OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 20015731
R. JONES	)
	)
	)
	)

OPINION

Representing the Parties:

For Appellant: Danielle Shehadeh,
Tax Appeals Assistance Program

For Respondent: Phillip C. Kleam, Tax Counsel III

H. LE, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) 19324, R. Jones (appellant) appeals an action by Franchise Tax Board (respondent) denying appellant's claim for refund of $1,699.50 for the 2016 tax year.

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

ISSUES

1. Whether appellant has established that respondent incorrectly imposed the demand penalty.
2. Whether appellant has established reasonable cause to abate the late-filing penalty.
3. Whether appellant has established a basis to abate the filing enforcement cost recovery fee.
4. Whether appellant has established a basis to abate interest.

FACTUAL FINDINGS

1. On May 10, 2018, respondent issued to appellant a Demand for Tax Return (2016 Demand) because its records indicated that appellant's 2016 California resident income tax return had not been filed and he had received sufficient income to trigger a filing

obligation. The 2016 Demand required appellant to respond by a certain date, by either filing a 2016 tax return, providing evidence that a return has already been filed, or providing information on why he was not required to file a return. Appellant did not respond.

2. Subsequently, respondent issued a Notice of Proposed Assessment (NPA) on July 9, 2018 (2016 NPA), which proposed to assess tax (based on income reported by his employer), the demand penalty, late-filing penalty, filing enforcement fee, and interest. Appellant did not protest the 2016 NPA, and the assessment became due and payable.
3. Respondent sent appellant two Notices of State Income Tax Due and a Final Notice Before Levy and Lien. Appellant did not timely pay the amount due.
4. Appellant ultimately filed his 2016 California resident income tax return nearly two years late in March 2019. Appellant reported a total tax of $5,366, withholding of $3,934, and a tax due of $1,432. Appellant's return reflected the same total tax, withholding, and tax due as listed in respondent's 2016 NPA. Appellant also submitted a check for $1,432.
5. Respondent sent appellant a letter of Intent to Offset Federal Payments on June 24, 2019, informing appellant that he had a remaining balance due of $1,069.88. Respondent subsequently received payment for approximately this amount.
6. Appellant filed a claim for refund, which respondent denied, asserting appellant did not establish reasonable cause for abatement of the demand penalty and the late-filing penalty. This timely appeal followed.
7. As relevant here, respondent had previously issued a Request for Tax Return (Request) dated May 2, 2017, for appellant's 2015 tax return (2015 Request). After appellant failed to respond, respondent issued an NPA (2015 NPA) dated July 3, 2017.

DISCUSSION

Issue 1: Whether appellant has established that respondent incorrectly imposed the demand penalty.

R&TC section 19133 imposes a penalty when a taxpayer fails to file a return or provide information upon respondent's notice and demand to do so, unless the failure is due to reasonable cause and not willful neglect. Respondent will only impose a demand penalty if: (1) the taxpayer fails to respond to a current Demand and (2) at any time during the preceding

four tax years, respondent issued an NPA following the taxpayer's failure to timely respond to a Request or a Demand. (Cal. Code Regs., tit. 18, § 19133(b).)

Illustrating this rule are two examples in California Code Regulations, title 18, (Regulation) section 19133(d). Example 1 assumes that a taxpayer has failed to file a California income tax return for the 1999 tax year and that respondent mailed to the taxpayer a Request for the 1999 tax year on January 15, 2001. The taxpayer failed to respond to this request, and respondent issued an NPA on March 20, 2001, assessing tax, a late-filing penalty, and interest, but no demand penalty. Example 2 continues under the same facts as Example 1, except that the taxpayer has also failed to file a return for the 2001 tax year. Respondent issued a Demand for the 2001 tax year and will impose the demand penalty should the taxpayer fail to respond because the taxpayer received an NPA for not filing a return within the previous four years.

However, an inconsistency develops in concurrently applying the second condition above and Example 2 to the facts of this appeal. Here, respondent issued both the 2015 Request and the 2015 NPA in 2017, which is after the 2016 tax year. Therefore, respondent did not propose an assessment, after appellant failed to timely respond to the 2015 Request, during one of the four years preceding the 2016 tax year at issue (i.e., 2012 through 2015). Thus, the second condition of the regulation has not been met. Nevertheless, according to Example 2 and consistent with the regulation's intent, discussed below, the demand penalty's imposition is warranted because appellant received an NPA for previously failing to timely file his 2015 tax year return.

This interpretation is supported by the intent of Regulation section 19133, which is to impose the demand penalty only upon individual taxpayers who are repeat nonfilers; that is, those taxpayers who received an NPA for previously failing to timely file within any one of the preceding four taxable years.[1] In keeping with the drafters' intent, the language in Example 2 should control. Otherwise, it would lead to a demonstrably absurd result. In particular, respondent's 2015 Request required appellant to file a 2015 return in 2017, making it impossible for respondent to issue the requisite NPA for the 2015 tax year any earlier than 2017.

