

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 18010925
P. APPLEBY AND)
J. APPLEBY)
_____)

OPINION

Representing the Parties:

For Appellants: P. Appleby and J. Appleby

For Respondent: Jean M. Cramer, Tax Counsel IV

For Office of Tax Appeals: Ellen L. Swain, Tax Counsel

S. HOSEY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, P. Appleby and J. Appleby (appellants) appeal an action by respondent Franchise Tax Board (FTB) denying appellants’ claim for refund of the demand penalty of \$66,756.75 and the late-filing penalty of \$11,401.75, for the 2013 tax year.

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

ISSUES

1. Are appellants liable for the demand penalty imposed under R&TC section 19133?
2. Are appellants liable for the late-filing penalty imposed under R&TC section 19131?¹

FACTUAL FINDINGS

1. Appellants are citizens of Australia who came to the United States in 2011 and lived in Atherton, California, during the 2013 tax year, pursuant to Mr. Appleby’s (appellant-husband) E-3 visa sponsored by appellant-husband’s employer, Salesforce.com, Inc.

¹ FTB incorrectly states in its supplemental brief that the Office of Tax Appeals (OTA) requested an additional brief on the “late payment penalty,” and incorrectly refers to the penalty issue as a late-payment penalty in the brief. On March 26, 2018, OTA requested an additional brief on the late-filing penalty.

- (Salesforce). The E-3 visa is issued for certain specialty occupation professionals from Australia, for two years, and the holder can renew it for subsequent two-year periods but is prohibited from establishing permanent residence in the United States.
2. Salesforce reported to the State of California that appellant-husband earned substantial compensation in California during 2013, with \$221,420 of California state income tax withholding. As part of its Integrated Non-Filer Compliance program, FTB matched wage and salary income reported to the Employment Development Department (EDD) and learned that appellants had not filed a California return.
 3. FTB issued a Demand for Tax Return (demand) for the 2013 tax year on January 14, 2015, with a reply deadline of February 18, 2015. Since appellant-husband did not reply to the demand, FTB then issued a Notice of Proposed Assessment (NPA) on March 16, 2015, assessing tax, a demand penalty, and a late-filing penalty.
 4. Appellants filed their 2013 California tax return on October 15, 2015, nearly eight months after the demand's deadline for replying, and paid their tax, penalties and interest in full.²
 5. FTB accepted the return as filed and reduced the demand and late-filing penalties to \$66,756.75 and \$11,401.75, respectively.
 6. Appellants filed refund claims related to the penalties alleging they had moved to the United States on August 10, 2011, from Australia, and were “new to the U.S. and state income tax systems” and “not aware of the reduced statutory income tax withholding from one-time payouts such as bonus compensation and taxable earnings from RSU vesting and nonqualified stock options.”
 7. FTB denied appellants' request to waive the demand and late-filing penalties on March 15, 2016, and sent an additional denial of appellants' claim for refund of the demand penalty on April 19, 2017.

² Appellants filed their 2013 federal income tax return on October 15, 2015, with the IRS. The IRS assessed penalties for late filing and late payment.

8. Appellants' timely appeal was treated as a claim for refund of the demand penalty only. Appellants filed a new claim for refund of the late-filing penalty, which was denied.³
9. FTB had previously issued Requests for Tax Returns to appellant-husband for the 2011 and 2012 tax returns on January 10, 2014, and October 14, 2014, respectively, and had issued NPAs for the 2011 and 2012 tax years on December 29, 2014 and March 10, 2014, respectively, after appellant-husband failed to respond to FTB's request for the 2011 and 2012 tax returns.

DISCUSSION

Issue 1 – Are appellants liable for the demand penalty imposed under R&TC section 19133?

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 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., § 19133(b)(1)-(2), emphasis added.)

Under the plain and unambiguous language of subsection (b)(2) above, we find, contrary to FTB's interpretation and application to the facts here, that this subsection requires the 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 2013 tax year, FTB's regulation requires that FTB have

³The State Board of Equalization declined to accept the appeal related to the late-filing penalty because it was informed by FTB that appellants had not originally included the \$11,401.75 late-filing penalty in the claim for refund filed with FTB. Although that is incorrect (see March 15, 2016 denial letter), appellant subsequently filed a claim for refund with FTB for the late-filing penalty on March 22, 2017; FTB denied the claim on April 19, 2017. FTB filed briefs opposing the refund of the demand penalty on February 27, 2017, and the late-filing penalty on May 25, 2018.

issued an NPA for a prior tax year on a date anytime between January 1, 2009, through December 31, 2012. This threshold requirement has not been met in this case.

