OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18042786
STEVEN E. REED	)
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	)
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	)

OPINION

Representing the Parties:

For Appellant:	Steven E. Reed
For Respondent:	Ellen L. Swain, Tax Counsel III
For Office of Tax Appeals:	Neha Garner, Tax Counsel III

J. LAMBERT, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, Steven E. Reed (appellant) appeals an action by respondent Franchise Tax Board (FTB) proposing: (1) an assessment of tax of $1,734, a late-filing penalty of $433.50, and a notice and demand (demand) penalty of $647.50, plus interest, for the 2014 tax year; and (2) an assessment of tax of $5,657, a late-filing penalty of $1,414.25, and a demand penalty of $1,499.50, plus interest, for the 2015 tax year.

Administrative Law Judges Josh Lambert, Amanda Vassigh, and Suzanne B. Brown held an oral hearing for this matter in Sacramento, California, on November 21, 2019. At the conclusion of the hearing, the record was closed and this matter was submitted for decision.

ISSUES

1. Whether appellant established error in the proposed assessments of tax for the 2014 and 2015 tax years.
2. Whether appellant established a basis for abatement of the late-filing penalties for the 2014 and 2015 tax years.

3. Whether appellant established a basis for abatement of the demand penalties for the 2014 and 2015 tax years.
4. Whether Office of Tax Appeals (OTA) should impose a frivolous appeal penalty.

FACTUAL FINDINGS

2014 Tax Year

1. On April 13, 2015, appellant filed a 2014 California income tax return (Form 540), federal Forms 4852 (Substitute for Form W-2),[1] and a federal Form 1099-MISC. On the tax return, appellant reported zero state wages, federal adjusted gross income (AGI), and total tax. Appellant also reported California withholding of $856.96 and claimed a refund of that amount. On the Forms 4852, appellant reported that his employers were Granada Wrought Iron, Inc. (Granada) and Kiewit Infrastructure West Co. (Kiewit). On a Form 1099-MISC with handwritten entries by appellant, appellant reported zero income from the Employment Development Department (EDD). Appellant writes that the Form 1099-MISC is a "corrected" version to "rebut a document known to have been submitted by the party identified above as 'PAYER' [EDD] which erroneously alleges a payment or payments to the party identified above as the 'RECIPIENT' [appellant] of 'gain, profit, or income,' within the meaning of relevant law."
2. Appellant's 2014 federal Wage and Income transcript indicates wages reported as paid to appellant by Granada of $59,255 and Kiewit of $540, and unemployment compensation paid from EDD of $5,525.
3. On May 24, 2016, FTB issued a Notice of Frivolous Return and Demand for Tax Return (Demand) and demanded that appellant file a valid return within 30 days.
4. Appellant did not respond to the Demand and FTB issued a Notice of Proposed Assessment (NPA) on March 20, 2017, which increased appellant's taxable income by wages reported by Granada of $59,256 and Kiewit of $540, and allowed appellant the standard deduction of $3,992. The NPA proposed an assessment of tax of $1,734, a late-filing penalty of $433.50, a demand penalty of $647.50, and applicable interest.[2]

[1] Substitute for Form W-2, Wage and Tax Statement, or Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.

[2] FTB also issued Demands and NPAs to appellant for the 2010, 2011, 2012, 2013 tax years. Those assessments have become final.

2015 Tax Year

5. On April 15, 2016, appellant filed a 2015 California income tax return, federal Forms 4852, California Forms 3525 (Substitute for Form W-2), and his 2015 federal tax return. On the return, appellant reported zero wages, federal AGI, and total tax. Appellant reported excess State Disability Insurance (SDI) withholding of $871, and claimed a refund of that amount. On the Forms 3525, appellant reported zero wages, SDI withholding from Granada of $736, income tax withholding of $340, and SDI withholding from Security Paving Company, Inc. (Security Paving) of $135.
6. Appellant's 2015 federal Wage and Income transcript indicates wages reported as paid to appellant from Security Paving of $15,071 and Granada of $81,770.
7. On May 24, 2016, FTB issued a Demand that demanded that appellant file a valid return within 30 days.
8. Appellant did not respond to the Demand and FTB issued an NPA on March 20, 2017, which increased appellant's taxable income by wages reported by Granada of $81,771 and Security Paving of $15,071, and allowed appellant the standard deduction of $4,044. The NPA proposed an assessment of tax of $5,657, a late-filing penalty of $1,414.25, a demand penalty of $1,499.50, and applicable interest.

2014 and 2015 Tax Years

9. Appellant timely protested the NPAs. On November 29, 2017, FTB issued Notices of Action (NOAs) affirming the NPAs. The NOAs advised appellant that a $5,000 frivolous appeal penalty may be imposed pursuant to R&TC section 19714 if appellant continued to pursue a frivolous appeal. Appellant filed this timely appeal.

