

**OFFICE OF TAX APPEALS
STATE OF CALIFORNIA**

In the Matter of the Appeal of:

T. AUCHTER) OTA Case No. 18042726
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)**OPINION**

Representing the Parties:

For Appellant:

T. Auchter

For Respondent:

Anne Mazur, Specialist

M. GEARY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, appellant T. Auchter appeals an action by the respondent Franchise Tax Board denying appellant's claim for refund of \$1,682.75 for the 2015 taxable year.

We decide the matter based on the written record because appellant waived his right to an oral hearing.

ISSUES

1. Should the demand penalty be abated and refunded to appellant?
2. Should the filing enforcement cost recovery fee be abated and refunded to appellant?

FACTUAL FINDINGS

1. Appellant did not timely file a California income tax return for the 2014 taxable year.
2. Respondent sent appellant a Request for Tax Return (Request) dated February 9, 2016, which explained that respondent had no record that appellant had filed a 2014 return, and instructed appellant to file a return, provide a copy of a filed return if there was one, or explain why appellant was not required to file a return, by March 16, 2016.
3. When appellant did not timely respond to the Request, respondent sent appellant a July 6, 2016 Notice of Proposed Assessment (NPA) for the 2014 taxable year.
4. Appellant did not timely file a California income tax return for the 2015 taxable year.

5. Respondent learned through its Integrated Non-filer Compliance program that appellant earned California wages during 2015 in an amount that was sufficient to require appellant to file a California return for that year.¹
6. On April 19, 2017, respondent sent appellant a Demand to File Tax Return (Demand), which explained that respondent had no record that appellant had filed a 2015 return. The Demand instructed appellant to file a return, provide a copy of a filed return if there was one, or explain why appellant was not required to file a return, by May 24, 2017.²
7. Respondent did not issue an NPA to appellant, after appellant failed to timely respond to a Request or Demand, at any time during the four-taxable-year period preceding the 2015 taxable year.
8. On June 19, 2017, after respondent did not receive a timely reply to the April 19, 2017 Demand, respondent issued to appellant an NPA, which proposed additional tax, a late-filing penalty, a demand penalty, and a filing enforcement fee, plus applicable interest.
9. Appellant timely protested the NPA. Respondent denied the protest and, on December 8, 2017, issued a Notice of Action (NOA) affirming the NPA. This timely appeal followed.
10. On August 22, 2018, respondent received appellant's 2015 tax return. Respondent states it will process the return at the conclusion of this appeal, revising appellant's tax liability, canceling the late-filing penalty and reducing the demand penalty to \$1,682.75.³

¹ According to respondent, the Integrated Non-filer Compliance program matches income records obtained from various reporting sources against filed tax returns to identify individuals who may not have fulfilled their legal requirement to file a California income tax return.

² The Request and Demand forms are substantially similar, the only relevant difference being that the Demand includes the following language: "If you do not respond to this Demand by the reply date indicated and in the manner prescribed on this notice, a demand penalty will be assessed at 25% of your total tax without regard to payments." (See Cal. Code Regs., tit. 18, § 19133(c).)

³ Respondent cancelled the late-filing penalty because appellant's timely payments exceeded his reported tax liability.

DISCUSSION

Issue 1. Should the demand penalty be abated and refunded to appellant?

Once the taxing agency has produced evidence to show that a penalty has been properly calculated and imposed, a presumption of correctness arises and the burden shifts to the taxpayer to rebut that presumption. (*Appeal of Myers* (2001-SBE-001) 2001 WL 37126924.)

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 notice and demand by respondent, 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 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.*” (Regulation 19133(b)(2), emphasis added.)

Subsection (d) of Regulation 19133 contains two purportedly illustrative examples of the application of R&TC section 19133. The first, which does not result in imposition of the penalty for the 1999 taxable year, describes a hypothetical wherein a taxpayer, for the first time, does not file a return. Approximately 90 days after the extended due date for the return, respondent sends a Request to the taxpayer. Although the taxpayer does not timely reply to the Request, respondent does not include the demand penalty on the NPA issued to the taxpayer in March 2001. The second example builds on the first and states that the same taxpayer also does not file a return for the 2001 taxable year, which prompts respondent to issue a Demand to the taxpayer. The second example goes on to state that, “Because X received an NPA for not filing a return *within the previous four years*, [respondent] issues a Demand ... for the 2001 taxable year. If [the taxpayer] fails to timely respond to the Demand [respondent] will issue an NPA that includes tax, a late filing penalty, interest, and a ... demand penalty under Revenue and Taxation Code section 19133.” (Emphasis added.)

