

ISSUES

1. Whether the notice and demand penalty (demand penalty) of $668.50 for the 2014 tax year should be abated.
2. Whether appellant is entitled to abatement of interest for the 2014 tax year.

FACTUAL FINDINGS

1. Appellant did not timely file a 2013 California income tax return. On June 28, 2016, FTB issued to appellant a Request for Tax Return (Request). Because appellant did not file a return by the date specified in the request, FTB issued him a Notice of Proposed Assessment (NPA) on September 19, 2016.
2. Appellant did not timely file a 2014 California income tax return. On July 25, 2017, FTB sent him a Demand for Tax Return (Demand). The Demand required appellant, by

August 30, 2017, to file a tax return, send a copy of the tax return, or explain why he was not required to file a tax return. On September 25, 2017, FTB issued to appellant an NPA because it did not receive any response to the Demand. The NPA proposed a tax liability of $2,674, a delinquent filing penalty of $668.50, a demand penalty of $668.50, a filing enforcement fee of $84, and applicable interest.

3. In November 2017, appellant paid $4,376.06 to FTB for the 2014 tax year. On April 15, 2018, appellant filed his California income tax return for the 2014 tax year. On or about September 24, 2018, FTB issued appellant a refund of $3,777.19.
4. Appellant filed a timely claim for refund, requesting a refund of the demand penalty of $668.50 and applicable interest.[1]
5. On February 21, 2019, FTB denied appellant's claim for refund. This timely appeal followed.

DISCUSSION

Issue 1: Whether the demand penalty of $668.50 for the 2014 tax year should be abated.

Generally, personal income tax returns are due by April 15th of the year following the close of the taxable year. (R&TC, § 18566.) FTB may add a penalty of 25 percent of the amount of tax determined or assessed if a taxpayer fails to make and file a return after notice and demand by FTB, unless the taxpayer establishes the failure is due to reasonable cause and not willful neglect. (R&TC, § 19133.) The implementing regulation, California Code of Regulations, title 18, section (Regulation) 19133, states that FTB will impose the demand penalty only if the taxpayer fails to timely respond to a current Demand in the manner prescribed, and FTB "has 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 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)(2), emphasis added.)

[1] Appellant's opening brief also states that he wants a $46 refund that he requested on his 2014 return. Appellant did not provide any additional information or argument about why he is entitled to that additional refund amount, including why it was not covered by the refund he received in September 2018. In a June 2019 letter, the Office of Tax Appeals (OTA) acknowledged appellant's appeal for "the amount of $668.50, plus applicable interest." In an August 2019 letter, OTA invited appellant to submit any further response, but thereafter appellant did not do so. Accordingly, this opinion does not further address this topic.

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 Cal. Code Regs., tit. 18, § 19133(d).) Subsequently, a Demand and NPA were issued for 2001, and the example states that the demand penalty would apply: "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, and 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.

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] (*Kisor*), the U.S. Supreme Court held that an agency's interpretation of its own regulations should be given deference only as a last resort. While the *Kisor* opinion declined to overrule prior decisions such as *Auer* v. *Robbins, supra*, the court recognized the limited scope of the doctrine. *Kisor* explains 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. at p. 2414.) The opinion establishes 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.) In this appeal, we need to 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 FTB's interpretation of it. (See *Barnhart v. Sigmon Coal Co.* (2002) 534 U.S. 438, 450.)

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 occurred *during* the four taxable years preceding the taxable year for which the demand penalty is imposed. (Cal. Code Regs., tit. 18, § 19133(b)(2).) FTB'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 prior 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, to defer to the "*within* the previous four years" language in the regulation's Example 2 would require us to ignore "the four-taxable-year period preceding" language in the regulation. Hence, we decline to defer to Example 2's illustration of the regulation to the extent that this illustrative example is inconsistent with the plain, common-sense meaning of the word "during."

