

**OFFICE OF TAX APPEALS
STATE OF CALIFORNIA**

In the Matter of the Appeal of:
M. ALTOBELLI

) OTA Case No. 20056213
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)
)

OPINION

Representing the Parties:

For Appellant: M. Altobelli

For Respondent: Gi Nam, Tax Counsel

H. LE, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, M. Altobelli (appellant) appeals an action by respondent Franchise Tax Board (FTB) denying appellant’s claim for refund of \$2,413 for the 2017 tax year.

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

ISSUES

1. Whether FTB properly imposed the demand penalty for the 2017 tax year.
2. Whether appellant has shown reasonable cause for failing to timely respond to FTB’s Demand for Tax Return (Demand) for the 2017 tax year.

FACTUAL FINDINGS

1. FTB issued the Demand to appellant on April 24, 2019, for the 2017 tax year, to appellant’s last known address in Los Angeles, California. The Demand stated that if appellant did not respond to the notice by May 29, 2019, FTB would assess a demand penalty. Appellant failed to respond to the Demand, which required appellant to either file a California tax return, send a copy of a filed California tax return, or complete FTB’s questionnaire to determine if he was required to file a California tax return for that year

2. Thereafter, FTB issued a Notice of Proposed Assessment (NPA) on December 2, 2019, for the 2017 tax year. The NPA included, among other items, a demand penalty of \$3,359.
3. Appellant filed his 2017 California tax return on December 13, 2019. In the return, appellant notified FTB of his new address in Tujunga, California.
4. FTB subsequently issued a Notice of Tax Return Change, reducing the demand penalty to \$2,413 based on the amount of tax reported on appellant's 2017 California tax return.
5. Appellant then paid the balance due and filed a claim for refund, which FTB denied. This timely appeal followed.
6. As relevant to the demand penalty in this appeal, in 2018, FTB issued an NPA for the 2016 tax year, after appellant failed to timely respond to a Request for Tax Return (Request).

DISCUSSION

Issue 1: Whether FTB properly imposed the demand penalty for the 2017 tax year.

R&TC section 19133 imposes a penalty on a taxpayer who fails to furnish a tax return or any information requested in writing by FTB. This penalty is commonly known as the demand penalty. The penalty is 25 percent of the amount of the tax deficiency determined by FTB unless the taxpayer establishes the failure to respond to the Demand was due to reasonable cause and not willful neglect. (R&TC, § 19133.) For individuals subject to tax under the California Personal Income Tax Law, FTB will only impose the demand penalty if: (1) the taxpayer fails to respond to a current Demand in the manner prescribed; and (2) FTB previously proposed an assessment of tax under R&TC section 19087(a), after the taxpayer failed to timely respond to a Request or a Demand in the manner prescribed, at any time *during* the four-taxable-year period preceding the tax year for which the current Demand is issued. (Cal. Code Regs., tit. 18, § 19133(b)(1)-(2), *italic added*.)

In applying California Code of Regulations, title 18, (Regulation) section 19133, we must decide between two conflicting interpretations under subdivision (b) and (d) of Regulation section 19133. The first interpretation requires that the previous NPA be issued on a date falling within the four-taxable-year period, i.e., 48-month time period, preceding the tax year for which the current Demand is issued. We refer to this interpretation as the “subdivision (b)

interpretation.” The second interpretation, as advocated by FTB, uses the term “during” in subdivision (b) consistently with Example 2 of subdivision (d), which indicates that the prior Request or Demand and NPA must have been issued for one of the four tax years preceding the tax year of the current Demand. We refer to FTB’s interpretation as the “subdivision (d) interpretation.”

The rules of statutory construction govern the interpretation of regulations. (*Butts v. Bd. of Trustees of Cal. State Univ.* (2014) 225 Cal.App.4th 825, 835 (*Butts*.) Accordingly, we must give regulatory language its plain, commonsense meaning. (*Ibid.*) At the same time, if possible, we must “accord meaning to every word and phrase in the regulation, and we must read regulations as a whole so that all of the parts are given effect [citation].”¹ (*Ibid.*, citing *Price v. Starbucks* (2011) 192 Cal.App.4th 1136, 1145.) Regulation section 19133 is made up of four subdivisions, and the examples provided in subdivision (d) are as much a part of the regulation as subdivisions (a) through (c). Thus, when interpreting Regulation section 19133, we must examine all subdivisions of the regulation, including the examples in subdivision (d), which provide the following:

Example 1: Assume Taxpayer X has not filed a California personal income tax return for the 1999 taxable year. This is the first time that X has not filed a timely California personal income tax return. As a result of X’s non-filing, the FTB mails a Request for Tax Return to X on January 15, 2001. When X does not timely respond to the Request for Tax Return, the FTB issues a Notice of Proposed Assessment (NPA) on March 20, 2001, assessing tax, a late filing penalty, and interest, but the NPA does not include a notice and demand penalty under Revenue and Taxation Code section 19133.

