OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **J. LEE AND** **V. LEE**	OTA Case No. 19105396

OPINION

Representing the Parties:

For Appellants: Dan Lo, Representative

For Respondent: Sarah J. Fassett, Tax Counsel
Eric A. Yadao, Tax Counsel III

A. ROSAS, Administrative Law Judge: Under Revenue and Taxation Code (R&TC) section 19324, appellants J. Lee and V. Lee appeal respondent Franchise Tax Board's action in denying appellants' claim for refund for tax year 2016. The claim for refund consists of a late-filing penalty of $1,474.25 plus a demand penalty of $7,830.

Office of Tax Appeals (OTA) Administrative Law Judges Tommy Leung, John O. Johnson, and Alberto T. Rosas held an oral hearing on September 22, 2021.[1] At the conclusion of the hearing, OTA closed the record and the matter was submitted for decision.

ISSUES

1. Whether appellants' failure to timely file a tax return for tax year 2016 was due to reasonable cause.
2. Whether respondent properly imposed the demand penalty, in whole or in part. If so, whether appellants established reasonable cause to abate the demand penalty.

FACTUAL FINDINGS

1. In February 2015, respondent sent a Demand for Tax Return (Demand) to V. Lee, which concerned V. Lee's 2013 California income tax return. The Demand requested that V. Lee either file a 2013 return, provide evidence that a 2013 return was already filed, or explain why a 2013 return was not required. This 2013 Demand was not a joint notice; rather, this

[1] Although noticed for Sacramento, California, OTA conducted this hearing electronically due to COVID-19.

2013 Demand was addressed only to V. Lee. On April 6, 2015, respondent issued to V. Lee a Notice of Proposed Assessment (NPA) when she failed to respond to the 2013 Demand. This NPA was addressed only to V. Lee.

2. Two years later, appellants did not file a timely California tax return for tax year 2016.

3. Respondent received information that each appellant had sufficient income to require the filing of a 2016 California tax return. Respondent sent separate Demand letters to each appellant:

   - On March 15, 2018, respondent sent a Demand to J. Lee.
   - On April 10, 2018, respondent sent a Demand to V. Lee.

4. Each separate Demand requested that the recipient either file a 2016 return, provide evidence that a 2016 return was already filed, or explain why a 2016 return was not required. When neither appellant responded timely to their respective Demand letters, respondent sent separate NPAs to each appellant:

   - On May 14, 2018, respondent sent an NPA to J. Lee, which estimated his income and proposed a late-filing penalty of $2,358.75 and a demand penalty of $8,348.25. The NPA also proposed a tax liability, interest, and a filing enforcement fee.
   - On June 11, 2018, respondent sent an NPA to V. Lee, which estimated her income and proposed a late-filing penalty of $429.25 and a demand penalty of $795.25. The NPA also proposed a tax liability, interest, and a filing enforcement fee.

5. Neither appellant protested their respective NPAs, and each NPA went final and became due and payable.

6. On August 13, 2018, respondent issued a Notice of State Income Tax Due addressed only to J. Lee. Later that same month, appellants' representative wrote to respondent and explained that appellants had a bereavement with J. Lee's father. The representative also explained that appellants were working diligently to file their return.

7. On September 6, 2018, respondent received appellants' 2016 California tax return. Based on the amount of tax as reported on appellants' tax return, respondent reduced the late-filing penalty to $1,474.25.[2] Respondent imposed a demand penalty of $7,830.[3]
8. In June and August 2019, respondent received appellants' Claims for Refund requesting abatement of the penalties.
9. Respondent denied appellants' claim for refund. Appellants then filed this timely appeal with OTA.

DISCUSSION

Issue 1 – Whether appellants' failure to timely file a tax return for tax year 2016 was due to reasonable cause.

