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9 **BOARD OF EQUALIZATION**
10 **STATE OF CALIFORNIA**

11 In the Matter of the Appeal of:) **HEARING SUMMARY²**
12) **PERSONAL INCOME TAX APPEAL**
13 **TODD LUTWAK¹**) Case No. 482917

14 Year Claim
2005 For Refund³
\$43,295.50

15 Representing the Parties:

16 For Appellant: Todd Lutwak
17 For Franchise Tax Board: Marguerite Mosnier, Tax Counsel III

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19 **QUESTION:** Whether appellant has shown the notice and demand penalty imposed by
20 respondent should be abated.

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23 ¹ Appellant resides in Los Gatos, Santa Clara County, California. Appellant's wife is not a party to this appeal because the
24 Board received an appeal letter signed only by appellant.

25 ² This appeal was originally scheduled for the April 13, 2010, oral hearing calendar. The Board granted appellant's request
26 for a postponement and rescheduled the appeal for the May 25, 2010, oral hearing calendar.

27 ³ This is the amount of the notice and demand penalty, as reflected in respondent's information. As discussed below,
28 respondent abated the late filing penalty and reduced the notice and demand penalty from \$44,606.00 to \$43,295.50 after
appellant and his wife filed a late 2005 joint return. (Resp. Opening Br., p. 2, Exhibits C-D.)

1 HEARING SUMMARY

2 Background

3 Appellant did not file a timely California tax return for 2005. Respondent obtained
4 information indicating that appellant had sufficient income to require the filing of a tax return for
5 2005. (Resp. Opening Br., p. 1.) On January 22, 2007, respondent issued a notice and demand that
6 required appellant to file a return or explain why no return was required by no later than February 21,
7 2007. (*Id.*, Exhibit A.) When appellant neither filed a return nor demonstrated why a return was not
8 required, respondent issued a Notice of Proposed Assessment (NPA) on April 2, 2007. On its NPA,
9 respondent identified taxable income of \$1,849,078.80 consisting of reported wages of \$1,839,622.00
10 from eBay Inc., \$11,313.00 of interest income from Wells Fargo Bank, N.A., Citibank (West), FSB,
11 and National Financial Services LLC reported on federal Forms 1099-INT, \$993.00 of dividend
12 income from National Financial Services LLC and Charles Schwab & Co., Inc. reported on federal
13 Forms 1099-DIV or 1099-PATR, \$404.80 of estimated income using a percentage of the proceeds
14 reported from Charles Schwab & Co., Inc. on a federal Form 1099-B less a standard deduction of
15 \$3,254.00. After applying withholding credits of \$167,690, respondent proposed a tax deficiency of
16 \$10,734, which includes a mental health services tax of \$8,491; no exemption credits were applied.
17 Respondent also proposed to impose a late filing penalty of \$2,683.50, a notice and demand penalty of
18 \$44,606.00, and a filing enforcement fee of \$125.00, plus interest. (*Id.*, Exhibit B.)

19 Appellant did not protest the NPA and it became final. (*Id.*, p. 2.) Respondent's records
20 indicate that on April 15, 2007, appellant and his wife filed a joint return for tax year 2005. (*Ibid.*,
21 Exhibit C.) On the 2005 return, appellant and his wife reported California adjusted gross income (AGI)
22 of \$1,858,822 and a tax liability of \$164,013 after claiming exemption credits of \$990 and itemized
23 deductions of \$40,914. On the return, appellant and his wife claimed withholding credits of \$167,818,
24 estimated tax and other payments of \$7,351, and overpaid tax of \$11,156, which they directed to be
25 applied to their 2006 estimated tax. (*Ibid.*) Respondent processed the return, disallowed the claimed
26 exemption credits due to the reported amount of AGI, and reduced the estimated tax and other payments
27 to \$6,000. Respondent reduced the mental health tax to \$8,179 and consequently reduced the tax
28 deficiency to \$173,182 (\$164,013 of tax and \$8,179 of mental health tax). Respondent also abated the

1 late filing penalty of \$2,683.50 and reduced the notice and demand penalty to \$43,295.50. Appellant's
2 2005 account had a zero balance after respondent applied \$5,993 of credits from appellant's 2004
3 account and collected a payment of \$39,621.86 on March 3, 2008, from Wells Fargo Bank after issuing
4 an Order to Withhold Personal Income Tax. (*Id.*, pp. 2-3, 5, fn. 5; Exhibit D.)