Example 2: Assume the same facts as in Example 1, and X does not file a California personal income tax return for the 2001 taxable year. 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. If X fails to timely respond to the Demand for Tax Return, the FTB will issue an NPA that includes tax, a late filing penalty, interest,

¹“Our primary aim is to ascertain the intent of the administrative agency that issued the regulation.” (*Butts, supra*, 225 Cal.App.4th 825, 835.) “When that intent ‘cannot be discerned directly from the language of the regulation, we may look to a variety of extrinsic aids, including the purpose of the regulation, the legislative history, public policy, and the regulatory scheme of which the regulation is a part.’” (*Id.* at p. 836.)

and a notice and demand penalty under Revenue and Taxation Code section 19133.

(Cal. Code Regs., tit. 18, § 19133(d).)

Example 2 does not comport with the subdivision (b) interpretation of the word “during,” but does fit within the subdivision (d) interpretation. Thus, we find that subdivisions (b) and (d) are in conflict and that, consequently, ambiguity exists within the regulation. Accordingly, we must evaluate regulatory history and administrative deference to decide the proper interpretation of Regulation section 19133.

History and Development of Regulation section 19133

When interpreting a regulation, the history and development of the regulation may be enlightening to determine the drafters’ intent. (*Butts, supra*, 225 Cal.App.4th at p. 839.)

Before implementation of Regulation section 19133, individual taxpayers were potentially subject to the demand penalty after any failure to respond to a demand for a tax return under R&TC section 19133, regardless of the taxpayer’s prior filing history. There were concerns in the taxpayer community that this penalty was too harsh. (See Respondent’s Proposal on the Demand Penalty for Nonfilers.)² As a result, FTB conducted a study and developed a proposal to limit the demand penalty only to repeat nonfilers. (See *ibid.*)

The regulatory history states that only taxpayers “who fail to file income tax returns for the first time would not be penalized.” (Economic and Fiscal Impact Statement.) However, under the subdivision (b) interpretation, a second-time nonfiler, such as appellant in this case, would indeed escape the penalty. Because tax returns are never due until the following tax year, it is impossible under the subdivision (b) interpretation to impose the demand penalty on a repeat nonfiler who fails to file in consecutive years, which is an absurd result given that the purpose of the regulation to provide relief for first-time nonfilers only.³ (Respondent’s Proposal on the

² In this document, FTB proposes three alternative recommendations to “address public concerns regarding the perceived harshness of the demand penalty”: (1) “[o]nly repeat nonfilers would be assessed the demand penalty”; (2) “[f]irst time nonfilers would receive a reminder letter prior to the demand letter”; or (3) “continue with current policy.” FTB selected the first alternative. (FTB minutes, September 19, 2000.)

³ “One of the fundamental rules of statutory construction is that a law should not be applied in a manner producing absurd results, because the Legislature is presumed not to intend such results.” (*Fireside Bank Cases* (2010) 187 Cal.App.4th 1120, 1129.)

Demand Penalty for Nonfilers.) As such, this indicates that the subdivision (b) interpretation is contrary to the intent of Regulation section 19133.

Deference to FTB's Interpretation of its Own Regulation

“While an agency’s interpretation of its own regulations [is] usually entitled to deference, the amount of deference is ‘fundamentally situational.’” (*Butts, supra*, 225 Cal.App.4th at p. 840.) We consider two broad categories of interrelated factors relevant to the weight due an agency interpretation: (1) those indicating that the agency has a “comparative interpretive advantage” over courts and tribunals; and (2) those indicating that the interpretation in question is “probably correct.” (*New Cingular Wireless PCS, LLC v. Pub. Utilities Com.* (2016) 246 Cal.App.4th 784, 812 (*New Cingular*).

Regarding the “comparative interpretive advantage” criteria, we look to whether the agency has expertise and technical knowledge, “as for example when an agency is interpreting its own regulations, since it is ‘likely to be intimately familiar with regulations it authored and sensitive to the practical implications of one interpretation over another.’” (*New Cingular, supra*, 246 Cal.App.4th at p. 812.) Here, it is undeniable that FTB has considerable expertise relevant to its interpretation of its regulation since it is intimately familiar with its history, authorship, and implementation.