Because appellants failed to timely file their 2016 California tax return by April 15, 2017, or by the automatic six-month extension, respondent imposed a late-filing penalty of $1,474.25. Respondent imposes a late-filing penalty when a taxpayer does not timely file a return, unless it is shown that the failure to timely file was due to reasonable cause and not due to willful neglect. (R&TC, § 19131(a).) When respondent imposes this penalty, the law presumes that it is correct. (*Appeal of Xie*, 2018-OTA-076P.) Appellant does not contest the specific calculation; rather, appellant appeals the fact that respondent did not waive the late-filing penalty. Thus, our focus is on whether appellant's failure to timely file was due to reasonable cause. A taxpayer has the burden of establishing reasonable cause. (*Ibid*.) As a general matter, for a taxpayer to establish that a failure to act was due to reasonable cause, the taxpayer must show that the failure occurred despite the exercise of ordinary business care and prudence, or that cause existed as would prompt an ordinarily intelligent and prudent businessperson to have so acted under similar circumstances. (*Appeal of Triple Crown Baseball, LLC*, 2019-OTA-025P; *Appeal of Bieneman* (82-SBE-148) 1982 WL 11825.)

The applicable standard of proof is by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(c).) That is, a party must establish by documentation or other evidence that the

[2] Per R&TC section 19131(a), "5 percent of the tax shall be added to the tax for each month or fraction thereof elapsing between the due date of the return (determined without regard to any extension of time for filing) and the date on which filed, but the total penalty may not exceed 25 percent of the tax." The late-filing penalty of $1,474.25 represents 25 percent of the total tax due, as appellants reported on their 2016 California income tax return.

[3] R&TC section 19133 provides that 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 a demand by respondent. The demand penalty of $7,830 represents 25 percent of the total tax that appellants reported on their 2016 California income tax return, without accounting for any tax payments or withholdings.

circumstances it asserts are more likely than not to be correct. (*Concrete Pipe and Products of Cal., Inc. v. Construction Laborers Pension Trust for So. Cal.* (1993) 508 U.S. 602, 622.) Taxpayers must provide credible and competent evidence to support the claim of reasonable cause; otherwise, the penalties will not be abated. (*Appeal of Xie, supra*.)

Appellants' request for penalty abatement is based on the fact that J. Lee's father was extremely ill, that appellants spent much of their free time caring for him and visiting him at a nursing home. J. Lee's father passed away in October 2017. Appellants also argue that V. Lee was laid-off and suffered from depression. Appellants argue that these facts and circumstances establish reasonable cause to abate the late-filing penalty. Illness or other personal difficulties may be considered reasonable cause if the taxpayers present credible and competent proof that they were continuously prevented from filing a tax return. (*Appeal of Head and Feliciano*, 2020-OTA-127P.) When taxpayers allege reasonable cause based on an incapacity due to illness or the illness of an immediate family member, the duration of the incapacity must approximate that of the tax obligation deadline. (*Ibid*.) However, if the difficulties simply caused the taxpayers to sacrifice the timeliness of one aspect of their affairs to pursue other aspects, the taxpayers must bear the consequences of that choice. (*Ibid*.) The taxpayers' selective inability to perform tax obligations, while participating in regular business activities, does not establish reasonable cause. (*Ibid*.)

As to J. Lee, we note that despite the health issues affecting his spouse and father, J. Lee continued his employment as a high-income earner. The evidence suggests that the difficulties in his life—his father's health and eventually passing, as well as his spouse's unemployment and depression—did not prevent him from continuing to function in his career. The evidence indicates that the difficulties in his life caused J. Lee to sacrifice the timeliness of one aspect of appellants' affairs to pursue other aspects.

Furthermore, there is little or no evidence to establish whether or when V. Lee suffered from depression. She did not testify during the hearing. Even assuming that the existence of V. Lee's depression is more likely than not to be true, and that her depression prevented her from filing appellants' tax return, when a joint return is at issue, if one spouse is unable to file, the taxpayers must provide evidence to show that the other spouse was also unable to file the return. (See *Appeal of Head and Feliciano, supra*.) Here, no such evidence was provided. Therefore, appellants have not established reasonable cause for the late filing of their 2016 return. As such, the late-filing penalty shall not be abated.

Issue 2 – Whether respondent properly imposed the demand penalty, in whole or in part. If so, whether appellants established reasonable cause to abate the demand penalty.

