

In the Matter of the Appeal of:) OTA Case No. 241118006
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¹ Specifically, appellant claimed refunds of \$9,042, \$17,298.75, \$33,982.50, and \$9,300.50 for the 2019, 2020, 2021, and 2022 tax years, respectively, which totals the amount in the Notice of Action. Appellant also sought to appeal respondent's denial of her claim for refund for the 2018 tax year; however, appellant did not file her appeal timely with OTA and, accordingly, the 2018 tax year will not be considered.

FACTUAL FINDINGS

1. Appellant did not timely file a Form 540 California Resident Income Tax Return (Return) for the Years at Issue.
2. Respondent received information from third parties indicating that appellant received income in the 2019 tax year. One of the third-party reporters issued a Form W-2, Wage and Tax Statement (Form W-2), to appellant reflecting wage income for the 2019 tax year. Accordingly, respondent issued appellant a Request for Tax Return requesting that appellant either file a Return or provide a written explanation as to why a Return was not required. When appellant did not respond or file a Return, respondent issued a Notice of Proposed Assessment (NPA) for the 2019 tax year.
3. On December 26, 2023, appellant filed a Return for each of the Years at Issue. On each Return, appellant reported Form W-2 state wage income from an S corporation that she started and owned, other income, and capital gains. Appellant's Returns for the Years at Issue reflected the signature of K. Blackburn, who is identified as appellant's third-party designee on all appellant's Returns.
4. Appellant reported balances due for each of the Years at Issue but did not remit payment with the Returns. Appellant subsequently fully paid the balance due (including penalties) for each of the Years at Issue.
5. Appellant filed a Reasonable Cause – Individual and Fiduciary Claim for Refund for each of the Years at Issue that was signed by K. Blackburn, who was appellant's representative and power of attorney (POA).²
6. Appellant provided a letter from her psychiatrist (Doctor 1), dated June 11, 2024, as well as a form FTB 1564, Physician Affidavit of Physical or Mental Impairment (FTB 1564) dated and certified on October 24, 2024.³ The letter states that appellant "is currently under my medical care. [Appellant] has shown progressive signs of dementia since January 10, 2019." Additionally, FTB 1564 states that appellant "has progressive cortical dementia."

² Appellant did not include the dollar amount of the Estimated Tax Penalty with the refund claim for the 2020 tax year. However, the Estimated Tax Penalty was included in various correspondence to respondent with respect to the refund claim for all Years at Issue. Accordingly, respondent agrees that the refund claim for the 2020 tax year includes the Estimated Tax Penalty of \$826.

³ FTB 1564 is used to establish a financial disability under R&TC section 19316 for the purpose of an untimely refund claim under R&TC section 19306, which is not at issue.

7. Appellant provided a letter dated July 1, 2018, from another medical doctor (Doctor 2) that was addressed to appellant's attorney. The letter states that Doctor 2 met with appellant for the purpose of performing a psychiatric assessment of appellant's testamentary capacity at that time for estate planning purposes, but not to perform an assessment for the purpose of treatment.
8. Appellant provided a letter dated September 5, 2023, from another psychiatrist and neurologist (Doctor 3). The letter states that Doctor 3 has been appellant's treating neurologist since March 29, 2022, that appellant "has moderate stage dementia," and that appellant "is not capable of making financial or medical decisions."
9. Respondent issued a Notice of Action denying appellant's refund claims for the Years at Issue.
10. This timely appeal followed.
11. At OTA's request, appellant and respondent both provided additional briefs.
12. Appellant's additional briefing includes a letter from her representative, Mr. Healey, and certain documents. In his letter, Mr. Healey responded to respondent's arguments generally and indicated that appellant remains the sole shareholder and an officer of her business but has been retired from active business operations for many years.
13. Appellant provides the federal income tax returns (Form 1040) that she late-filed for the Years at Issue. Appellant provides the notices from the IRS indicating that, for the Years at Issue, the IRS abated the federal late-filing penalty for appellant's failure to timely file her federal income tax returns. Appellant also provides the letter from her representative to the IRS requesting the abatement of the federal late-filing penalty for all Years at Issue for reasonable cause due to her dementia. Appellant additionally provides a statement that was attached to her federal Form 1040 for the 2019 tax year that requests the IRS to "[p]lease waive all penalties and interest as the taxpayer has Alzheimer's disease. The taxpayer's medical condition precludes her from the timely filing requirement due to her physical and mental disabilities."
14. Appellant also provides an Immediate Durable Power of Attorney dated November 2, 2021. The Durable Power of Attorney includes a statement that appellant's agents "may prepare, sign, and file all federal, state, and local tax returns" or "prepare, file, and sign claims for refund." The Durable Power of Attorney further states that the word "may" is used "to allow or permit, but not require" appellant's agent to act, but that the use of the word "shall" is intended to "impose a fiduciary duty on my Agent." Additionally, appellant provides forms FTB 3520-PIT, Individual or Fiduciary Power of

Attorney Declaration (Form 3520), executed by K. Dean-Blackburn⁴ and M. Dean Davis as appellant's agent.