[1] "Under this proposed regulation, the Franchise Tax Board defines a repeat nonfiler as an individual who has received a proposed assessment of tax after receiving and failing to respond to either a request for tax return or a demand for tax return within the previous four years. The Franchise Tax Board has also determined that four years is a reasonable period of time to look back in making a determination as to whether a taxpayer is a repeat nonfiler." (Cal. Reg. Notice Register 2004, No. 17-Z, p. 504.)

Here, appellant failed to timely respond to the 2016 Demand and also failed to timely respond to the 2015 Request, resulting in a 2015 NPA during one of the four years preceding the 2016 tax year at issue. Thus, respondent properly imposed the demand penalty for the 2016 tax year.

Appellant also argues that respondent erred in its computation of the penalty because respondent did not account for appellant's income tax withholding. Appellant contends that the penalty should be calculated at 25 percent of the balance due after withholding is subtracted. However, the demand penalty is computed at 25 percent of the amount of the taxpayer's total tax liability, which is determined without regard to tax withholding and other payments. (See R&TC, § 19133 [the demand penalty is calculated on the "amount of tax" or any deficiency tax respondent assesses and the statute does not modify the phrase "amount of tax" or provide for any reductions based on payments]; see also *Appeal of Scott* (83-SBE-094) 1983 WL 15480.)

Finally, to establish reasonable cause, a taxpayer must show that the failure to timely respond to a demand occurred despite the exercise of ordinary business care. (*Appeal of Bieneman* (82-SBE-148) 1982 WL 11825.) The taxpayer's reason for failing to respond to the Demand must be such that an ordinarily intelligent and prudent businessperson would have acted similarly under the circumstances. (*Appeal of GEF Operating, Inc.*, 2020-OTA-057P.) Here, appellant has not explained or submitted evidence to establish reasonable cause for failure to respond to the 2016 Demand.

Issue 2: Whether appellant has established reasonable cause to abate the late-filing penalty.

The late-filing penalty shall not apply if a taxpayer establishes that the failure to file a return within the prescribed deadline was due to reasonable cause and not willful neglect. (R&TC, § 19131(a).) The standard of reasonable cause requires the taxpayer to establish that the failure to timely file occurred despite the exercise of ordinary business care and prudence. (*United States v. Boyle* (1985) 469 U.S. 241, 246.)[2] The taxpayer carries the burden of establishing that reasonable cause exists to abate the penalty. (*Appeal of Xie*, 2018-OTA-076P.) "In the absence of an acknowledgement that a return was transmitted, received, or accepted, an

[2] Because the relevant language of R&TC section 19131 pertaining to the reasonable cause exception is patterned after Internal Revenue Code section 6651, the federal courts' interpretation of the "reasonable cause" standard is persuasive authority in determining the proper construction of these California statutes. (*Andrews v. Franchise Tax Bd*. (1969) 275 Cal.App.2d 653, 658; *Rhin v. Franchise Tax Bd*. (1955) 131 Cal.App.2d 356, 360.)

ordinarily prudent person would have its e-filing history and acknowledgement records for [its] return to confirm whether [the return] had been transmitted, received, and accepted." (*Appeal of Auburn Old Town Gallery, LLC*, 2019-OTA-319P, citing *Appeal of Quality Tax & Financial Services, Inc*., 2018-OTA-130P.)

Here, appellant asserts that although he used TurboTax software to complete his tax return, the TurboTax software failed to transmit the return to respondent. For support, appellant provided a document labeled "Electronic Postmark – Certification of Electronic Filing," but the document is for appellant's federal, not California, tax return.[3] Appellant did not provide evidence his return had been transmitted, received, and accepted by respondent. Also, appellant's signed 2016 California income tax return and his check for payment of his 2016 tax liability are both dated March 21, 2019, nearly two years late. Accordingly, appellant failed to establish reasonable cause to abate the late-filing penalty.

Issue 3: Whether appellant has established a basis to abate the filing enforcement cost recovery fee.

R&TC section 19254(a)(2) provides if a person fails or refuses to make and file a tax return within 25 days after formal legal demand to file the tax return is mailed to that person by respondent, respondent shall impose a filing enforcement cost recovery fee (currently set at $97 for individuals), which is adjusted annually to reflect actual costs as reflected in the annual Budget Act. Once properly imposed, the statute provides no grounds upon which the fee may be abated. (R&TC, § 19254.)

Respondent sent appellant a Demand for appellant's 2016 return, to which appellant did not respond within 25 days. Therefore, respondent properly imposed the filing enforcement cost recovery fee, and there is no basis for abating the fee.[4]

Issue 4: Whether appellant has established a basis to abate interest.

Tax is due on the original due date of the return without regard to any filing extension. (R&TC, § 19001.) If a taxpayer does not pay the tax by the original due date of the tax return, or

[3] Appellant did not indicate that his California return was filed on the same date as his federal return.

[4] Appellant also requested an explanation of a "collection fee" of $317, but nothing in the record indicates such fee in this amount was imposed for the 2016 tax year.

if respondent assesses additional tax, the law provides for charging interest at the adjusted annual rate established on the balance due. (R&TC, § 19101.) Imposing interest is mandatory, and respondent cannot abate interest except where authorized by law. (*Appeal of Balch*, 2018-OTA-159P.) Interest is not a penalty; it is compensation for the use of money. (*Ibid.*) To obtain waiver or abatement of interest, appellant must qualify under R&TC section 19104, 19112, or 21012. (*Ibid.*) Appellant has not alleged, and no evidence in the record indicates, that any of these statutory provisions apply. Therefore, appellant did not establish that he qualified for any waiver or abatement of interest.