Respondent imposed a demand penalty of $7,830 for tax year 2016. California imposes a penalty for the failure to file a return upon respondent's notice and demand, unless the failure is due to reasonable cause and not willful neglect. (R&TC, § 19133.) With respect to individuals, respondent will only impose a demand penalty if two requirements are satisfied: (1) the taxpayer fails to 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); *Appeal of Jones*, 2021-OTA-144P.) Here, both requirements are satisfied as to V. Lee, but only the first requirement is satisfied as to J. Lee. Below we explain why respondent did not impose the demand penalty properly as to J. Lee.

The demand penalty is designed to penalize a taxpayer's failure to respond to the demand, not a taxpayer's failure to pay the proper tax. (*Appeal of Bryant* (83-SBE-180) 1983 WL 961596.) The intent of California Code of Regulations, title 18, (Regulation) section 19133(b) is to impose the demand penalty only upon individual taxpayers who are repeat nonfilers; that is, those taxpayers who received an NPA for previously failing to timely file within any one of the preceding four taxable years.[4] (*Appeal of Jones*, *supra*.) Here, there is no evidence in the record to establish that J. Lee is a repeat nonfiler; that is, there is no evidence in the record to establish that J. Lee received an NPA for previously failing to timely file within any one of the preceding four taxable years.

In February 2015, respondent sent a Demand to V. Lee, which concerned V. Lee's 2013 California income tax return. The Demand requested that V. Lee either file a 2013 return, provide evidence that a 2013 return was already filed, or explain why a 2013 return was not required. This 2013 Demand was not a joint notice; rather, this 2013 Demand was addressed only to V. Lee. On April 6, 2015, respondent issued to V. Lee an NPA when V. Lee failed to respond to the 2013 Demand. This NPA was addressed only to V. Lee. It was not a joint NPA issued to both spouses. And there is no evidence that respondent issued a separate NPA to J. Lee at any time during the preceding four tax years (i.e., 2012, 2013, 2014, or 2015), following J. Lee's failure to timely respond to a Request or a Demand.

[4] Respondent "will impose the notice and demand penalty only upon those individual taxpayers who are determined to be 'repeat nonfilers'. A repeat nonfiler is an individual who has received a proposed assessment of tax after receiving and failing to respond to either a request for tax return or a demand for tax return within the previous four years. A repeat nonfiler who fails to respond to a current demand for tax return in the manner and within the time period specified on the demand for tax return will be subject to the imposition of the notice and demand penalty." (Cal. Reg. Notice Register 2004, No. 17-Z, p. 504.)

In 1988 the Legislature enacted a series of statutes collectively entitled the "California Taxpayers' Bill of Rights." (The Katz-Harris Taxpayers' Bill of Rights Act, Stats.1988, ch. 1573, § 2, p. 5668, enacting R&TC sections 21001 et seq. (Taxpayers' Bill of Rights).) With these rights, the Legislature intended "to place guarantees in California law to ensure that the rights, privacy, and property of California taxpayers are adequately protected during the process of the assessment and collection of taxes." (R&TC, § 21002.) These Taxpayers' Bill of Rights bestow many rights on taxpayers, including, for our purposes, the right to proper notice. (See, e.g., R&TC, §§ 21007, 21015.5, 21015.6(e)(2), 21019, and 21020.) In addition, although not directly related to demand penalties imposed under R&TC section 19133, we note that, in the case of a joint return, a notice of proposed deficiency assessment may be a single joint notice, except that if the respondent is notified by either spouse that separate residences have been established, it shall mail to each spouse, in lieu of the single joint notice, duplicate originals of the joint notice. (R&TC, § 19035.) Although this statute is not at issue, it highlights the importance of providing taxpayers filing a joint return with proper notice, whether in the form of a single joint notice or separate notices sent to each spouse. And because the penalty at issue, the demand penalty, is intended to penalize individual taxpayers who are repeat nonfilers, we conclude that each appellant was required to receive proper notice. We also note that the cases cited in the dissent in footnote 1 and the accompanying text pre-date both the Taxpayers' Bill of Rights and Regulation section 19133(b). Without the proper notice required by both the Taxpayers' Bill of Rights and Regulation section 19133(b), the demand penalty imposed on J. Lee cannot be sustained.