DISCUSSION

Issue 1: Whether appellant has established reasonable cause to abate the late-filing penalty for each of the Years at Issue.

A late-filing penalty shall be imposed when a taxpayer fails to file a tax return by either the due date or the extended due date, unless the taxpayer establishes that the late filing was due to reasonable cause and not due to willful neglect. (R&TC, § 19131(a).) The late-filing penalty is calculated at five percent of the tax, for each month or a fraction thereof, that the return is late, with a maximum penalty of 25 percent of the tax. (*Ibid.*) When respondent imposes a penalty, the law presumes that the penalty was imposed correctly, and the burden of proof is on the taxpayer to establish reasonable cause. (*Appeal of Cremel and Koepfel*, 2021-OTA-222P.)

Appellant does not challenge the calculation of the late-filing penalty or Estimated Tax Penalty for any of the Years at Issue. Rather, appellant argues that she qualifies for reasonable cause abatement of the late-filing penalty. Accordingly, OTA will consider whether appellant's dementia diagnosis qualifies as reasonable cause for the Years at Issue.

To establish reasonable cause, a taxpayer must show that the failure to timely file a return 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 GEF Operating, Inc.*, 2020-OTA-057P.) Respondent may abate a penalty if the taxpayer can prove that the IRS abated the same penalty for reasonable cause. (*Appeal of Belcher*, 2021-OTA-284P.) Illness or other personal difficulties may be considered reasonable cause if a taxpayer presents credible and competent proof that she was continuously prevented from filing a tax return. (*Appeal of Head and Feliciano*, 2020-OTA-127P.) When the taxpayer alleges reasonable cause based on an incapacity due to illness, the duration of the incapacity must approximate that of the tax obligation deadline. (*Ibid.*) However, a "taxpayer's selective inability to perform tax obligations, while participating in regular business activities, does not excuse the failure to file timely." (*Ibid.*) If the difficulties simply caused the taxpayer to perform some actions timely but not others, "the taxpayer must bear the consequences of that choice." (*Ibid.*)

⁴ K. Blackburn, K. Dean, and K. Dean-Blackburn appear to be the same individual.

Appellant argues that she has suffered from dementia since January 10, 2019 (or earlier) and points to the diagnosis and symptoms identified in the notes from Doctors 1, 2, and 3 to support her argument that her dementia diagnosis constitutes reasonable cause . Appellant provides documentation that the IRS abated the federal late-filing penalty due to reasonable cause for the Years at Issue. However, the documentation does not specifically indicate why the IRS abated the federal late-filing penalty for the 2019 tax year.

Appellant acknowledges that she received a Form W-2 reporting wage income for each of the Years at Issue. However, appellant argues that,

[i]n accordance with S corporation requirements, she continued to receive a salary as shareholder employee, consistent with the corporation's established practices. Beginning in 2019, the appellant developed progressive dementia, which significantly limited her ability to oversee the corporation's affairs. Her daughter, [K.] Dean Blackburn is responsible for the day-to-day business operations. The wages paid to the appellant were consistent with her prior compensation levels. There is no formal written employment agreement, as this was a long-standing internal arrangement maintained to comply with tax regulations for reasonable shareholder compensation.

In addition, appellant acknowledges that she received capital gains but argues that the gains were from the sale of her primary residence and second home, which she had to sell because she could no longer live independently. Appellant also argues that her financial advisor sold investments on her behalf.

Respondent argues that because appellant earned wage income and sold capital assets during the Years at Issue and the 2023 tax year (as reflected on the federal tax returns), appellant engaged in "business activity" during each of the periods when the Returns for the Years at Issue were due to be filed. Specifically, respondent argues that appellant's "selective inability to perform tax obligations does not excuse the failure to timely file." Respondent notes that the medical opinion of Doctor 2 was obtained for estate tax purposes, not for diagnostic purposes. In addition, respondent argues that appellant had an authorized representative, K. Blackburn, who should have filed appellant's Returns timely on her behalf.

