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7 **BOARD OF EQUALIZATION**
8 **STATE OF CALIFORNIA**

10 In the Matter of the Appeal of:) **HEARING SUMMARY**
11) **PERSONAL INCOME TAX APPEAL**
12 **MATTHEW HELLER¹**) Case No. 554452

13 _____
14

	<u>Year</u>	<u>Claim for</u>
	2007	Refund
		\$2,192.25 ²

16 Representing the Parties:

18 For Appellant: Jerry J. Kurlak, Representative
19 For Franchise Tax Board: Shail Shah, Tax Counsel

21 **QUESTIONS:** (1) Whether appellant has shown reasonable cause for the abatement of the late filing
22 penalty; and
23 (2) Whether appellant has demonstrated reasonable cause for the abatement of the
24 failure to file upon demand penalty.

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27 ¹ Appellant resides in Los Angeles, Los Angeles County.

28 ² This amount consists of a late filing penalty of \$180.00 and a failure to file upon demand penalty of \$2,012.25.

1 HEARING SUMMARY

2 Background

3 Appellant did not file a timely 2007 California return and respondent received
4 information from the Employment Development Department (EDD) indicating appellant had a filing
5 requirement. (Resp. Op. Br., p.1.) Thereafter, on January 26, 2009, respondent mailed a Demand for
6 Tax Return (Demand) to appellant demanding him to file a 2007 return or explain why a 2007 return
7 was not required. (Resp. Op. Br., Ex. A.) Although the Demand required appellant-husband respond by
8 February 25, 2009, respondent received no response from appellant by that date. (Resp. Op. Br., p. 2.)

9 Subsequently, respondent issued a Notice of Proposed Assessment (NPA) on March 30,
10 2009. Respondent based the NPA tax calculation on wages received from three sources: Carat Brand
11 Experience, Inc., Posterscope USA, Inc., and Studio Payroll Services, Inc. Respondent received
12 information that appellant received total income of \$120,965 comprised of wage income of \$116,965
13 and miscellaneous 1099 income of \$4,000. After applying a personal exemption credit of \$94 and a
14 standard deduction of \$3,516, appellant's 2007 tax liability before withholding credits was \$8,634.
15 After the application of \$7,127 in withholding credits, appellant owed \$1,507 in tax. Respondent also
16 imposed a late filing penalty of \$376.75, a demand penalty of \$2,158.50, accrued interest, and a filing
17 enforcement fee of \$119.00. Appellant's total outstanding liability on the date of the NPA was
18 \$4,285.74, including interest. (Resp. Op. Br., Ex. B.)

19 Appellant subsequently filed his 2007 return on September 11, 2009. On the return,
20 appellant reported federal adjusted gross income of \$115,919, itemized deductions of \$4,757, taxable
21 income of \$111,162, and tax of \$8,143. After applying the \$94 exemption credit, a withholding credit of
22 \$7,127, and \$202 in excess State Disability Insurance credit, appellant reported a tax due of \$720.
23 (Resp. Op. Br., Ex. C.)

24 Upon review, respondent accepted appellant's return as filed and adjusted appellant's
25 account accordingly.³ (Resp. Op. Br., p. 2.) Appellant then had an outstanding balance due of
26 \$2,059.25 plus interest. The amount included the remaining amount of the demand penalty, the filing
27

28 ³ Adjustments made by respondent included reducing the late filing penalty from \$376.75 to \$180.00 and the demand penalty from \$2,158.50 to \$2,012.25.

1 enforcement fee, and the lien fee plus interest. On September 30, 2009, respondent transferred \$51.16
2 from appellant's 2008 tax year account to the balance due for the 2007 tax year account. On October 5,
3 2009, respondent transferred the amount of \$236.35 from appellant's 2006 year to the balance due for
4 2007, leaving a balance of \$1,771.74 plus interest. (Resp. Op. Br., Exh. D.)

