OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **R. ISLEY**	) OTA Case No. 20116974)))))

OPINION

Representing the Parties:

For Appellant:	Steven R. Mather, Attorney
For Respondent:	Parviz T. Iranpour, Tax Counsel Ron Hofsdal, Tax Counsel IV
For Office of Tax Appeals:	David Kowalczyk, Tax Counsel

J. JOHNSON, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, appellant R. Isley appeals an action by respondent Franchise Tax Board denying appellant's claim for refund of $49,938 for the 1997 tax year, $8,765 for the 1998 tax year, and $51,458 for the 1999 tax year.[1]

Office of Tax Appeals (OTA) Administrative Law Judges John O. Johnson, Kenneth Gast, and Ovsep Akopchikyan held an electronic oral hearing for this matter on November 18, 2022. At the conclusion of the hearing, the record was closed and this matter was submitted for an opinion.

[1] The amounts listed here reflect the amounts listed on the claims for refund and respondent's denial of those claims, and do not include penalties and interest also originally at issue. During briefing on appeal, respondent withdrew the failure to furnish information penalty for the 1997 through 1999 tax years, and those amounts will be refunded. During the oral hearing, respondent conceded the residency issue and resulting adjustments to income for the 1998 and 1999 tax years, with reference to witness testimony provided at the hearing. The conceded tax amounts, as well as penalties and interest relating to the 1998 and 1999 tax years, shall be refunded. Also during the hearing, appellant conceded that he was a California resident for entirety of the 1997 tax year, and thereby conceded the contested income tax amount for that tax year. Accordingly, the remaining amounts on appeal are the late filing penalty of $12,484.50 for the 1997 tax year, the calculation of the $19,419.13 post-amnesty penalty for the 1997 tax year, and the calculation of interest on amounts owed by appellant as well as amounts to be refunded by respondent.

ISSUES

1. Whether appellant has established reasonable cause sufficient to abate the late filing penalty for the 1997 tax year.
2. Whether appellant has shown error in respondent's calculation of the post-amnesty penalty for the 1997 tax year.
3. Whether appellant has shown respondent abused its discretion with regard to any interest not abated for the 1997 tax year.[2]

FACTUAL FINDINGS

1. On May 15, 2010, appellant untimely filed his 1997 California Nonresident or Part-Year Resident Income Tax Return.[3] Appellant did not file a Missouri Individual Income Tax Return for the 1997 tax year.
2. On May 22, 2012, respondent informed appellant that respondent had selected appellant's 1997 to 1999 California tax returns for an audit and requested documentation supporting his returns. Appellant did not respond.
3. On August 6, 2012, respondent issued a demand to appellant to provide documents respondent requested in its letter dated May 22, 2012. Appellant did not respond.
4. On January 21, 2014, respondent issued a Notice of Proposed Assessment (NPA) for each of the 1997 through 1999 tax years. For 1997, the NPA proposed to assess $69,938.00 of additional tax, a $12,484.50 late filing penalty, a $19,419.13 post-amnesty penalty, and a $12,484.50 failure to furnish information penalty.
5. On March 28, 2016, respondent issued Notices of Action (NOAs) affirming the NPAs for the 1997 to 1999 tax years.[4]

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[2] Up to the date of the hearing, this issue was primarily focused on arguments from the parties' briefing regarding whether appellant had shown any error in respondent's calculation of interest to be paid to appellant on any refunds related to the tax years on appeal. As discussed herein, this issue is rephrased to better reflect the unresolved issues on appeal.

[3] Appellant indicated at the hearing that he received a notice of state income tax due for the 1997 tax year in 2006. A copy of this notice is not in the record. Respondent labels a May 22, 2012 letter (discussed herein) as the first contact it issued to appellant regarding the 1997 tax year.

[4] Respondent does not state if or when the proposed assessments became final. However, seeing no evidence of the NPAs being protested, it is likely that the proposed assessments became final in 2014 following the issuance of the NPAs.

6. On September 10, 2018, appellant remitted a $355,193.64, $50,066.57, and $191,648.99 payment for the 1997 to 1999 tax years, respectively, fully paying his liabilities for all three tax years.
7. On September 5, 2019, appellant filed amended California nonresident income tax returns for the 1997 to 1999 tax years, claiming refunds of $49,938, $8,765, and $51,458 for the 1997 to 1999 tax years, respectively. Appellant attached a statement to each return explaining that the changes on the amended returns were based on the position that appellant was not a California resident during the respective tax years.
8. On January 7, 2020, respondent requested that appellant provide documentation to substantiate his position that he was a California nonresident for the entirety of the 1997 to 1999 tax years. Appellant did not respond.
9. On February 26, 2020, respondent explained to appellant that it will deny appellant's claims for refund for the 1997 to 1999 tax years.
10. On March 10, 2020, respondent received a fax from appellant explaining that he did not receive respondent's letters and requested respondent to not deny his claims for refund until he can respond to respondent's request for additional documentation.
11. Also on March 10, 2020, respondent issued a letter requesting appellant to reply to respondent's January 7, 2020 letter, which respondent attached, for the case to remain open.
12. On April 1, 2020, respondent granted appellant additional time to respond to its letter.
13. On May 29, 2020, appellant responded to respondent's January 7, 2020, letter.
14. On September 3, 2020, respondent denied appellant's claims for refund for the 1997 to 1999 tax years, and this timely appeal followed.