Because respondent failed to present any evidence that J. Lee also received a prior notice (i.e., during tax years 2012, 2013, 2014, or 2015),[5] we conclude that there is no evidence to establish J. Lee as a repeat nonfiler. Furthermore, Regulation section 19133(b) specifically requires the prior notice be sent to "the taxpayer" and not the spouse of the taxpayer. Moreover, because there is no evidence whatsoever that at any time during the preceding four tax years, respondent issued an NPA to J. Lee following his failure to timely respond to a Request or a Demand (Cal. Code Regs., tit. 18, § 19133(b)), the demand penalty as applied to J. Lee was improper.

[5] During the oral hearing, respondent stated that it had issued prior notices to J. Lee. But this is mere argument. It is well established that argument is not evidence. (*People v. Cash* (2002) 28 Cal.4th 703, 734; *Hoffman v. Brandt* (1966) 65 Cal.2d 549, 552; see *Mel Williamson, Inc. v. U.S.* (1982) 229 Ct. Cl. 846, 848 [indicating that "[a]rgument is not fact"]; and see also Evid. Code, § 140 [" 'Evidence' means testimony, writings, material objects, or other things presented to the senses that are offered to prove the existence or nonexistence of a fact"].) Respondent's statement was not under oath and was not testimony. Accordingly, our analysis is based on the application of the law to the evidence presented, and we cannot consider evidence that is not properly before us.

There is no dispute, however, that V. Lee is a repeat nonfiler and that the demand penalty as applied to her is proper. In February 2015, respondent sent a Demand for a 2013 return to V. Lee. On April 6, 2015, respondent issued to V. Lee an NPA for her failure to respond to the 2013 Demand. Three years later, in 2018, respondent sent a Demand to V. Lee regarding tax year 2016. Then, on June 11, 2018, respondent sent an NPA to V. Lee, which, amongst other things, proposed a demand penalty of $795.25. When V. Lee did not protest this NPA, the NPA went final and became due and payable. The demand penalty was properly imposed on V. Lee—a repeat nonfiler.

When FTB imposes a demand penalty, the law presumes that the penalty was imposed correctly. (*Appeal of Wright Capital Holdings LLC*, 2019-OTA-219P.) As to the demand penalty of $795.25, which respondent properly imposed on V. Lee, there are no allegations of willful neglect in this appeal. Thus, our sole focus here is on reasonable cause. To establish reasonable cause to abate the demand penalty, a taxpayer must show that the failure occurred despite the exercise of ordinary business care and prudence. (*Appeal of GEF Operating, Inc.*, 2020-OTA-057P.) A taxpayer bears the burden of proving that an ordinarily intelligent and prudent businessperson would have acted similarly under the circumstances. (*Ibid*; *Appeal of Moren*, 2019-OTA-176P.)

Appellants offer the same reasonable cause explanations as for the late-filing penalty, and, for the same reasons, we conclude that appellants did not meet their burden of proving that reasonable cause existed to support an abatement of the demand penalty.

HOLDINGS

1. Appellants did not show that the failure to timely file a tax return for tax year 2016 was due to reasonable cause.
2. The demand penalty imposed on J. Lee was not properly imposed because respondent did not establish that J. Lee was a repeat nonfiler, as required by Regulation section 19133. The demand penalty imposed on V. Lee in the amount of $795.25 was properly imposed because respondent established that V. Lee was a repeat nonfiler. Accordingly, the demand penalty at issue in the amount of $7,830 shall be reduced to $795.25. As to this demand penalty in the amount of $795.25, appellants did not establish reasonable cause to abate the penalty.

DISPOSITION

We sustain in part and reject in part respondent's denial of appellants' claim for refund. The demand penalty at issue in the amount of $7,830 shall be reduced to $795.25. As to all other matters in appellants' claim for refund, we sustain respondent's action.

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Alberto T. Rosas
Administrative Law Judge

I concur:

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Tommy Leung
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Tommy Leung
Administrative Law Judge

J. JOHNSON, Concurring and Dissenting, in part:

I respectfully dissent from the majority's position granting the partial refund of the demand penalty, and otherwise concur with the majority.

