

**OFFICE OF TAX APPEALS
STATE OF CALIFORNIA**

In the Matter of the Appeal of:) OTA Case No. 20086421
K. FENCIL AND)
V. SALAMON)
_____)

OPINION

Representing the Parties:

For Appellants: Tina A. Fisher, CPA

For Respondent: Noel Garcia, Tax Counsel

For Office of Tax Appeals: Megan Gregory, Graduate Student Assistant

A. LONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, K. Fencil and V. Salamon (appellants) appeal an action by the Franchise Tax Board (respondent) denying appellants’ claim for refund of \$4,110 for the 2015 tax year.¹

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

ISSUES

1. Whether respondent properly imposed a notice and demand penalty (demand penalty).
2. Whether appellants have established reasonable cause for failing to timely reply to a Demand for Tax Return (Demand) for the 2015 tax year.

FACTUAL FINDINGS

1. Respondent determined from its records that appellant-husband may have earned enough income to require filing a California tax return for 2011.
2. On May 20, 2014, respondent sent appellant-husband a Request for Tax Return (Request) for the 2011 tax year with the deadline of June 25, 2014, to respond to the Request by

¹ On appeal, appellants state that they are only appealing the demand penalty of \$2,733 and related interest. Respondent concedes to reducing the demand penalty to \$2,619.75.

- filing a return, providing evidence that a 2011 return was already filed, or explaining why a 2011 return need not be filed.
3. Respondent did not receive a response to the 2011 Request, and so respondent issued appellant-husband a Notice of Proposed Assessment (NPA) on July 28, 2014. The NPA states that the proposed assessment would become due and payable on September 26, 2014, unless respondent received a 2011 tax return or a protest of the proposed assessment.
 4. Appellants filed their 2011 tax return on September 30, 2014.
 5. In 2017, respondent determined from its records that appellant-husband may have earned enough income to require filing a California tax return for the 2015 tax year.
 6. On May 9, 2017, respondent sent appellant-husband a 2015 tax year Demand. The Demand states, “[i]f 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” To avoid the demand penalty, respondent advised appellant-husband that he had until June 14, 2017, to file a 2015 tax return, provide evidence that he had already filed it, or provide information showing that he did not need to file a 2015 tax return.
 7. When respondent did not receive a response, it issued appellant-husband an NPA on July 10, 2017. The NPA listed a demand penalty of \$2,733. The NPA explained that the assessment would become due and payable on September 8, 2017, unless respondent received a 2015 tax return or a protest of the proposed assessment.
 8. On September 2, 2017, appellants mailed their joint 2015 California tax return with their payment to respondent, and it was filed on September 28, 2017.
 9. Respondent processed and accepted the return as filed. During processing, respondent reduced the demand penalty from \$2,733.00 to \$2,619.75, and imposed a late filing penalty and a filing enforcement fee. Appellants paid the balance due in full through an installment agreement.
 10. On April 14, 2020, appellants filed a claim for refund to request an abatement of the 2015 demand penalty, arguing that the late filing of their return was due to financial hardship. Respondent denied the claim.
 11. This timely appeal followed.

DISCUSSION

Issue 1: Whether respondent properly imposed the demand penalty.

Respondent may impose a penalty on a taxpayer for 25 percent of the amount of tax assessed if the taxpayer fails to file a return or provide information upon a notice and demand from respondent. (R&TC, § 19133.) Respondent may only impose a demand penalty if two criteria are met: (1) the taxpayer fails to timely 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)(1)-(2).) A "timely response" is defined as a response within the time period specified in the Demand or Request. (Cal. Code Regs., tit. 18, § 19133(c)(3).) The demand penalty was designed to penalize the taxpayer's failure to respond to the Demand, not the NPA. (See *Appeal of Scott* (83-SBE-094) 1983 WL 15480.)

Here, appellants failed to timely respond to the 2015 Demand and also failed to timely respond to the 2011 Request, which resulted in the 2011 NPA. Because the 2011 NPA occurred during the four tax years preceding the 2015 tax year, and appellants untimely responded to the 2015 Demand, respondent properly imposed a demand penalty for the 2015 tax year. (See *Appeal of Jones*, 2021-OTA-144P.)