Appellant argues that the demand penalty should be abated. He asserts that he had been late filing his federal returns, a circumstance allegedly accepted by the Internal Revenue Service, because of their complexity and his personal circumstances, including his frequent absence from

the place where he received his mail and the poor health of his wife. Appellant alleges that he could not timely file his California return because he lacked the essential details from his federal return, and that he could not timely respond to the demand because he was not aware that it had been mailed to him until after the time to respond had passed. In essence, appellant argues that these circumstances constitute reasonable cause and that he was not guilty of willful neglect.

We must first determine whether respondent has produced evidence to show that it properly imposed the penalty.

There is a conflict between the language of Regulation 19133(b)(2) and the language of the illustrative examples in subsection (d).⁴ Specifically, subsection (b)(2) clearly provides that respondent will not impose the demand penalty unless the taxpayer had previously failed to timely respond to a Request or Demand and, as a result, respondent had proposed an assessment during the four taxable years before the taxable year at issue. In contrast, the examples state that the penalty may be imposed as long as the taxpayer “received an NPA for not filing a return within the previous four years.”

Respondent did not propose an assessment against appellant, after appellant failed to timely respond to a Request or Demand, during 2011, 2012, 2013 or 2014. It issued the prior NPA (for the 2014 taxable year) to appellant in 2016, the year *after* the taxable year at issue, and, citing Regulation 19133(d), Example 2, it argues that this was sufficient to allow imposition of the penalty. Respondent contends that the language of Example 2 of the regulation is entitled to weight equal to any other language contained in Regulation 19133, that there is a resulting ambiguity, and that we must resolve the resulting ambiguity by giving great deference to respondent’s interpretation, which allegedly is consistent with the regulatory intent: to look back four years and impose the penalty on repeat non-filers.⁵ Respondent asserts that focusing on the specific wording of subsection (b)(2), while ignoring subsection (d)’s Example 2, produces an absurd result, which allows repeat non-filers to continue not filing for years without the threat of a penalty because of the time it takes respondent to identify repeat non-filers, determine whether a return was required, send a Demand, and issue an NPA.

⁴ We note that there also appears to be a conflict between what respondent asserts it is trying to accomplish and the language of the examples upon which it relies. We discuss this further below.

⁵ As relevant here, according to respondent, a repeat non-filer is a taxpayer who fails to file a return more than once within a four-taxable-year period.

Regulation 19133(b)(2) clearly establishes two requirements for imposition of the penalty: (1) the taxpayer must have failed to respond to a current Demand; and (2) respondent must have proposed an assessment of tax, after the taxpayer failed to timely respond to prior Request or Demand, during the prior four taxable years. As written, the key event for the second requirement is respondent's issuance of an NPA after the taxpayer has failed to timely respond to a Request or Demand. In other words, before the penalty can be imposed, four things must have happened: (1) the taxpayer must have failed to file a required return; (2) respondent must have sent taxpayer a Request or Demand to file that return (or provide information); (3) taxpayer must have failed to timely (and properly) respond to that Request or Demand; and (4) as a result, respondent must have proposed an assessment during the four previous taxable years. In other words, subsection (b)(2) requires that all four events occur prior to the taxable year for which respondent seeks to impose the demand penalty. The reference in Regulation 19133(b)(2) to prior four taxable years creates the primary anomaly that brings us to this discussion: when respondent issues the prior NPA during the same taxable year for which the current demand penalty is under consideration, or during any later year, subsection (b)(2) does not permit imposition of the penalty, regardless of the fact that the taxpayer is a repeat non-filer, as defined above.

Example 2 in subsection (d) of Regulation 19133 purports to give an example of the application of the regulation. However, it states that respondent may impose the penalty as long as the taxpayer "received an NPA for not filing a return within the previous four years." Respondent argues here that Regulation 19133 must be interpreted to allow respondent to impose the demand penalty when there is an NPA following a Request or Demand *for* (as opposed to *during*) one of the four taxable years prior to the current year.⁶ It further contends that the date such prior NPA was mailed is not a relevant fact.

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

⁶ We interpret this to mean the year for which respondent proposes to impose the demand penalty.

limited scope of the doctrine. *Kisor* tells us 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.)