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

FTB issued a Demand for the 2014 taxable year, and appellant did not timely respond in the manner prescribed, satisfying the first condition of Regulation section 19133. However, 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 2014, the demand penalty was improperly imposed. Therefore, FTB shall abate the demand penalty.

Issue 2: Whether appellant is entitled to abatement of interest for the 2014 tax year.

Interest is not a penalty. It is compensation to the state for a taxpayer's use of the funds, and the law requires FTB to collect interest on past-due liabilities. There is no reasonable cause exception to the imposition of interest. (R&TC, § 19101(a); *Appeal of Yamachi* (77-SBE-095) 1977 WL 3905.) FTB can abate interest when the interest is attributable to unreasonable error or delay by an FTB officer or employee while performing a ministerial or managerial act in his or her official capacity. (R&TC, § 19104(a).)

OTA's jurisdiction in an interest abatement case is limited. We only review FTB's determination for abuse of discretion. (R&TC, § 19104(b)(2)(B); *Appeal of Gorin*, 2020-OTA-018P.) To show an abuse of discretion, a taxpayer must establish that, in refusing to abate interest, FTB exercised its discretion arbitrarily, capriciously, or without sound basis in fact or law. (*Woodral v. Commissioner* (1999) 112 T.C. 19, 23.) Interest abatement provisions are not intended to be routinely used to avoid the payment of interest, and thus abatement should be ordered only where failure to abate interest would be widely perceived as grossly unfair. (*Lee v. Commissioner* (1999) 113 T.C. 145, 149.)

Appellant argues that the Demand for the 2014 taxable year used the identical format as the Request he received regarding the 2013 taxable year, and that FTB's use of the same format for different types of correspondence created confusion and was an abuse of power. Appellant states that he prepaid his 2014 tax liability and thus had until April 15, 2018, to file his return for the 2014 tax year. Appellant contends that FTB failed to timely process his return and refund because he filed his return in April 2018, but FTB did not issue the refund until September 24, 2018, after he telephoned FTB to inquire about the status of the refund.

None of the facts in the record show any unreasonable error or delay by FTB. Thus, appellant failed to establish that FTB's refusal to abate interest was an abuse of discretion. Consequently, appellant is not entitled to abatement of interest. However, we note that given the abatement of the demand penalty, FTB may need to adjust the amount of interest due accordingly.

HOLDINGS

1. The demand penalty should be abated because FTB failed to satisfy the conditions prescribed in Regulation section 19133 for imposing the demand penalty.
2. Appellant is not entitled to abatement of interest for the 2014 tax year.

DISPOSITION

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

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Suzanne B. Brown
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Suzanne B. Brown
Administrative Law Judge

I concur:

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Alberto T. Rosas
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Alberto T. Rosas
Administrative Law Judge

N. DANG, concurring in part and dissenting in part:

I concur entirely as to Issue 2. However, I respectfully disagree with the application of California Code of Regulations, title 18, section (Regulation) 19133 as discussed in Issue 1.

The majority opinion acknowledges the direct conflict between the plain language of subdivisions (b) and (d) of Regulation section 19133, but resolves that conflict by disregarding regulatory language which it considers to be merely illustrative. In reaching this result, the majority opinion confuses the standard for assessing the validity of an agency's post-enactment, extrinsic interpretations with that of interpreting language contained within the regulation itself. The latter requires that every *word, phrase, sentence and part of a regulation be given significant consideration* in discerning its purpose. (*Curle v. Superior Court* (2001) 24 Cal.4th 1057, 1063.) "Interpretations that lead to absurd results or *render words surplusage* are to be avoided." (*Tuolumne Jobs & Small Business Alliance v. Superior Court* (2014) 59 Cal.4th 1029, 1037, italics added.) It is clear from applying these rules, that further inquiry is necessary to resolve the conflicting language of Regulation section 19133.

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Nguyen Dang
Administrative Law Judge

Date Issued: 6/18/2020