OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 21067950
S. SHAPIRO	)
	)
	)
	)

OPINION

Representing the Parties:

For Appellant: S. Shapiro

For Respondent: Topher T. Tuttle, Tax Counsel III

A. WONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, S. Shapiro (appellant) appeals an action by respondent Franchise Tax Board (FTB) proposing a tax assessment of $10,422, a late-filing penalty of $2,605.50, a notice and demand penalty (demand penalty) of $2,605.50, a filing enforcement cost recovery fee of $97, and applicable interest, for the 2016 tax year.

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

ISSUES

1. Whether appellant has established that FTB's proposed tax assessment is erroneous.
2. Whether appellant has established reasonable cause for failing to file a 2016 California income tax return (2016 return).
3. Whether appellant has established reasonable cause for failing to make and file a 2016 return in response to FTB's Demand for Tax Return (Demand).
4. Whether there is a basis to abate the filing enforcement cost recovery fee.
5. Whether appellant has established that interest should be abated.

FACTUAL FINDINGS

1. Appellant was a nonresident of California in 2016.
2. Through its Integrated Non-Filer Compliance Program, FTB learned that a California casino made payments totaling $146,287 to appellant during the 2016 tax year. The casino had reported these payments to the IRS on multiple Form W-2G (*Certain Gambling Winnings*) forms (W2-Gs).
3. $146,287 exceeds the income threshold above which a single individual under 65 with no dependents must file a 2016 return.[1]
4. Appellant did not file a 2016 return.
5. On August 24, 2020, FTB issued to appellant a Demand for his 2016 return, stating that if appellant did not timely respond, FTB would assess a late-filing penalty, a demand penalty, a filing enforcement cost recovery fee, and applicable interest.
6. On December 22, 2020, having no record of receiving appellant's 2016 return, FTB issued to appellant a Notice of Proposed Assessment (NPA), which proposed to assess the tax, penalties, fee, and interest at issue for the 2016 tax year.
7. Appellant timely protested the NPA, which FTB affirmed in a Notice of Action.
8. This timely appeal followed.

DISCUSSION

Issue 1: Whether appellant has established that FTB's proposed tax assessment is erroneous.

California imposes a tax on the entire taxable income of a nonresident to the extent it is derived from sources within this state. (R&TC, §§ 17041(b) & (i)(1)(B), 17951(a).) Every individual subject to the Personal Income Tax Law—including a nonresident—must make and file a return with FTB "stating specifically the items of the individual's gross income from all sources and the deductions and credits allowable" if the individual's gross income exceeds certain filing thresholds. (R&TC, § 18501(a).) If any taxpayer fails to file a return, FTB, at any time, "may make an estimate of the net income, from any available information, and may propose to assess the amount of tax, interest, and penalties due." (R&TC, § 19087(a).)

[1] Per FTB's Demand, the relevant income threshold is either $16,597 in California gross income or $13,278 in California adjusted gross income.

When FTB makes a proposed assessment of additional tax based on an estimate of income, FTB's initial burden is to show why its proposed assessment is reasonable and rational. (*Appeal of Bindley*, 2019-OTA-179P.) An assessment based on unreported income is presumed correct when FTB introduces a minimal factual foundation to support the assessment. (*Ibid*.)

Here, FTB introduced into the record a five-page schedule of payments a California casino made to appellant during the 2016 tax year and reported to the IRS as gambling winnings on W2-Gs. The payments totaled $146,287, a gross income amount that would have triggered a filing requirement for appellant. But appellant did not file a 2016 return, so FTB used the IRS information to estimate appellant's California-derived net income and timely issued the NPA. We find that FTB has introduced a minimal factual foundation supporting its proposed assessment and shown why it is reasonable and rational.

Once the FTB has met its initial burden, the proposed assessment of tax is presumed correct, and the taxpayer has the burden of proving it to be wrong. (*Appeal of Bindley*, *supra*.)