5 On December 8, 2009, respondent sent appellant a Notice of State Income Tax Due
6 (Notice). The Notice reflected the self-reported tax liability and requested appellant pay a balance due
7 of \$1,905.43, including interest. (App. Op. Br., Notice 1.) In response, appellant sent a letter dated
8 December 16, 2009 to respondent disputing the calculation of the demand penalty. In appellant's letter,
9 he asserted that \$181 is the correct balance due. (App. Op. Br., Attachment 1, pg. 9.) On March 11,
10 2010, respondent responded to appellant's letter, explaining the calculation of the demand penalty and
11 the late filing penalty. (App. Op. Br., Attachment 4, Notice 2, p. 22.)

12 On March 19, 2010, respondent sent appellant a Tax Lien Notice for \$1,942.45, including
13 interest. (App. Op. Br., Attachment 4, Notice 3.) In response to respondent's Tax Lien Notice,
14 appellant made a payment of \$1,953.79, which satisfied the balance due, including interest.
15 (Resp. Op. Br., Ex. D.) Appellant also filed a claim for refund, asserting that the calculation of the
16 demand penalty is unreasonable and excessive because it is calculated based on the income tax liability
17 before the application of credits. Appellant states that he agreed to the calculation of the late filing
18 penalty because this penalty is calculated after the application of payments and credits. Appellant
19 further states that the tax lien is unreasonable because appellant has not willfully neglected his duty to
20 pay taxes. (App. Op. Br., Attachment 1.)

21 Respondent issued a Notice of Action (NOA) denying appellant's claim for refund on
22 August 23, 2010. Respondent explained the distinction between a late filing penalty and the demand
23 penalty. Respondent also explained in the NOA that interest is mandatory and cannot be waived unless
24 certain requirements are met and appellant has not met these requirements. (App. Op. Br., NOA.)

25 Appellant then filed this timely appeal.

26 Contentions

27 Appellant

28 Appellant indicates that he was diagnosed with a brain tumor and underwent surgery in

1 September 2007. Appellant states that the recovery for such an operation was severe and on-going.
2 Appellant asserts that he was not in any condition to file or gather his tax documents for the 2006
3 extended filing deadline. Appellant further asserts his recovery and therapy made it very difficult to
4 properly file his 2007 tax return timely. (App. Op. Br., p. 1.)

5 Appellant states that the general rule of applying penalties and interest is to charge
6 taxpayers for amounts that they have not paid. Considering the facts and circumstances, appellant
7 argues that to penalize him for 25 percent of the total tax without regard to the credits paid or tax
8 withheld not only defies most of the logic in the tax codes, but also appears to be grossly unfair to
9 appellant since he was undergoing the treatment and therapy for a brain tumor. As such, appellant
10 contends the facts and circumstances do not show that his failure to file a timely return was due to
11 willful neglect. Rather, appellant contends there is reasonable cause for waiving the late filing penalty.
12 (App. Op. Br., p. 2.)

13 Appellant's representative notes that the first notice from the FTB regarding the 2007 tax
14 year that there is a record of was dated March 30, 2009. Appellant's representative states that due to
15 some communication breakdowns with the client as well as information gaps regarding the 2007 tax
16 return, the return was not filed until September 2009. Appellant's representative also notes that during
17 this time, they were assisting appellant in gathering information for the 2006, 2007, and 2008 tax years.
18 Thus, appellant asserts that the time period between his receipt of the NPA dated March 30, 2009, and
19 the filing date of early September 2009 is an acceptable time period for filing considering his
20 circumstances and the necessity of ensuring that the returns were complete and accurate. Appellant
21 states that he and his representatives took precautions to do their due diligence. Appellant contends that
22 performing due diligence is not grounds for assessing a 25 percent penalty for willful neglect under
23 R&TC section 19133. (App. Op. Br., p.2.)

24 Appellant further states that he has now filed Forms 540 for the tax years 2004 through
25 2009 and the only return that was not timely filed and had a balance due was 2007. Appellant notes that
26 he had withholdings of \$7,127 from two Form W-2s in 2007, which covered over 91 percent of his
27 California tax due on his return. Appellant notes that the penalty is not mandatory citing the use of the
28 word "may" in R&TC section 19133 and argues that respondent has discretion to impose the penalty.