5 Appellant subsequently requested abatement of the notice and demand penalty, which
6 respondent treated as a claim for refund. (*Id.*, p. 3.) Respondent issued a Denial of Claim for Refund
7 dated December 8, 2008, which states that it is denying appellant's claim for a refund because the
8 circumstances described in his claim for refund do not constitute reasonable cause. It further states
9 that it imposed a penalty for failure to file a tax return by the due date and if appellant disagrees with
10 its denial he may appeal with the Board. (Appeal Letter, Attachment.) Appellant filed this timely
11 appeal.

12 Appellant's Contentions

13 Appellant contends that on April 15, 2006, he filed for an extension for filing his 2005
14 return and remitted a payment for \$6,000. (App. Reply Br., p. 1.) Appellant asserts, "I believed at that
15 time and it was later proven that when I made this payment, I had more than satisfied my 2005 tax
16 obligation and was entitled to a refund." (*Ibid.*) For this reason, appellant contends that he "did not
17 fully appreciate the importance of timely filing the return itself." (Appeal Letter, p. 1.) Appellant
18 contends that he has a long history of overpaying his taxes and allowing California to use his money
19 interest free, and he thought by doing this he was doing California a favor. (App. Reply Br., p. 1.)
20 Appellant states that he received correspondence from respondent, "but can honestly say that I really
21 did not understand it." (*Ibid.*) He contends that he now understands the "severity of the message" but
22 at the time he received the correspondence he thought "if they knew that they owed me money they
23 would not be sending me stuff." (*Ibid.*) Appellant concedes that he did not file a 2005 return until
24 July 2, 2007. (Appeal Letter, p. 1.)

25 Thus, appellant contends that he did not appreciate the importance of timely filing a
26 return for tax year 2005 because he knew he overpaid his 2005 income tax liability and was due a
27 refund. Appellant contends that Revenue & Taxation Code (R&TC) section 19133 is not clear to an
28 ordinary taxpayer. According to appellant, a reasonable person would assume that there would be no

1 penalty because there is no deficiency. (App. Reply Br., p. 2.) Appellant states, “I will admit that
2 during this time I did know that I was behind schedule in filing my taxes but thought that since I was
3 overpaid that ‘it was not a problem.’” (*Id.*, p. 1.) Appellant also contends that “[t]he state might argue
4 the one-bite rule and say that this penalty is only assessed after another instance has occurred.” (*Id.*,
5 p. 2.) Assuming he is allowed “one-bite,” appellant asks if he can choose to take the notice and
6 demand penalty in a year in which he would not have suffered a large penalty. (*Id.*, pp. 2-3.)
7 Appellant further contends that his 2005 income was much higher than other years due to stock option
8 compensation and the penalty amount constitutes a significant percentage of his overall compensation
9 and net worth. (App. Opening Br., p. 2.) Appellant also contends that the late filing penalty “is a
10 fairly unusual penalty which was intended to be reserved for egregious situations and tax evaders.”
11 (*Ibid.*) Appellant contends that the size of the penalty is “staggering,” “punitive,” and “life changing.”
12 (App. Reply Br., p. 3.) Appellant contends that he would have to earn about \$75,000 in pre-tax
13 income in order to pay the notice and demand penalty and this amount represents a considerable
14 amount of his income, especially because he is a sole wage earner for a family of five. (*Ibid.*)

15 Appellant contends that he is entitled to have the late filing penalty waived or
16 significantly reduced due to the difficult circumstances he faced. He contends that he was going
17 through an extremely difficult time because Bob Hebler, his boss and friend, died in late 2006 and his
18 grandfather died in early 2007. Appellant contends that Mr. Hebler was killed in a cycling accident
19 and appellant subsequently had to assume most of Mr. Hebler’s responsibilities at work. Appellant
20 contends that he has some of Mr. Hebler’s possessions at his desk and still wears a wristband
21 commemorating Mr. Hebler’s life. (App. Opening Br., p. 1.) Appellant further contends that his
22 grandfather was battling sickness and he made a few visits before and after his grandfather’s death in
23 early 2007. (App. Reply Br., pp.1-2.) In addition, appellant contends that his grandfather’s illness and
24 death in early 2007 created some delay because his grandfather’s accountant and friend for over 40
25 years prepared appellant’s tax returns. (App. Opening Br., p. 1.)