DISCUSSION

Issue 1 - Whether appellant established error in the proposed assessments of tax for the 2014 and 2015 tax years.

R&TC section 19501 provides that FTB is required to administer and enforce the income tax laws of California. This duty includes the responsibility to determine the correctness of any return, to request the making of a return where none has been made, and to ensure the collection of a tax liability imposed under California tax laws. (R&TC, § 19504.) R&TC

section 17041(a)(1) imposes a tax "upon the entire taxable income of every resident of this state…." R&TC section 18501 requires every individual subject to the Personal Income Tax Law to make and file a return with FTB "stating specifically the items of the individual's gross income from all sources and the deductions and credits allowable . . . ." R&TC sections 17071 and 17072 define "gross income" and "adjusted gross income" by referring to and incorporating into California law Internal Revenue Code (IRC) sections 61 and 62, respectively. IRC section 61 provides that unless otherwise provided "gross income means all income from whatever source derived," including compensation for services, gross income derived from business, gains derived from dealings with property, interest, dividends, annuities, and pensions. Income includes any "accessions to wealth." (*Commissioner v. Glenshaw Glass Co*. (1955) 348 U.S. 426, 431; *Appeal of Couchman* (2005-SBE-018) 2005 WL 3106917.)

R&TC section 19087(a) provides that if a taxpayer fails to file a return for any taxable year, FTB may, at any time, require a return or make an estimate of the net income, from any available information, and may propose to assess the amount of the tax, interest, and penalties due. If FTB makes a tax assessment based on an estimate of income, its initial burden is to show why its assessment is reasonable and rational. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Myers* (2001- SBE- 001) 2001 WL 37126924.) Once FTB has met its initial burden, the assessment is presumed correct and the taxpayer has the burden of proving it to be erroneous. (*Todd v. McColgan, supra*; *Appeal of Myers, supra*.) Federal courts have held that the taxing agency need only introduce some evidence linking the taxpayer with the unreported income before the presumption of correctness is established. (See *Rapp v. Commissioner* (9th Cir. 1985) 774 F.2d 932.)

It was held in *Palmer v. Internal Revenue Service* (9th Cir. 1997) 116 F.3d 1309, 1313, that only "minimal evidence" is required to show the link between the taxpayer and the unreported income, thereby establishing the presumption of correctness. FTB's use of information from various sources to estimate a taxpayer's taxable income, when the taxpayer fails to file his or her own return, is a reasonable and rational method of estimating taxable income. (*Andrews v. Commissioner*, T.C. Memo. 1998-316; *Giddio v. Commissioner* (1970) 54 T.C. 1530, 1533; *Appeals of Tonsberg* (85-SBE-034) 1985 WL 15812.) Returns that do not contain sufficient data from which FTB can compute and assess the tax liability of a particular taxpayer, or that do not demonstrate an honest and genuine attempt to satisfy the requirements of

California's tax law (including "zero returns"), are not valid returns. (*Appeal of Hodgson* (2002-SBE-001) 2002 WL 245667.)

Appellant failed to file valid returns, as his returns incorrectly reported income and tax of zero. (See *Appeal of Hodgson*, *supra*.) FTB verified that appellant received income by obtaining a copy of his federal Wage and Income transcripts. The 2014 transcript indicates wages reported as paid to appellant by Granada of $59,255 and Kiewit of $540, and unemployment compensation reported as paid to appellant by EDD of $5,525. The 2015 transcript indicates wages reported as paid to appellant by Security Paving of $15,071 and Granada of $81,770. FTB's use of such income information is both reasonable and rational. (See *Appeals of Bailey* (92-SBE-001) 1992 WL 44503; *Appeals of Tonsberg*, *supra*.) Therefore, FTB has met its initial burden such that its proposed assessments are presumed correct, and the burden now shifts to appellant to show error in the assessments.

Appellant argues that he timely filed his tax returns, that the information on his Forms W-2 are incorrect, and that he did not receive income or wages. Appellant also contends that FTB violated his due process rights. Appellant provides letters from the EDD to establish that he did not earn any wages. The letters indicate that appellant requested information from the EDD, such as quarterly reports and documents relating to appellant as an agent or officer of the State of California. The EDD in response states that it is unable to locate appellant in its database of registered employers. The EDD states that it has no records of quarterly reports "related to doing business as Steven E. Reed." The EDD asserts that the California State Controller's Office is the state agency that maintains personnel and payroll information for employees of the State of California. The letters from the EDD indicate that appellant requested incorrect information, such as information related to appellant as an employer. Appellant is a not an employer. Therefore, EDD could not provide such records. However, FTB requested the proper information from the EDD, which is appellant's wages and withholding records. In return, the EDD provided wage information that matched the income indicated on appellant's Wage and Income Transcripts, which confirms that the proposed assessments are correct.