1 Appellant asserts he has been compliant to the best of his ability. Appellant further contends that
2 assessing a penalty of over 300 percent of the tax paid after the due date and submitted with the tax
3 return is excessive. Accordingly, appellant requests that the demand penalty, plus applicable interest
4 charged and paid on the total tax due according to his return be abated and the amount paid by appellant
5 be refunded. (App. Op. Br., p. 3.)

6 Respondent

7 With respect to the late filing penalty, respondent contends that while appellant provided
8 medical documentation supporting that he was diagnosed with a brain tumor on August 18, 2007,
9 appellant failed to provide evidence showing that the illness prevented him from timely filing his 2007
10 return by April 15, 2008. Respondent states that if appellant can provide documentation that he was
11 medically incapable of timely filing his 2007 return by the due date and that no one was able to file on
12 his behalf, then respondent may consider abating the late filing penalty of \$180. Without such
13 documentation, respondent contends appellant has not shown reasonable cause to abate the late filing
14 penalty. Respondent notes that appellant worked in 2007 and 2008, the appeal year and the year in
15 which the tax return was due. Respondent further notes that appellant received total wages of \$116,965
16 in 2007 from three sources and received business income as shown on appellant's 1099. For 2008, the
17 year that the return was due, respondent notes that appellant received wage income of \$105,617 from
18 Posterscope, USA, Inc. and incurred unreimbursed employee expenses. (Resp. Op. Br., p. 3-4.)

19 Respondent contends the demand penalty was properly imposed. For the 2007 tax year,
20 appellant failed to respond to respondent's Demand by February 25, 2009, and therefore was charged
21 with a demand penalty. Respondent notes that it sent the Demand to the same address as the one listed
22 on appellant's 2007 return which appears to be the address of appellant's tax preparer and
23 representative. Respondent further contends it satisfied the requirements under California Code of
24 Regulations, title 18, section 19133 as appellant did not file his 2006 return until September 11, 2009,
25 and respondent issued a Request for Tax Return and an NPA for the 2006 tax year. (Resp. Op. Br., Exs.
26 I and J.) With respect to appellant's assertion that the calculation of demand penalty is unfair,
27 respondent contends that it is respondent's obligation to follow R&TC section 19133's language which
28 requires imposition of the demand penalty prior to the application of credits and payments. In support of

1 its contention that the demand penalty is computed at 25 percent of the amount of the taxpayer's total
2 tax liability without regard to payments or credits, respondent cites *Appeal of Elmer S. and Barbara*
3 *Malakoff*, 83-SBE-140, decided by the Board on June 21, 1983. Respondent further contends it is not
4 able to modify a statute based on a taxpayer's assertion that the statute is unfair. (Resp. Op. Br., p. 4-5.)

5 Respondent also contends appellant failed to provide sufficient documentation to show
6 that he was medically incapable of responding to respondent's demand notice by February 25, 2009.
7 Respondent notes that if appellant is able to provide evidence supporting the assertion he was medically
8 incapable of responding to respondent's demand notice, the demand penalty may be abated as discussed
9 in the Board's decisions in *Appeal of Kerry and Cheryl James*, 83-SBE-009, decided on January 3,
10 1983, *Appeal of Michael J. and Diane M. Halaburka*, 85-SBE-025, decided on April 9, 1985, and *Appeal*
11 *of Allen L. and Jacqueline M. Seaman*, 75-SBE-080, decided on December 16, 1975. However, without
12 such documentation, respondent contends appellant has not shown reasonable cause for abatement of the
13 demand penalty. (Resp. Op. Br., p. 5.)

14 Applicable Law

15 Burden of Proof

16 The FTB's determination is presumed to be correct, and a taxpayer has the burden of
17 proving error. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Michael E. Myers*,
18 2001-SBE-001, May 31, 2001; *Appeal of Robert E. and Argentina Sorenson*, 81-SBE-005, Jan. 6, 1981.)
19 Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Aaron and*
20 *Eloise Magidow*, 82-SBE-274, Nov. 17, 1982.)