DISCUSSION

Issue 1: Whether appellant has established reasonable cause sufficient to abate the late filing penalty for the 1997 tax year.

California imposes a penalty for failing to file a return on or before the due date, unless the taxpayer shows that the failure is due to reasonable cause and not due to willful neglect. (R&TC, § 19131.) Tax returns for calendar year individual taxpayers are due on or before

April 15th following the close of the calendar year. (R&TC, § 18566.) Here, appellant filed his 1997 California tax return on May 15, 2010, well after the due date of April 15, 1998.[5]

To establish reasonable cause for the late filing penalty, the 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.)

Appellant argued at the hearing that reasonable cause exists for the late filing based on the confusion caused by his ongoing bankruptcy action that began in April 1997. Appellant bases this contention on activity and large monetary amounts involved between attorneys and accountants, what was "attributable to" or going to appellant, and what was reported on returns during the bankruptcy proceedings. However, even if the bankruptcy proceedings caused confusion over appellant's fiduciary obligations, such as filing tax returns, to such an extent as to qualify as reasonable cause for missing the filing due date in 1998, the bankruptcy proceedings concluded in July 2001. Appellant still did not file his 1997 tax return until May 2010, nearly nine years later.[6] An acceptable reason for failing to file will excuse such failure only so long as the reason remains valid. (*Appeal of Triple Crown Baseball LLC*, 2019-OTA-025P.)[7]

Beyond the asserted confusion caused by the bankruptcy action, appellant's only contention as to why a 1997 return was not filed until 2010 is that he relied upon competent tax professionals. Reasonable cause may be established when a taxpayer shows reasonable reliance on substantive tax advice from a tax professional that it was unnecessary to file a return. (*U.S. v. Boyle* (1985) 469 U.S. 241, 250; *Appeal of Summit Hosting LLC*, 2021-OTA-216P.) However,

[5] Appellant's 1997 return was labeled as a "duplicate return" at the top of the first page. At the hearing, appellant explained that the return was labeled as a duplicate return because he believed something must have been filed before that point to have generated respondent's notice regarding an assessment of tax for the 1997 tax year in 2006. At the hearing, appellant clarified that he is not contending that a timely return was filed for 1997, only that there was reasonable cause for the late filing of that return.

[6] The late filing penalty is calculated at five percent of the tax for each month or fraction of each month the return is late, with a maximum penalty of 25 percent of the tax due. (R&TC, § 19131(a).) Accordingly, even if reasonable cause were found to exist through the end of the bankruptcy proceedings, and only up to that point, the maximum penalty amount would still apply.

[7] Opinions analyzing whether reasonable cause for failing to timely pay tax are persuasive authority for analyzing whether there is reasonable cause for failing to timely file a tax return. (*Appeal of Triple Crown Baseball LLC*, *supra*, at fn. 8.)

reasonable cause does not include taxpayers delegating their duty to timely file a tax return to their tax advisor. (*U.S. v. Boyle*, *supra*, 469 U.S. at p. 250.)

Appellant asserts that he employed competent tax professionals and ensured they had all available tax information. At the hearing, his representative indicated that there was a level of sophistication surrounding the filing of the 1997 tax return and bankruptcy activity that was beyond appellant's comprehension, and beyond his representative's comprehension. Conflicting with these assertions, however, is the fact that when appellant's 1997 California return was eventually filed it reported significant California sourced income in 1997, which a competent tax professional would know necessitates the filing of a California return. There is no indication that this California source income was not known as of the end of 1997, and yet no California return was prepared and filed by the standard filing due date. Accordingly, reasonable cause has not been shown based on reliance on tax professionals, or for any other reason.

Issue 2: Whether appellant has shown error in respondent's calculation of the post-amnesty penalty for the 1997 tax year.

R&TC section 19777.5(e)(2) provides that a taxpayer may only file a claim for refund for any amounts paid to satisfy the amnesty penalty "on the grounds that the amount of the penalty was not properly computed by the Franchise Tax Board." Accordingly, OTA's jurisdiction over the post-amnesty penalty at issue here is limited to disputes regarding the calculation of the penalty.

Appellant argued for relief of the post-amnesty penalty for the first time at the hearing, asserting that the penalty should not have been imposed because appellant timely applied for amnesty for the 1997 tax year, and while other years in the same application were granted amnesty treatment, 1997 was for some reason denied.[8] When the question was raised at the hearing as to whether OTA's jurisdiction over the post-amnesty penalty was limited to its calculation, appellant stated that he did not have any authority to indicate otherwise. Accordingly, the imposition of the post-amnesty penalty is not at issue, and only the calculation

[8] The applicable tax amnesty program was conducted during the first half of 2005. (R&TC, § 19731.) As a requirement to participate in the program, taxpayers had to have filed a return for the tax year at issue within 60 days after the close of the amnesty period, i.e., in 2005. (R&TC, § 19733(a)(3)(A)(i).)

of the penalty is. No arguments were provided as to how the penalty may have been miscalculated, and there are no errors in the calculation shown by the evidence.