Appellant argues that FTB may not obtain appellant's EDD wage and withholding information without his consent, pursuant to the Information Practices Act (IPA) of 1977. (Civ. Code, § 1798 et seq.) However, where a taxpayer fails to file a return, FTB is authorized to estimate a taxpayer's net income from "any available information." (R&TC, § 19087.) FTB "is

given great latitude to seek such data and its authority includes the ability to request and use EDD information." (*Appeals of Bailey, supra*.) Furthermore, OTA has no power to remedy any perceived violation of appellant's procedural rights under the IPA, and we cannot consider any alleged violation in the determination of appellant's tax liability. (*Appeals of Wesley, et al.* (2005-SBE-002) 2005 WL 3106917; Cal. Code Regs., tit. 18, § 30104(c).) "[T]he only power that [OTA] has is to determine the correct amount of an appellant's California personal income tax liability for the appeal years." (*Appeals of Dauberger, et al*. (82-SBE-082) 1982 WL 11759.)

In *Bates v. Franchise Tax Bd.* (2004) 124 Cal.App.4th 367, 377, the court concluded that "[t]he Revenue and Taxation Code provisions governing the estimation of income for persons who do not file tax returns, and the related provisions for the assessment and collection of taxes based on that estimate, are not superseded by the IPA." (See also *Appeals of Wesley, et al.*, *supra*.) Additionally, the California Legislature has confirmed by statute that a person cannot avoid a tax liability because of an alleged violation of the IPA. (R&TC, § 19570.) Therefore, the IPA does not prohibit or prevent FTB from collecting information about persons to attempt to accurately assess tax due.

Furthermore, appellant's constitutional arguments are outside of OTA's jurisdiction, as OTA has an established policy of declining to consider constitutional issues. (Cal. Const., art. III, § 3.5; *Appeal of Aimor Corp*. (83-SBE-221) 1983 WL 15592.) Due process is satisfied with respect to tax matters so long as an opportunity is given to question the validity of a tax at some stage of the proceedings. (*Appeals of Bailey, supra*.) As appellant has provided no evidence to contradict FTB's estimate of his taxable income, we must sustain FTB's proposed assessment.

Issue 2 - Whether appellant established a basis for abatement of the late-filing penalties for the 2014 and 2015 tax years.

R&TC section 19131 provides that FTB shall impose a late-filing penalty when a taxpayer fails to file a tax return on or before its due date, computed at five percent of the tax due, after allowing for timely payments, for every month that the return is late, up to a maximum of 25 percent. The penalty shall be imposed unless the taxpayer establishes that the late filing was due to reasonable cause and not willful neglect. (R&TC, § 19131.) When FTB imposes a late-filing penalty, the law presumes that the penalty was imposed correctly. (*Todd v. McColgan, supra*; *Appeal of Goodwin* (97-SBE-003) 1997 WL 258474.) To establish reasonable cause, a taxpayer must show that the failure to file a return occurred despite the exercise of

ordinary business care. (*Appeal of Tons* (79-SBE-027) 1979 WL 4068; *Appeal of Bieneman* (82-SBE-148) 1982 WL 11825.) The taxpayer's reason for failing to file 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.)

Although appellant filed returns with FTB, the returns incorrectly reported income of zero. Therefore, the submitted returns are not valid, as they do not contain sufficient data to calculate his tax liability and are not an honest and genuine attempt to satisfy the requirements of California's tax law. (*Appeal of Hodgson, supra*.) Appellant has not provided any evidence to show reasonable cause for the failure to timely file valid returns. Therefore, appellant has not met his burden of showing that his failure to timely file a valid return was due to reasonable cause. We therefore uphold the late-filing penalties.

Issue 3 - Whether appellant established a basis for abatement of the demand penalties for the 2014 and 2015 tax years.

California imposes a penalty for the failure to file a return or to provide information upon FTB's demand to do so, unless reasonable cause prevented the taxpayer from responding to the Demand. (R&TC, § 19133.) FTB will only impose a demand penalty if the taxpayer fails to respond to a current Demand and the 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 four taxable years preceding the year for which the current Demand is being issued. (Cal. Code Regs., tit. 18, § 19133(b)(1)-(2).) Appellant failed to timely respond to Demands for 2014 and 2015, and appellant was issued prior Demands and NPAs for the 2010, 2011, 2012, and 2013 tax years. Therefore, the prerequisites of Regulation section 19133 are satisfied and the demand penalties were properly imposed.