On appeal to the Office of Tax Appeals (OTA), appellant asserts that he has repeatedly provided FTB with documentation proving that he owes no money to California, but elaborates no further. The record contains correspondence between the parties in which appellant asserts that he has no net/taxable income derived from California for the period from 2012 through 2019 and claims that he has supporting documentation of the same. But the only supporting documentation in the record are information statements from two California casinos indicating that, based on tracked play, appellant had net gambling losses for 2014 and 2015. The record contains no such information statement for the 2016 tax year.

Per R&TC section 17201(a), which incorporates Internal Revenue Code section 165(d), gambling losses are generally allowable as an itemized deduction, but only to the extent of gambling winnings. (See also Treas. Reg. § 1.165-10.) The taxpayer bears the burden of proving the correct amount of gambling losses sought to offset gambling winnings. (*Mack v. Commissioner* (6th Cir. 1970) 429 F.2d 182, 184.)

Here, the record contains no evidence of deductible gambling losses for the 2016 tax year despite appellant's claim to the contrary. In certain circumstances, the *Cohan* rule could allow an estimate of gambling losses. (See, e.g., *Drews. v. Commissioner*, 25 T.C. 1354, citing *Cohan v. Commissioner* (2nd Cir. 1930) 39 F.2d 540.) However, absent adequate substantiation that appellant is entitled to *some* gambling losses, the *Cohan* rule does not apply. (See *Norgaard v.*

Commissioner (9th Cir. 1991) 939 F.2d 874, 879-880.) Accordingly, appellant has not carried his burden of proving any gambling losses that would offset his unreported California-derived gambling winnings for the 2016 tax year, and we conclude that appellant has not established error in FTB's proposed tax assessment.

Issue 2: Whether appellant has established reasonable cause for failing to file a 2016 return.

Appellant's California-derived income of $146,287 for the 2016 tax year subjected him to a California filing requirement, but he has yet to file a 2016 return.

R&TC section 19131 imposes a late-filing penalty if a taxpayer fails to file a return on or before the return's due date or the due date as extended by FTB unless the taxpayer shows that the failure is due to reasonable cause and not due to willful neglect.[2] When FTB imposes a penalty, it is presumed to have been imposed correctly. (*Appeal of Xie*, 2018-OTA-076P.) A taxpayer may rebut this presumption by providing credible and competent evidence supporting abatement of the penalty for reasonable cause. (*Ibid*.) To establish reasonable cause, a taxpayer must show that the failure to file a timely return occurred despite the exercise of ordinary business care and prudence, or that such cause existed as would prompt an ordinarily intelligent and prudent businessperson to have so acted under similar circumstances. (*Appeal of Head and Feliciano*, 2020-OTA-127P.)

On appeal to OTA, appellant does not specifically address the late-filing penalty and offers no reasonable cause arguments against it. However, the record contains correspondence between the parties in which appellant asserted that he had no net/taxable income derived from California for the tax year at issue and therefore he was not subject to a California filing requirement.

A California nonresident's sincere belief that he or she was not required to file a return in California does not, by itself, constitute reasonable cause for failing to file a timely return. (*Appeal of Cremel and Koeppel*, 2021-OTA-222P.) Accordingly, we conclude that appellant has not established reasonable cause for failing to file a 2016 return.

[2] There are no allegations of willful neglect, so we focus on whether appellant has established reasonable cause.

Issue 3: Whether appellant has established reasonable cause for failing to make and file a 2016 return in response to FTB's Demand.

R&TC section 19133 provides that if a taxpayer fails to make and file a return upon notice and demand by FTB, then FTB may impose a demand penalty unless taxpayer's failure is due to reasonable cause. The requirements for imposing the demand penalty for the 2016 tax year were satisfied here; the issue is whether there is reasonable cause to abate the demand penalty.