Issue 3: Whether appellant has shown respondent abused its discretion with regard to any interest not abated for the 1997 tax year.

With regard to interest to be refunded, the parties raised both the calculation of interest on amounts to be refunded and interest abatement for interest paid on amounts owed. However, at the hearing, appellant acknowledged that respondent "concedes that we're entitled to interest on any amounts that are refunded as required by statute on the refund. So, I don't think that's an issue." As such, and seeing no indication at this time that respondent has or will miscalculate that interest amount, this section will only address the question of interest abatement. Since respondent has conceded all amounts for the 1998 and 1999 tax years, the question of interest abatement on appeal is only applicable to the 1997 tax year.

Appellant contends that respondent issued a notice of state income tax due in 2006 in response to a 1997 tax year California return that appellant believes he must have filed prior to that date. This, appellant argues, shows an eight-year gap between when respondent first contacted appellant, in 2006, and when it issued its NPAs, in 2014. However, appellant concedes that beyond this conjecture, there is otherwise no evidence of a 1997 tax year California return being filed prior to 2010 and there is likewise no 2006 notice in the record. Instead, the record reflects that the first contact issued by respondent to appellant regarding the 1997 tax year is the May 22, 2012 letter (labeled as an "initial contact letter" by respondent), informing appellant that his 1997 tax return was being examined. Accordingly, no period prior to May 22, 2012, at the earliest, may be considered for purposes of interest abatement. (R&TC, § 19104(b)(1).)[9]

Appellant points out that the tax year at issue was 25 years ago, asserting that this matter "has taken way too long to sort out," and ultimately contends that "a lot of the blame for [the] delay is on [respondent]." Beyond general contentions that the length of time it has taken to

[9] While interest may be abated for reasons other than an error or delay by respondent in certain circumstances, the parties only present arguments relating to abatement based on an alleged error or delay by respondent, which is governed by R&TC section 19104, and no other abatement statutes appear relevant.

resolve the matter was attributable to undue delay on respondent's part, appellant does not point to specific actions or periods that qualify for interest abatement under R&TC section 19104.

As show in the facts above, respondent began an audit of appellant's 1997 tax return in May 2012, and issued a demand for documents to appellant in August 2012.[10] Appellant did not respond, which led to a timely NPA being issued in January 2014 (see R&TC section 19057(a)), and an NOA affirming the proposed assessment in March 2016.[11] The next action taken was appellant paying the amounts due in September 2018. Since that stopped the accrual of interest, the interest abatement analysis ends there.

In reviewing the activity between May 2012 and September 2018, there is no indication that there was any undue delay or error during this process attributable to the actions of respondent's staff. To the contrary, it appears that appellant's inaction can be considered to have contributed to any extended passage of time. In fact, despite requests and opportunities for appellant to provide information and documentation beginning in May 2012, the record suggests that appellant's first action in response was paying outstanding amounts in September 2018.[12] Under R&TC section 19104(b)(1), interest will not be abated when a significant aspect of an error or delay at issue can be attributed to the taxpayer. Appellant has not shown that interest abatement is warranted under R&TC section 19104.

[10] The demand for information also references a July 10, 2012 follow-up letter that came after the May 2012 letter. A copy of this follow-up letter was not provided on appeal.

[11] As noted above, there is no record of appellant protesting the NPA. If that is true, then the proposed assessments would have gone final in 2014, and the NOA issued in March 2016 served the same role as a notice or statement of amounts due.

[12] Although not discussed by the parties, a list of appellant's payments for his 1997 tax year liability shows 18 payments, all but one for the same dollar amount, made on a nearly monthly basis from March 1, 2017, to August 31, 2018. It is unclear whether these resulted from collection activity by respondent or voluntary payments by appellant. These payments were each less than one-half of one percent of the September 2018 payment, and therefore do not substantially alter the analysis of the issues on appeal.

HOLDINGS

1. Appellant has not established reasonable cause sufficient to abate the late filing penalty for the 1997 tax year.
2. Appellant has not shown error in respondent's calculation of the post-amnesty penalty for the 1997 tax year.
3. Appellant has not shown respondent abused its discretion with regard to any interest not abated for the 1997 tax year.

DISPOSITION

Appellant concedes that he was a California resident for the 1997 tax year, and therefore respondent's proposed assessment of additional tax for that year is sustained. Respondent has conceded all amounts at issue for the 1998 and 1999 tax years, including tax, penalties, and interest. Respondent has also conceded the failure to furnish information penalty for 1997. Appellant's remaining claim for refund of penalties and interest for the 1997 tax year is otherwise denied.

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John O Johnson
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John O. Johnson
Administrative Law Judge

We concur:

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Kenneth Gast
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