Clearly, we have a conflict between the language of subsections (b)(2) and (d) of Regulation 19133. That does not necessarily mean the regulation is ambiguous. We must first decide whether illustrative examples are entitled to consideration and weight equal to that afforded to the regulatory language that precedes them.

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 we agree with respondent that illustrative examples are part of a regulation and must be considered as such by us, we 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, emphasis added.) This at least suggests that conflicts between regulatory language and illustrative examples should be resolved in favor of the regulatory language. We agree. We are not persuaded that the language in Example 2 should control our interpretation of Regulation 19133, and we find that there is only one reasonable construction of Regulation 19133, one based on the clear language of subsection (b)(2). Therefore, because respondent did not propose an assessment of tax under the authority of R&TC section 19087(a), after the appellant failed to timely respond to a Request or Demand, at any time during the four-taxable-year period preceding the 2015 taxable year, we find that respondent did not properly impose the demand penalty on appellant. Consequently, it must be abated and refunded to appellant. While this finding is dispositive of the issue, we will address some of respondent’s other arguments below.⁷

We agree with respondent’s assertion that our interpretation could effectively prevent respondent from imposing the penalty until there have been several years of consecutive failures

⁷ Because we find that respondent improperly imposed the demand penalty, there is no need for us to address appellant’s reasonable cause arguments.

to file within a four-taxable-year period. The extended due date for returns is usually October 15 following close of the taxable calendar year. Allowing 90 days for the Request, 35 days for the response, and another 30 days for issuance of the NPA, the earliest the NPA could be issued is March 20 of the second year following the taxable year.⁸ According to our calculations, the conditions for issuing an NPA with the demand penalty could not be met sooner than the third year following the first NPA. This result may in some circumstances be contrary to the purpose and intent of Regulation 19133. However, having determined that the language of subsection (b)(2) controls and that this subsection is clear on its face, our job is done. 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. 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.”

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

Finally, respondent’s argument that the date the first NPA is mailed is irrelevant ignores the clear language in Regulation 19133. Subsection (b)(2) states that the prior NPA must have been mailed during one or more of the four-taxable-year period before the year for which respondent contemplates imposing the demand penalty, and subsection (d), Example 2, clearly states that respondent cannot impose the demand penalty unless it has already issued the prior NPA within the previous four years.⁹

Issue 2. Should the filing enforcement cost recovery fee be abated?

R&TC section 19254 requires respondent to impose collection cost recovery fees and filing enforcement cost recovery fees. Respondent imposes a filing enforcement cost recovery fee when a taxpayer fails to file a return within 25 days after a formal legal demand to

⁸ These are the time frames used in the examples in Regulation 19133(d).

⁹ Recognizing that the language of Example 2 of Regulation 19133(d) will not allow the four-year look-back period allegedly intended, respondent also invites us to interpret the phrase in that example “within the previous four years” to mean “for the previous four taxable years,” another invitation we respectfully decline.

file a return is mailed to the taxpayer.¹⁰ The amount of the fee is set annually to reflect actual enforcement costs. The statute does not allow for abatement of or relief from the fee, even on a showing that the failure to pay was due to reasonable cause.

Appellant alleges the same bases for relief of this penalty that he does for the demand penalty. He asserts that the complexity of his federal returns, his frequent and lengthy absences from the residence where he receives his mail, and his wife's poor health prevented him from timely filing his return and responding to the Demand.

The imposition of the filing enforcement cost recovery fee is mandatory if the conditions for its imposition are met. There is no dispute that those conditions were met in this case. We find that respondent properly imposed the fee, and there is no authority for abatement. Consequently, we find that the filing enforcement cost recovery fee cannot be abated.

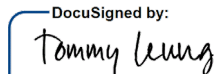
HOLDINGS


1. Respondent did not correctly impose the demand penalty on appellant and, therefore, it shall be abated and refunded to appellant.
2. The filing enforcement cost recovery fee cannot be abated.

DISPOSITION

The demand penalty shall be abated and refunded to appellant, with interest as appropriate, but respondent's action is otherwise sustained.

We concur:

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Tommy Leung
Administrative Law Judge

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Michael F. Geary
Administrative Law Judge

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Jeffrey I. Margolis
Administrative Law Judge

Date Issued: 4/21/2020

¹⁰ Organizations that are exempt from tax under R&TC section 23701 are not subject to the fee.