HOLDINGS

1. Appellant has not established that respondent incorrectly imposed the demand penalty.
2. Appellant has not established reasonable cause to abate the late-filing penalty.
3. Appellant has not established a basis to abate the filing enforcement cost recovery fee.
4. Appellant has not established a basis to abate interest.

DISPOSITION

We sustain respondent's action in full.

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Huy "Mike" Le
Administrative Law Judge

I concur:

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Andrea LH Long
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Andrea L.H. Long
Administrative Law Judge

M. GEARY, Administrative Law Judge, concurring in part and dissenting in part:

I concur in the majority Opinion insofar as it sustains respondent's denial of appellant's claim for refund of the late-filing penalty, the filing enforcement cost recovery fee, and interest. However, for the reasons stated below, I dissent from the majority's conclusion that respondent correctly imposed the penalty for appellant's failure to timely respond to respondent's Demand for Tax Return (Demand), and I would overrule respondent's denial of the refund of that penalty amount.

I agree that Revenue and Taxation Code (R&TC) section 19133 provides that respondent 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 a demand by respondent, unless the taxpayer establishes the failure is due to reasonable cause and not willful neglect. The implementing regulation, California Code of Regulations, title 18 (Regulation), section 19133, states that respondent will impose the demand penalty only if the taxpayer fails to timely respond to a current Demand in the manner prescribed, and respondent "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), italics added.) Regulation section 19133(d), however, contains two purportedly illustrative examples of the application of R&TC section 19133. The second example indicates that respondent may impose the penalty if, after failing to respond to a prior demand, the taxpayer received an NPA for not filing a return *within the previous four years*. Where the majority equates this conflict to an ambiguity that requires deference to respondent's longstanding interpretation of the regulation, I am reluctant to allow respondent's illustrative example to control over the clear regulatory language that precedes it.

The United States Supreme Court recently examined the rules for the interpretation and construction of an agency's regulations, particularly the circumstances that warrant giving deference to an agency's interpretation of its own regulation, in *Kisor v. Wilkie* (2019)___U.S. ___[139 S.Ct. 2400] (*Kisor*). While the *Kisor* Court declined to overrule *Bowles v. Seminole Rock & Sand Co*. (1945) 325 U.S. 410, or *Auer* v. *Robbins* (1997) 519 U.S. 452, the seminal decisions that established rules for deferring to an agency's interpretation, it recognized the

limited scope of the doctrine. *Kisor* tells us that deference comes into play only if a regulation is "genuinely ambiguous after a court has resorted to all the standard tools of interpretation." (*Kisor*, *supra*, 139 S.Ct. at p. 2414.)

As stated in Regulation 19133(d), "[t]he … examples are intended to illustrate the provisions of this regulation." Thus, subsection (d) states that the examples describe respondent's interpretation of the regulation that precedes them. And while I agree with respondent that illustrative examples are part of a regulation, I conclude that there are situations where the language in an illustrative example is not entitled to consideration and weight equal to the regulatory language that precedes the examples.

It has been held that the fact that regulatory language "comes from an example contained in a regulation, rather than the body of a regulation, is of no import, as 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, italics added.) This at least suggests that conflicts between regulatory language and illustrative examples should be resolved in favor of the regulatory language. I agree. I am not persuaded that the language in Example 2 should control our interpretation of Regulation section 19133, and I find that there is only one reasonable construction of Regulation section 19133, one based on the clear language of subsection (b)(2). This interpretation could effectively prevent respondent from imposing the penalty until there have been several years of consecutive failures to file within a four-taxable-year period and that this result may be contrary to the purpose and intent of Regulation section 19133. However, our job is to interpret and apply the regulation, not rewrite it. As stated in *Kisor*:

> If uncertainty does not exist, there is no plausible reason for deference. The regulation then just means what it means—and the court must give it effect, as the court would any law. Otherwise said, the core theory of *Auer* deference is that sometimes the law runs out, and policy-laden choice is what is left over. [Citations.] But if the law gives an answer—if there is only one reasonable construction of a regulation—then a court has no business deferring to any other reading, no matter how much the agency insists it would make more sense. Deference in that circumstance would "permit the agency, under the guise of interpreting a regulation, to create *de facto* a new regulation." [Citations.]

(*Kisor*, *supra*, 139 S.Ct. at p. 2415.)

Therefore, because respondent did not propose an assessment of tax under the authority of R&TC section 19087(a), after appellant failed to timely respond to a Request for Tax Return or demand, at any time during the four-taxable-year period preceding the 2016 taxable year, I find that respondent did not properly impose the demand penalty on appellant. On that basis, I would overrule respondent's denial of appellant's claim for refund of the demand penalty amount.

Michael F. Geary
Administrative Law Judge

Date Issued: 3/4/2021