The burden of proving reasonable cause for failing to file upon demand is on the taxpayer. (*Appeal of GEF Operating, Inc.*, 2020-OTA-057P.) 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 Jones*, 2021-OTA-144P.) The taxpayer's reason for failing to respond to a demand must be such that an ordinarily intelligent and prudent businessperson would have acted similarly under the circumstances. (*Appeal of GEF Operating, Inc.*, *supra*.)

On appeal, appellant does not specifically address the demand penalty and offers no reasonable cause arguments against it. Again, however, the record contains correspondence between the parties in which appellant argues that he was not subject to a California filing requirement because he had no net/taxable income derived from California for the 2016 tax year.

Generally, a belief that no tax will be due does not constitute reasonable cause sufficient to abate a penalty. (*Appeal of Xie*, *supra*.) Thus, appellant has not established reasonable cause for failing to make and file a 2016 return in response to FTB's Demand.

Issue 4: Whether there is a basis to abate the filing enforcement cost recovery fee.

R&TC section 19254(a)(2) provides that if a taxpayer fails to make and file a tax return within 25 days after FTB mails to that person a formal legal demand to file the tax return, FTB will impose a filing enforcement cost recovery fee. Once properly imposed, there is no provision in the R&TC which would excuse FTB from imposing the filing enforcement cost recovery fee under any circumstances, including reasonable cause. (*Appeal of Wright Capital Holdings LLC*, 2019-OTA-219P.)

Here, FTB informed appellant in its Demand that appellant would be subject to the filing enforcement cost recovery fee if appellant did not file a timely 2016 return. Appellant did not

file such a return. Therefore, FTB properly imposed the filing enforcement cost recovery fee, and we conclude that there is no basis to abate it.

Issue 5: Whether appellant has established that interest should be abated.

R&TC section 19101 provides that taxes are due and payable as of the original due date of the taxpayer's return (without regard to extension). If tax is not paid by the original due date or if FTB assesses additional tax and that assessment becomes due and payable, the taxpayer is charged interest on the resulting balance due, compounded daily. (R&TC, § 19101.) Interest is not a penalty, but is compensation for a taxpayer's use of money after it should have been paid to the state. (*Appeal of GEF Operating, Inc.*, *supra*.) There is no reasonable cause exception to the imposition of interest, and interest is mandatory except where abatement is authorized under the law. (*Appeal of Moy*, 2019-OTA-057P.)

Generally, to obtain relief from interest, taxpayers must qualify under one of the following three R&TC sections: 19104, 19112, or 21012. Under R&TC section 19104, FTB may abate all or a part of any interest on a deficiency to the extent that interest is attributable in whole or in part to any unreasonable error or delay committed by FTB in the performance of a ministerial or managerial act. Under R&TC section 19112, FTB may waive interest for any period for which it determines that an individual or fiduciary demonstrates inability to pay that interest solely because of extreme financial hardship caused by significant disability or other catastrophic circumstance. Under R&TC section 21012, if a person's failure to make a timely return or payment is due to the person's reasonable reliance on written advice from FTB, the person may be relieved of the taxes assessed or any interest, additions to tax, and penalties added thereto, subject to numerous conditions.

Appellant does not allege, and nothing in the record suggests, that any of these three statutory provisions for interest abatement apply. Therefore, we conclude that appellant has not established that interest should be abated.

HOLDINGS

1. Appellant has not established error in FTB's proposed tax assessment.
2. Appellant has not established reasonable cause for failing to file a 2016 return.
3. Appellant has not established reasonable cause for failing to make and file a 2016 return in response to FTB's Demand.
4. There is no basis to abate the filing enforcement cost recovery fee.
5. Appellant has not established that interest should be abated.

DISPOSITION

We sustain FTB's action.

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Andrew Wong
Administrative Law Judge

We concur:

DocuSigned by:
Sara A Hosey
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Sara A. Hosey
Administrative Law Judge

DocuSigned by:
John O Johnson
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John O. Johnson
Administrative Law Judge

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