Regarding the “probably correct” criteria, we focus on circumstantial evidence surrounding the agency’s interpretation, such as whether there are indications of careful consideration by senior agency officials, whether the agency has consistently maintained the interpretation in question, especially if it is long-standing, and whether the rule was adopted per the Administrative Procedure Act (i.e., through formal notice-and-comment procedures). (*Ibid.*)

First, senior FTB officials carefully considered the regulation. As previously noted, FTB conducted a study and developed a proposal, which was considered by and approved by FTB’s board. (See Respondent’s Proposal on the Demand Penalty for Nonfilers; FTB meeting, September 19, 2000, Transcript of Proceedings.) Then, FTB’s staff were granted permission to proceed with the formal rulemaking process to codify FTB’s new procedure. (See Franchise Tax Board Minutes, October 1, 2002.) FTB then engaged in the formal rulemaking process under the Administrative Procedures Act before adopting the regulation in its current form on November 23, 2004. (See Notice of Proposed Rulemaking; Register 2004, No. 48.) Therefore, the evidence indicates careful consideration by senior FTB officials.

Second, FTB has consistently maintained its current interpretation of Regulation section 19133. Since January 1, 2001, FTB’s software has been programmed to “differentiate between first-time nonfilers and repeat nonfilers.” (Staff Request for Permission to Proceed.)⁴ FTB sends a Request to a first-time nonfiler, which does not trigger the penalty, whereas a repeat nonfiler is sent a Demand, which triggers the penalty. (*Ibid.*) Accordingly, FTB’s software was contemporaneously programmed to penalize “only repeat nonfilers,” i.e., those who are sent a Demand and not a Request. (Respondent’s Proposal on the Demand Penalty for Nonfilers.) On the other hand, taxpayers “who fail to file income tax returns for the first time would not be penalized.” (Economic and Fiscal Impact Statement.)⁵ Thus, the regulation’s purpose is to penalize repeat nonfilers, unambiguously defined as excluding first-time nonfilers. Accordingly, FTB’s contemporaneous implementation of the subdivision (d) interpretation is demonstrated by the implementation of a process whereby a single Request is issued, followed by a Demand, which triggers the penalty.

Third and finally, Regulation section 19133 was adopted per the Administrative Procedure Act (i.e., through formal public notice and comment procedures).

In conclusion, while we acknowledge that the plain language of subdivision (b)(2) of Regulation section 19133 supports the subdivision (b) interpretation, we must accord meaning to every word and phrase in the regulation. We must read the regulation as a whole so that all of the parts are given effect. In doing so, we observe that subdivisions (b)(2) and (d) create ambiguity within the regulation. Accordingly, we turn to the history and development of Regulation section 19133 and apply the administrative deference analysis. Here, FTB’s interpretation of its regulation is consistent with the regulatory intent and is expressed in FTB’s contemporaneously implemented procedures. And we defer to FTB’s interpretation because of FTB’s interpretive advantage and because we find the interpretation is probably correct. Therefore, we find that Regulation section 19133 must be interpreted consistently with FTB’s

⁴ In this document, FTB staff requests permission from FTB to proceed with the formal regulatory process for the proposed regulation.

⁵ As part of the rulemaking process, FTB submitted an Economic and Fiscal Impact Statement in which FTB estimated there would be no fiscal impact to the state “because the proposed regulation codifies the Franchise Tax Board’s existing policy in effect since January 1, 2001, of not imposing the notice and demand penalty against first-time nonfilers” and the Department of Finance previously “anticipated this change in policy and adjusted baseline state revenues downward.”

subdivision (d) interpretation, which indicates that the prior Request or Demand and NPA must have been issued for one of the four tax years preceding the tax year of the current Demand.

As such, the demand penalty was properly imposed in this case because the prior Request and NPA were issued for the 2016 taxable year, which is one of the four taxable years preceding the 2017 tax year at issue.

Issue 2: Whether appellant has shown reasonable cause for failing to timely respond to FTB's Demand for the 2017 tax year.

The burden is on a taxpayer to prove that reasonable cause prevented a timely response to the Demand. (*Appeal of Wright Capital Holdings LLC*, 2019-OTA-219P.) To establish reasonable cause, a taxpayer must show that the failure to respond to a Demand occurred despite the exercise of ordinary business care. (*Ibid.*) The taxpayer's reason for failing to respond must be such that an ordinarily intelligent and prudent businessperson would have acted similarly under the circumstances. (*Ibid.*)

Here, appellant contends that he did not receive the Demand. However, FTB properly mailed the Demand to appellant's Los Angeles address because it was his last known address. It is well settled that any notice to a taxpayer shall be sufficient if it is mailed to the taxpayer's last known address, which is the address that appears on the taxpayer's last return filed with FTB, unless the taxpayer has provided to FTB clear and concise written or electronic notification of a different address, or FTB has an address it has reason to believe is the most current address for the taxpayer. (R&TC, § 18416(b), (c).) Here, appellant did not notify FTB of his current address until December 2019, approximately eight months after FTB mailed the Demand to appellant's last known address on file with FTB. Therefore, appellant failed to exercise ordinary business care and prudence by not updating his mailing address with FTB immediately after moving.