FTB had previously issued Requests for Tax Returns to appellant-husband for the 2011 and 2012 tax returns on January 10, 2014, and October 14, 2014, respectively. Specifically, rather than being issued “during the four-taxable-year period *preceding* the taxable year for which the current [demand] is issued,” FTB’s NPA for the 2011 tax year was not issued until December 29, 2014, and the NPA for the 2012 tax year was not issued until March 10, 2014, both which are *after* the 2013 tax year “for which the current [demand] is issued.” None of these notices were issued prior to the 2013 tax year, as required by California Code of Regulations, title 18, section 19133(b)(2). Therefore, FTB improperly imposed the demand penalty.

We also note that Example 2 of the regulation appears to apply the regulation as if it stated that the demand penalty could be imposed if an NPA were issued “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 “during the four-taxable-year period *preceding* the taxable year for which the current [demand] is issued.” (Emphasis added.) Thus, FTB’s regulation is internally inconsistent. However, the operative language of the regulation is 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, we see no reason to place greater weight on the implication of the example than on the clear and precise operative language. We therefore 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.

Issue 2 – Are appellants liable for the late-filing penalty imposed under R&TC section 19131?

R&TC section 19131 imposes a late-filing penalty on a taxpayer who fails to file a return by either the due date or the extended due date, unless a taxpayer demonstrates that the failure was due to reasonable cause and not willful neglect. The penalty is calculated at five percent of

the tax for each month or fraction thereof that the return is late, with a maximum penalty of 25 percent of the tax. (R&TC, § 19131(a); *Appeal of Xie*, 2018-OTA-076P; *Appeal of Myers* (2001-SBE-001) 2001 WL 37126924.) The taxpayer carries the burden of proof to show that reasonable cause exists to support an abatement of the penalty. (*Appeal of Xie, supra*; *Appeal of Beadling* (77-SBE-021) 1977 WL 3831.) The law presumes FTB imposed the penalty correctly. (*Todd v. McColgan, supra*, 89 Cal.App.2d 509, 514; *Appeal of Goodwin* (97-SBE-003) 1997 WL 258474.) To overcome the burden of correctness inherent in the imposition of a penalty, the taxpayer must provide credible and competent evidence supporting a claim of reasonable cause. (*Appeal of Xie, supra*; *Appeal of Walsh* (75-SBE-073) 1975 WL 3557.)

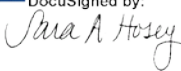
Here, appellants argue that reasonable cause exists because they did not have a California income tax filing requirement. The argument relies on an incorrect interpretation of the R&TC's provisions related to sourcing and residency. However, appellants paid and never disputed the California income tax assessment for the 2013 tax year. Appellants have not met their burden to establish they acted with ordinary business cause and prudence when they did not file a 2013 return until 18 months after the initial due date, particularly given that FTB sent a demand in January 2015. At a minimum, individuals acting with ordinary business care and prudence would have contacted FTB once they learned the taxing agency believed a 2013 return should have been filed. Finally, even if appellants believed there was no filing requirement, ignorance of the law is not an excuse for failing to file a timely return. (*Appeal of Diebold, Inc.* (83-SBE-002) 1983 WL 15389.)

HOLDINGS

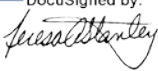
1. Appellants are not liable for the R&TC Section 19133 demand penalty.
2. Appellants are liable for the R&TC Section 19131 late-filing penalty.


DISPOSITION

FTB’s action as to the demand penalty is reversed and appellants are due a refund as to that amount, plus applicable interest. FTB’s action as to the late-filing penalty is sustained.

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 Sara A. Hosey
 Administrative Law Judge

We concur:

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 Teresa A. Stanley
 Administrative Law Judge

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 Amanda Vassigh
 Administrative Law Judge

Date Issued: 3/25/2020