OTA shall consider whether appellant had reasonable cause during the period that overlaps with her Return filing deadlines. For the Years at Issue, that period begins on April 15, 2020, and ends on November 16, 2023.⁵ (R&TC, § 18601; see *Appeal of Head and*

⁵ Respondent postponed the deadline for filing returns for the 2019 tax year to July 15, 2020, due to the COVID-19 pandemic. (*Appeal of Nguyen*, 2025-OTA-333P.) Respondent also postponed the deadline for filing returns for the 2022 tax year to November 16, 2023, due to winter storms in California. (*Appeal of Pomrehn*, 2025-OTA-269P.)

Feliciano, supra.) Thus, because the deadline to file the Return for the 2019 tax year (that is, April 15, 2020) occurred in the 2020 tax year, events that occurred as of April 15, 2020, and after will determine whether appellant has reasonable cause for untimely filing the Return for the 2019 tax year and the other later years.

As noted above, appellant provides documentation that the IRS abated the federal late-filing penalty for reasonable cause due to dementia for the 2020, 2021, and 2022 tax years, but not the 2019 tax year. While the IRS did not expressly state in its letter that it was abating appellant's federal late-filing penalty due to reasonable cause because of her dementia, this appears to be the case as appellant provided no other explanation to the IRS. Thus, it appears that the IRS abated the federal late-filing penalty for the Years at Issue for reasonable cause due to appellant's dementia. This documentation is highly persuasive evidence of appellant's inability to perform her tax obligations due to dementia. (*See Appeal of Belcher, supra.*)

Appellant's personal physician, Doctor 1, signed an affidavit and a separate letter stating that appellant was diagnosed with dementia as of January 10, 2019, but does not provide any symptoms indicating appellant's cognitive state. However, Doctor 1's diagnosis is consistent with an earlier assessment performed by another psychiatrist, Doctor 2, who was hired to observe appellant's behavior and to opine as to her capacity for estate planning purposes only.

Doctor 2 recorded appellant's statements and various behaviors, including: (1) appellant did not know all the medications she was taking or why she was taking them; (2) at times she was not able to call up information from memory; (3) she did not know the day of the week, date, or year; and (4) she had "no interest in that information and no need to know that information." Doctor 2 administered a test to determine appellant's cognitive skills, which indicated a decline in her executive function and was consistent with a Major Neurocognitive Disorder. Doctor 2's assessment provides details that are helpful for understanding appellant's cognitive state and Doctor 1's diagnosis.

The letter from Doctor 3, appellant's personal physician, states that as of September 5, 2023, appellant "has moderate stage dementia" and "is not capable of making financial or medical decisions." Doctor 3's diagnosis is consistent with Doctor 1's diagnosis and the facts identified in Doctor 2's assessment and reflects not only appellant's cognitive state but the continuing nature of appellant's dementia. This documentation is highly persuasive evidence of appellant's inability to perform her tax obligations due to dementia, and that appellant had reasonable cause for the late filing. (*Appeal of Head and Feliciano, supra.*)

Respondent argues that appellant did not qualify for reasonable cause abatement of the late-filing penalties because her receipt of wage income and sale of capital assets during the

Years at Issue indicate that appellant was selectively choosing to not perform her tax obligations. OTA is not convinced that appellant's receipt of wage income is reflective of appellant's actual performance of services for her business during the Years at Issue and not simply a tax return position that may be unusual. Appellant's explanation that she continued to be paid although removed from the day-to-day operations of the business due to her being the company's founder is plausible and not refuted by respondent's speculation that she was paid for services. Moreover, appellant's sale of capital assets by her financial advisor does not appear to be inconsistent with a diagnosis of dementia.

Respondent suggests that appellant's two POAs should have filed appellant's Returns for the Years at Issue. Appellant appointed her daughters, K. Blackburn and M. Dean-Davis, to be her agents in the Durable Power of Attorney and POAs in the Forms 3520. The Durable Power of Attorney states that appellant's agents "may prepare, sign, and file all . . . state . . . tax returns." The word "may" as defined in the Durable Power of Attorney reflects appellant's intent "to allow or permit, but not require" her agents to act. Thus, it is clear from appellant's Durable Power of Attorney and the Form 3520 that appellant authorized, but did not require, her agents to prepare and file her returns as her POA.