In the present appeal, Notices of Proposed Assessment (NPAs) that were issued to both appellants went final, including demand penalty amounts, and became due and collectible. However, no collection action occurred prior to appellants subsequently filing their joint tax return for the year at issue. Respondent processed the return, accepted the income and tax liability amounts reported, and revised the assessment amounts at issue accordingly. This revision includes the imposition of one demand penalty based on the reported tax on the return, for which appellants are jointly and severally liable. (R&TC, § 19006(b); see also *Appeal of Reynolds* (75-SBE-022) 1975 WL 3283 ["it is within respondent's discretion to assert this tax liability against either spouse"].) This is the demand penalty that was ultimately paid, requested as a refund by appellants, denied by respondent, and appealed to us. Accordingly, the demand penalty amount before us on appeal is one based on the joint return filed by appellants, for which appellants are jointly and severally liable, and is not calculated on the estimated income amounts reflected in the NPAs.

Even if we determine that the record on appeal shows that the regulatory requirements for the demand penalty are not met as to J. Lee, they were met as to V. Lee, as confirmed by the majority opinion. The imposition of the demand penalty as to V. Lee based on the reported tax on the joint return is proper. The law does not provide for splitting or allocating a joint and several tax liability on a return for the purposes of calculating a demand penalty. Instead, the penalty was properly calculated based on the tax reported on the return, for which V. Lee is fully liable. (See *Appeal of Lash* (86-SBE-021) 1986 WL 22692; *Appeal of Day* (82-SBE-061) 1982 WL 11739.)[1] This results in a demand penalty amount of $7,830, which is the amount respondent imposed here.

In addition, attempting to allocate the penalty between the joint filers at issue here creates an evidentiary and calculation problem. The amount of the penalty is 25 percent of the total tax liability, without consideration of withholding and estimated payments. (*Appeal of Jones*, 2021-

[1] Respondent is not required to adjust the calculation of the demand penalty based on a reported tax liability in a subsequently filed return, but it has the authority to do so. In *Appeal of Lash*, respondent issued a demand to Mr. Lash only, and a demand penalty was imposed based on estimated income. Mr. Lash then submitted a joint tax return with his spouse, and respondent adjusted the demand penalty based on the information on the joint return. In *Appeal of Day*, respondent issued a demand and subsequently imposed the demand penalty based on estimated income. Mr. Day then filed a return under the married filing separate status and respondent adjusted the demand penalty based on the tax liability reported on the return. That opinion provides: "We have previously been presented with the question of the proper computation of this penalty and have decided that the method used by respondent is correct." (See also *Appeal of Scott* (83-SBE-094) 1983 WL 15480; contra, *Appeal of Malakoff* (83-SBE-140) 1983 WL 15525 [penalty amount based on estimated tax liability not revised per tax reported on subsequently filed return].)

OTA-144P.) Due to differences in the taxable income and total tax between the NPAs and the return, the Demand penalty at issue is $1,313 less than the aggregate of the two demand penalties reflected on the NPAs. Based on the record before us, we do not know what changed from the income estimated on the NPAs to what was reported on the joint return accepted by respondent, and whether there was a reduction or increase in income earned by V. Lee. Therefore, if we attempt to only impose the demand penalty based on income attributable to V. Lee, there is no evidence available to accurately determine if that penalty amount should be greater, lesser, or equal to the $795.25 amount reflected on the NPA.[2] Pertinently, what we do know is that the penalty is properly imposed as to V. Lee, that the imposition of the penalty is presumed correct (*Appeal of Wright Capital Holdings LLC*, 2019-OTA-219P), and even if it was appropriate to separately allocate the demand penalty, there is nothing in the record or briefing reliably showing that as to V. Lee the penalty amount should certainly be lower than the $7,830 amount imposed by respondent. Therefore, appellants have not met their burden to show that the penalty was improperly imposed or that it should be reduced.

Accordingly, I would find that the demand penalty was properly imposed in its entirety.

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John O. Johnson
Administrative Law Judge

Date Issued: 10/21/2021

[2] Another concern with reducing the penalty to just the amount listed on the NPA issued to V. Lee is that it does not take into consideration V. Lee's community property interest in J. Lee's income.