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 the 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, supra*.) The taxpayer's reason for failing to respond to the Demand must be such that an ordinarily intelligent and prudent businessperson would have acted similarly under

the circumstances. (Appeal of Findley, supra.) Appellant hasnot provided any evidence to show reasonable cause for the failure to timely reply to the Demands. We therefore uphold the demand penalties.

Issue 4 - Whether OTA should impose a frivolous appeal penalty.

The law provides that a frivolous appeal penalty may be imposed when OTA finds that an appeal before OTA was instituted or maintained primarily for delay, or that the taxpayer's position is frivolous or groundless. (R&TC, § 19714; Cal. Code Regs., tit. 18, § 30217(a).) We may consider any relevant factors in determining whether an appeal is frivolous or is maintained primarily for delay. (Cal. Code Regs., tit. 18, § 30217(b).) The following is a non-exclusive list of factors that may indicate a frivolous appeal penalty is warranted: (1) whether appellant is making arguments that have been previously rejected by OTA in a precedential opinion, by the Board of Equalization in a Formal Opinion, or by the courts; (2) whether appellant is making the same arguments that the same appellant made in prior appeals; (3) whether appellant filed the appeal with the intent of delaying legitimate tax proceedings or the legitimate collection of tax owed; (4) whether appellant has a history of filing frivolous appeals or failing to comply with California's tax laws; or (5) whether appellant has been notified in the current or past appeal that a frivolous appeal penalty may apply. (*Ibid.*)

The R&TC, and existing regulations promulgated thereunder, do not specifically define what is meant by "frivolous or groundless" or "instituted or maintained by the taxpayer primarily for delay." (R&TC, § 19714.) Nevertheless, R&TC section 19714, California's frivolous or groundless position penalty, applies the same standard and uses substantially identical language as IRC section 6673(a)(1)(A)-(B), which is the comparable federal statute authorizing a frivolous appeal penalty. Therefore, it is appropriate to look to federal authority for guidance. (*Douglas v. State* (1948) 48 Cal.App.2d 835, 838.)

Existing federal authorities explain that the purpose of the frivolous appeal penalty is not to compensate the government for time spent handling frivolous appeals; instead, the purpose is to penalize taxpayers who raise frivolous claims. (*Sauers v. Commissioner* (1985) 771 F.2d 64.) A position maintained by the taxpayer is frivolous, and thus warrants imposition of a frivolous appeal penalty, where it is contrary to established law and unsupported by a reasoned, colorable argument for change in the law. (*Coleman v. Commissioner* (1986) 791 F.2d 68, 71; *Jensen v. Commissioner*, T.C. Memo. 2004-120.)

Appellant's arguments, such as that his wages are not considered income and that FTB violated his due process rights, are similar to arguments that have been clearly and consistently rejected by the Internal Revenue Service, federal courts, FTB, and the Board of Equalization.[3] (*Appeal of Myers, supra*; *Appeals of Bailey, supra*; *Appeals of Dauberger et al*., *supra*.) A taxpayer's pattern and practice of conduct in prior years is relevant in determining whether to impose a frivolous appeal penalty for the year on appeal. (*Appeal of Castillo* (92-SBE-020) 1992 WL 202571.) FTB's records indicate that it issued filing enforcement NPAs against appellant for the 2010, 2011, 2012, and 2013 tax years, which are final. Appellant was notified in the NOAs and by OTA that a frivolous appeal penalty may be imposed. Based on the facts and circumstances, including the frivolous nature of the arguments presented by appellant and his compliance history, we are imposing a frivolous appeal penalty in this case in the amount of $500. Appellant should be aware that we will not hesitate to impose additional frivolous appeal penalties, up to the maximum of $5,000 per appeal, if appellant pursues other appeals that raise similarly frivolous arguments.

HOLDINGS

1. Appellant failed to establish error in the proposed assessments of tax for the 2014 and 2015 tax years.
2. Appellant failed to establish a basis for abatement of the late-filing penalties for the 2014 and 2015 tax years.
3. Appellant failed to establish a basis for abatement of the demand penalties for the 2014 and 2015 tax years.
4. OTA imposes a frivolous appeal penalty of $500.

[3] <https://www.irs.gov/privacy-disclosure/the-truth-about-frivolous-tax-arguments-section-i-a-to-c#B1>.

DISPOSITION

FTB's action is modified to impose a frivolous appeal penalty of $500. FTB's action is otherwise sustained.

DocuSigned by:
Josh Lambert
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Josh Lambert
Administrative Law Judge

We concur:

DocuSigned by:
Amanda Vassigh
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Amanda Vassigh
Administrative Law Judge

DocuSigned by:
Suzanne B. Brown
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Suzanne B. Brown
Administrative Law Judge

Date Issued: 1/28/2020