When a representative is required to act on behalf of a taxpayer, such as when a fiduciary is required by statute under Internal Revenue Code (IRC) section 6012(b) to file a return but fails to do so, the law looks to the acts of the fiduciary to see whether the taxpayer's failure to file qualifies as reasonable cause. (*Bassett v. Commissioner* (1995) 67 F.3d 29, 31 (2d Cir.), affg. (1993) 100 T.C. 650, 655.) In contrast, the law does not look to the actions of an agent to determine whether the taxpayer's failure to file qualifies as reasonable cause because reliance on an agent is not reasonable cause to abate the late-filing penalty. (*U.S. v. Boyle* (1985) 469 U.S. 241, 252.) OTA declines to hold appellant's two POAs liable for appellant's non-delegable duties. (See *Appeal of Fisher*, 2022-OTA-337P.)

The IRS's abatement of the federal late-filing penalty for the Years at Issue combined with the diagnoses by appellant's physicians, Doctor 1 and Doctor 3, and with the facts identified by Doctor 2 paint a compelling picture of an individual suffering from dementia. One need not be a licensed physician to understand that dementia is a complex and distressing condition. OTA will not put its own judgment over the judgment of the physicians who have diagnosed appellant as incapable of making financial decisions. Appellant has established reasonable cause for the abatement of the late-filing penalty for each of the Years at Issue.

Issue 2: Whether appellant has established a basis to abate the Estimated Tax Penalty for each of the Years at Issue.

A penalty for failing to pay estimated taxes is imposed on a taxpayer who is required to pay, but underpays, estimated taxes under R&TC section 19136, which largely incorporates the addition to tax under IRC section 6654. The first estimated tax installment is due on April 15 of the tax year at issue, and the fourth and last installment is due on January 15 of the following taxable year. (IRC, § 6654(c)(2).) The time period when considering appellant's action runs from April 15, 2019, through January 15, 2023.

There is no provision in the IRC or R&TC that allows the Estimated Tax Penalty to be abated based solely on a finding of reasonable cause. (*Appeal of Johnson*, 2018-OTA-119P.) As a result, there is no general reasonable cause relief from the Estimated Tax Penalty. (*Ibid.*)

IRC section 6654(e)(3)(A) provides that the government may waive the addition to tax if it determines that, "by reason of casualty, disaster, or other unusual circumstances the imposition of such addition to tax would be against equity and good conscience." Under IRC section 6654(e)(3)(B), the addition to tax may be waived if the IRS (or here, respondent) determines that: (i) during the applicable taxable year or the preceding year, the taxpayer either retired after having attained age 62, or became disabled, *and* (ii) the underpayment was due to "reasonable cause" and not due to willful neglect. (*Italics added.*) The waiver for unusual circumstances is considerably narrower than reasonable cause, but it may include a situation where a taxpayer did not make estimated tax payments due to the death or serious illness of the taxpayer, as it would be against equity and good conscience. (*Appeal of Mazdyasni*, 2018-OTA-049P.)

Appellant does not dispute the imposition or computation of the Estimated Tax Penalty but argues generally that she is entitled to relief from the Estimated Tax Penalty because of her dementia. Neither appellant nor respondent presents any separate facts or legal argument with respect to this issue. Therefore, the same facts and argument that the parties presented with respect to the late-filing penalty discussed above shall be considered to determine if there were unusual circumstances that weigh in favor of abating the Estimated Tax Penalty for the period beginning on the first installment due date of April 15, 2019, and ending on the last installment due date of January 15, 2023. (IRC, § 6654(c)(2); IRC, § 6654(e)(3)(A).)

Appellant's diminished cognitive abilities were caused by her dementia, which was diagnosed as of January 10, 2019, and continued to worsen thereafter. Appellant's dementia was quite serious and qualifies as essentially a serious illness that makes imposition of the penalty to be "against good equity and conscience." (*Appeal of Mazdyasni, supra.*) Appellant

has, therefore, established a basis for the abatement of the Estimated Tax Penalty for each of the Years at Issue.

HOLDINGS

1. Appellant has established reasonable cause to abate the late-filing penalty for each of the Years at Issue.
2. Appellant has established a basis to abate the Estimated Tax Penalty for each of the Years at Issue.

DISPOSITION

Respondent's action denying appellant's claims for refund for the Years at Issue is reversed.

Signed by:



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L. Katrine Shelton
Administrative Law Judge

We concur:

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Teresa A. Stanley
Administrative Law Judge

DocuSigned by:



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Keith T. Long
Administrative Law Judge

Date Issued: 6/23/2026