21 Late Filing Penalty

22 R&TC section 19131 provides that a late filing penalty shall be imposed when a taxpayer
23 fails to file a tax return on or before its due date, unless the taxpayer establishes that the late filing was
24 due to reasonable cause and not due to willful neglect. To establish reasonable cause, a taxpayer must
25 show that the failure to file the return occurred despite the exercise of ordinary business care and
26 prudence. (*Appeal of Howard G. and Mary Tons*, 79-SBE-027, Jan. 9, 1979.)

27 Illness or other personal difficulties may be considered reasonable cause in some cases.
28 However, if the difficulties simply cause the taxpayer to sacrifice the timeliness of one aspect of the

1 taxpayer's affairs to pursue other aspects, the taxpayer must bear the consequences of that choice.
2 (*Appeal of William T. and Joy P. Orr*, 68-SBE-010, Feb. 5, 1968.) To show reasonable cause by reason
3 of illness, the taxpayer must present credible and competent proof that the circumstances of the illness or
4 other personal difficulty completely prevented the taxpayer from filing a timely return. (*Appeal of Allen*
5 *L. and Jacqueline M. Seaman*, 75-SBE-080, Dec. 16, 1975 [no evidence that the hospitalization of
6 taxpayer-husband prevented timely preparation and signing of the return to excuse the late filing
7 penalty].) When a taxpayer alleges reasonable cause based on the incapacity of a taxpayer due to his
8 illness or the illness of an immediate family member, the duration of the incapacity must approximate
9 that of the failure to file. (*Wright v. Commissioner* 75 T.C. Memo 1998-2536, citing *Hayes v.*
10 *Commissioner* T.C. Memo 1967-80 [Where two of the taxpayers' children were seriously ill, taxpayer-
11 wife suffered a ruptured appendix and taxpayer-husband suffered a mental and physical collapse, all of
12 which occurred between January and June of the filing year and confined the taxpayers to California
13 while their tax records were in Maine, there was reasonable cause to excuse a four month late filing in
14 August].) Moreover, in such circumstances, reasonable cause requires a showing of incapacity;
15 "selective inability" to file tax returns while attending to other responsibilities does not demonstrate
16 reasonable cause. (*Id.*)

17 Similarly, in *Watts v. Commissioner* T.C. Memo 1999-416, the taxpayers argued that they
18 had reasonable cause to file their 1994 and 1995 returns late because taxpayer-husband's mother and
19 daughter had prolonged illnesses, taxpayer-husband's sister was in a serious accident in 1994, taxpayer-
20 husband's mother died in 1996, and taxpayer-husband traveled extensively for his architectural business.
21 The Tax Court held that a taxpayer's selective inability to perform his or her tax obligations, while
22 performing their regular business, did not excuse failure to file timely returns. (*Id.*) It noted taxpayer-
23 husband was actively engaged as an architect which suggested that petitioners were able to file timely
24 returns for 1994 and 1995 and chose not to do so. (*Id.*)

25 Demand Penalty

26 California imposes a penalty for the failure to file a return or provide information upon
27 the FTB's demand to do so, unless reasonable cause prevented the taxpayer from responding to the
28 notice. (Rev. & Tax. Code, § 19133.) The penalty is computed as 25 percent of the total tax,

1 determined without regard to timely payments or other credits. (*Appeal of Elmer R. and Barbara*
2 *Malakoff*, 83-SBE-140, June 21, 1983; *Appeal of Frank E and Lilia Z. Hublou*, 77-SBE-102, July 26,
3 1977.) The FTB will only impose a demand penalty if the taxpayer fails to respond to a current Demand
4 for Tax Return and the FTB issued an NPA under the authority of R&TC section 19087, subdivision (a),
5 after the taxpayer failed to timely respond to a Request for Tax Return or a Demand for Tax Return at
6 any time during the four taxable years preceding the year for which the current Demand for Tax Return
7 is being issued. (Cal. Code Regs., tit. 18, § 19133, subd. (b).)