In addition, appellant appears to argue that the Demand penalty should be abated because he previously attempted to timely e-file his 2017 tax year return, but this was rejected by FTB. In support, appellant provided a document labeled "Electronic Postmark – Certification of Electronic Filing" stating that he filed his federal return on April 17, 2018. However, the postmark is related to appellant's federal, not California, tax return. Also, FTB submitted its records indicating that there had been no attempts to e-file which would result in a rejection. Regardless, appellant's purported attempt to e-file occurred before FTB issued its Demand and,

thus, cannot support reasonable cause for failing to timely respond to this Demand.⁶

Lastly, appellant notes his good history of filing compliance. However, California law does not provide for penalty abatement based upon a history of timely filing.⁷


In conclusion, we find that appellant has not shown reasonable cause for failing to timely respond to FTB’s Demand for the 2017 tax year.

HOLDINGS

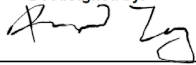
1. FTB properly imposed the demand penalty for the 2017 tax year.
2. Appellant has not shown reasonable cause for failing to respond to the Demand for the 2017 tax year.

DISPOSITION

FTB’s action is sustained.

DocuSigned by:

 Huy "Mike" Le
 Administrative Law Judge

I concur:

DocuSigned by:

 Richard Tay
 Administrative Law Judge

Date Issued: 5/13/2021

⁶ We need not address appellant’s arguments on FTB practices on rejecting certain e-filings since Office of Tax Appeals does not have jurisdiction to address due process assertions. (See Cal. Code Regs., tit. 18, § 30104(d).)

⁷ The California Legislature has previously considered and declined to adopt bills that would allow a first-time abatement for taxpayers with a history of good filing and payment compliance. (See, e.g., Assembly Bill No. 1777 (2013-2014 Reg. Sess.).)

K. GAST, dissenting:

I respectfully dissent with respect to Issue 1 and, for that reason, would not have reached Issue 2. As explained below, I would have found Franchise Tax Board (FTB) improperly imposed the demand penalty under Revenue and Taxation (R&TC) section 19133 for the 2017 tax year.

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, (Regulation) 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., tit. 18, § 19133(b)(1)-(2), emphasis added.)

Under the plain and unambiguous language of subsection (b)(2) above, I find, contrary to the majority’s conclusion, that this subsection requires the Notice of Proposed Assessment (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 2017 tax year, FTB’s regulation requires that it have issued an NPA for a prior tax year on a date anytime between January 1, 2013, through December 31, 2016. This threshold requirement has not been met in this case.

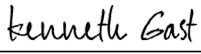
Specifically, rather than being issued “*at any time during the four-taxable-year period preceding the taxable year for which the current Demand for Tax Return is issued,*” FTB’s NPA for the 2016 tax year was not issued until 2018, which is *after* the 2017 tax year “*for which the current [Demand] is issued.*” Therefore, FTB improperly imposed the demand penalty.

I note that Example 2 of the regulation appears to interpret subsection (b)(2) as being met if the prior NPA were issued for a tax year “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 “at any time during the four-taxable-year period *preceding* the taxable year for which the current Demand for Tax Return is issued.” (Emphasis added.) Thus, FTB’s regulation is internally inconsistent. Contrary to the majority’s conclusion, I find the operative language of the regulation to be 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, I see no reason to place greater weight on the implication of the example than on the clear and precise operative language. Indeed, Regulation section 19133(d), where Example 2 is found, clearly indicates that the “examples are intended to *illustrate* the provisions of this regulation,” and thus, in my view, are not intended to be given greater weight than the rules themselves. (Emphasis added.) Therefore, I would 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.

Finally, while “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), here, Example 2 does create such a conflict and I would not give it persuasive authority. Accordingly, because the words “at any time during” are unambiguous, FTB’s interpretation should not be entitled to deference. (See *Kisor v. Wilkie* (June 26, 2019, No. 18-15) ___ U.S. ___ [139 S.Ct. 2400, 2415].)

For the foregoing reasons, I respectfully dissent with respect to Issue 1 and, for that reason, would not have reached Issue 2.

DocuSigned by:

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Kenneth Gast
Administrative Law Judge