Appellants argue that the demand penalty was improperly imposed because they timely filed their 2015 return by the NPA deadline of September 18, 2017. However, California Code of Regulations, title 18, section 19133 defines a timely response as a response to a Demand or Request and not an NPA. There is no dispute that appellants failed to respond to both the 2011 Request and the 2015 Demand. Accordingly, they did not timely respond to the 2011 Request and the 2015 Demand. Therefore, appellants' argument is unpersuasive.

Appellants also assert that they timely responded to the 2011 NPA, and therefore they do not meet the second criteria from R&TC section 19133 for respondent to impose a demand penalty for the 2015 tax year. Although appellants did timely respond to the 2011 NPA, this does not affect respondent's ability to impose a demand penalty. Respondent issued the 2011 NPA following appellants' failure to timely respond to the 2011 Request, which fulfills the second criteria of the demand penalty analysis. Therefore, respondent properly imposed the 2015 demand penalty.

Issue 2: Whether appellants have established reasonable cause for failing to timely reply to the Demand for the 2015 tax year.

The demand penalty can be abated if the taxpayer establishes that his or her untimely response was due to reasonable cause and not willful neglect. (R&TC, § 19133.) The burden of proof is on the taxpayer to show reasonable cause by demonstrating that an ordinarily intelligent and prudent businessperson would have acted similarly under the circumstances. (*Appeal of Jones, supra.*) An analysis of reasonable cause requires examining the taxpayer's actions leading up to the failure to timely respond, the timing of those actions, and whether they reflect ordinary business care and prudence such that an ordinarily intelligent and prudent businessperson would have acted similarly in the situation. (*Appeal of Moren, 2019-OTA-176P.*)

Personal difficulties that prevent a taxpayer from responding to a Demand or a Request may be considered reasonable cause if the taxpayer presents credible and competent proof that the taxpayer was continuously prevented from responding to the Demand. (See *Appeal of Head and Feliciano, 2020-OTA-127P.*)² Reasonable cause is not established if evidence shows that a taxpayer handled his or her business affairs while being selectively unable to timely manage his or her tax obligations. (*Ibid.*) When a taxpayer alleges their failure to timely respond was due to an incapacity, that excuse is valid only as long as the incapacity remains valid. (*Appeal of Moren, supra.*)

Appellants argue that they suffered financial hardship, which they contend constitutes reasonable cause. Appellants state they were unemployed or underemployed from 2009 to 2014 and accrued debts during this time. Upon gaining adequate employment in 2015, they explain that they began paying off past-due loans in chronological order.

However, appellants' alleged financial hardship does not explain their failure to timely respond to the 2015 Demand by June 14, 2017. Establishing reasonable cause due to financial hardship is often used in arguments to abate late payment penalties. (See *Appeal of Triple Crown Baseball LLC, 2019-OTA-025P.*) The 2015 Demand does not require that appellants remit any payments, and appellants do not explain how their alleged financial hardship affected their ability to timely file their 2015 tax return, show they had already filed it, or explain that

² *Appeal of Head and Feliciano, supra*, relates to reasonable cause in the context of a late-filing penalty, but the same standards for reasonable cause apply to the demand penalty.

they did not need to file it. Furthermore, the 2015 Demand was sent in 2017, two years after appellants' alleged period of financial hardship. Additionally, appellants' ability to pay off other past-due liabilities from 2015 onward indicates that they took care of other aspects of their business obligations during the time they did not respond to the 2015 Demand. An ordinarily intelligent and prudent businessperson can also be expected to timely respond to respondent's demand for information, which required no payments to avoid a demand penalty. Therefore, appellants' alleged financial hardship (even if it existed during the period in issue) does not demonstrate reasonable cause to abate the demand penalty.

Appellants' have not established that their failure to respond to the 2015 Demand was due to reasonable cause. Therefore, the demand penalty cannot be abated.

HOLDINGS

1. Respondent properly imposed the demand penalty.
2. Appellants have not established reasonable cause for failing to timely reply to the Demand for the 2015 tax year.

DISPOSITION

Respondent's denial of appellants' claim for refund is modified in accordance with its concession to reduce the demand penalty to \$2,619.75. Respondent's action is otherwise sustained.

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Andrea L.H. Long
Administrative Law Judge

We concur:

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Elliott Scott Ewing
Administrative Law Judge

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Daniel K. Cho
Administrative Law Judge

Date Issued: 9/23/2021