8 The demand penalty is designed to penalize the failure of the taxpayers to respond to a
9 notice and demand, and not the taxpayers' failure to pay the proper tax. (*Appeal of W. L. Bryant*, 83-
10 SBE-180, Aug. 17, 1983; *Appeal of Frank E and Lilia Z. Hublou*, *supra*.) The burden is on the
11 taxpayers to prove that reasonable cause prevented them from responding to the demand. (*Appeal of*
12 *Kerry and Cheryl James*, 83-SBE-009, Jan. 3, 1983.) To overcome the presumed correctness of
13 respondent's assessment of the notice and demand penalty, taxpayers must produce credible and
14 competent evidence supporting their contentions. (*Appeal of Yvonne M. Goodwin*, 97-SBE-003,
15 Mar. 19, 1997.) Illness or other personal difficulties may be considered reasonable cause to abate the
16 demand penalty if the taxpayer presents credible and competent proof that it completely prevented the
17 taxpayer from timely responding to the Demand. (*Appeal of Michael J. and Diane M. Halaburka*,
18 85-SBE-025, Apr. 9, 1985; *Appeal of Kerry and Cheryl James*, *supra*.)

19 Last Known Address Rule

20 R&TC section 18416 sets out the statutory mailing guidelines that the FTB is required to
21 follow. The statute provides that any notice may be given if sent by first class prepaid postage. In
22 addition, any notice mailed to a taxpayer's last known address is sufficient. The statute also provides
23 that the last known address shall be the address that appears on the taxpayer's last return filed with the
24 FTB, unless the taxpayer has provided to the FTB clear and concise written or electronic notification of
25 a different address, or the FTB has an address it has reason to believe is the most current address for the
26 taxpayer.

27 It is well settled that respondent's mailing of a notice to the taxpayer's last-known
28 address is considered sufficient even if the notice never actually reaches the taxpayer. (*Appeal of*

1 *Yvonne M. Goodwin*, 97-SBE-003, Mar. 19, 1997; *Appeal of Jon W. and Antoinette O. Johnston*,
2 83-SBE-238, Oct. 26, 1983.) This “last-known address rule” protects the taxing agency and the
3 statutory scheme of assessment and appeal from a failure by the taxpayer to inform the taxing agency of
4 a change in address. (*Delman v. Commissioner* (3rd Cir. 1967) 384 F.2d 929, 933.)

5 STAFF COMMENTS

6 Appellant asserts that his surgery for a brain tumor and the resulting therapy constitutes
7 reasonable cause for his failure to respond to the Demand by February 25, 2009. (App. Op. Br., p. 1.)
8 The Board has held in its previous decisions, as discussed above, that in order to show reasonable cause
9 due to illness, appellant must provide credible and competent evidence indicating that the illness
10 prevented him from timely responding to the Demand. At the hearing, appellant should be prepared to
11 explain how brain surgery in September 2007 and the related therapy prevented him from responding to
12 the Demand by February 25, 2009. Appellant will want to explain how he was able to work in 2007 and
13 2008 but not file a 2007 tax return as demanded by the FTB until September 11, 2009.

14 Appellant also contends the first notice he received related to the 2007 tax year was the
15 NPA dated March 30, 2009. (App. Op. Br., p. 2.) If appellant maintains this assertion at the hearing, he
16 should discuss the circumstances and provide supporting evidence, and the parties should discuss
17 whether the Demand was sent to appellant’s last known address.

18 Appellant filed his 2007 return on September 11, 2009, about 17 months after the due
19 date of his 2007 return. Although appellant states that he concedes the calculation of the late filing
20 penalty, his claim for refund includes the amount associated with the late filing penalty. During the
21 hearing, appellant should clarify whether he is contesting the late filing penalty. If appellant contests the
22 late filing penalty, appellant should be prepared to explain and provide evidence showing how his brain
23 surgery and resulting therapy prevented appellant from finding relevant tax documents and timely filing
24 his return by April 15, 2008.

25 Pursuant to California Code of Regulations, title 18, section 5523.6, if either party has
26 any additional evidence to present, it should provide the evidence to Board Proceedings at least 14 days

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1 prior to the oral hearing.⁴

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⁴ Evidence exhibits should be sent to: Claudia Madrigal, Appeals Analyst, Board Proceedings Division, State Board of Equalization, P.O. Box 942879 MIC:80, Sacramento, California, 94279-0080.