26 Appellant contends that he made several contacts with respondent concerning his 2005
27 return and the notice and demand penalty. First, he contends that he called respondent in July 2007 to
28 inform it that he was sending his “taxes in around that time.” (*Id.*, p. 2.) During this phone call, an

1 FTB representative purportedly informed him that there was a possibility that a notice and demand
2 penalty may be imposed, although it is rarely used. Second, appellant contends he sent several letters
3 via facsimile to respondent during the summer and fall of 2007 in which he requested waiver of the
4 penalty and respondent denied receiving these letters. Appellant contends that respondent incorrectly
5 asserts that he did not request abatement of the penalty until December 2008. Third, appellant
6 contends that he contacted a representative of the FTB's collection department after respondent seized
7 over \$39,621.86 from his bank account. According to appellant, the representative assured him that
8 the state should not be collecting from a case still in dispute. (*Ibid.*)

9 Respondent's Contentions

10 Respondent contends that the notice and demand penalty is presumed to be correct and
11 appellant has failed to meet his burden of showing with credible and competent evidence that his failure
12 to file his return was due to reasonable cause and not to willful neglect. Respondent contends that a
13 prudent businessperson would have found a means of responding to the notice and demand.

14 Respondent contends that the 2005 return was due on April 15, 2006, which is well before Mr. Hebel
15 and appellant's grandfather died. Respondent also contends that most or all of the automatic extension
16 through October 15, 2006, had passed before Mr. Hebel died in 2006. Respondent also contends that
17 it is not clear why appellant's tax preparer could not have prepared the 2005 return prior to 2007. In
18 addition, respondent contends that appellant has a history of not filing returns and not responding to its
19 notices. Respondent contends that appellant's pattern of failing to file timely returns, even in response
20 to its requests and demands, considerably weakens his argument that his failure to respond to the notice
21 and demand was due solely to the deaths of Mr. Hebel and appellant's grandfather.⁴

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24 ⁴ According to respondent, it sent appellant a request for tax return in February 2004 requiring him to file a 2002 return or
25 explain why a return was not required by March 10, 2004, and appellant waited until April 15, 2005 to file a 2002 return; it
26 sent appellant a demand for tax return in February 2005 requiring him to file a 2003 return or explain why a return was not
27 required by March 16, 2005, and appellant did not file a 2003 return until April 15, 2005; appellant did not file a 2006
28 return until December 15, 2007; and on March 3, 2008, respondent received a collection payment to satisfy appellant's
2005 account as a result of issuing an Order to Withhold Personal Income Tax to Wells Fargo Bank after appellant failed to
respond to the following notices: Statement of Tax Due dated June 26, 2007, Income Tax Due Notice dated August 13,
2007, and a Final Notice dated October 16, 2007. (Resp. Opening Br., p.5, fn. 5.)

1 Respondent contends that the Denial of Claim for Refund should have stated that the
2 claim was denied because appellant failed to file a return or furnish information after it requested it.
3 Respondent further states, “In any event, appellant’s claim for refund was denied.” (Resp. Opening
4 Br., p. 3.)

5 Applicable Law

6 R&TC section 19133 imposes a penalty when a taxpayer fails to file a return or provide
7 information when directed to do so by respondent, unless the failure is due to reasonable cause and not
8 willful neglect. The penalty is computed as 25 percent of the tax liability determined without applying
9 payments or other credits.⁵ (*Appeal of Elmer R. and Barbara Malakoff*, 83-SBE-140, June 21, 1983;
10 *Appeal of Robert Scott*, 83-SBE-094, Apr. 5, 1983.) The FTB will only impose the notice and demand
11 penalty if the taxpayer fails to respond to a current Demand for Tax Return and the FTB issued an
12 NPA under the authority of R&TC section 19087, subdivision (a), after the taxpayer failed to timely
13 respond to a Request for Tax Return or a Demand for Tax Return at any time during the four-taxable-
14 years preceding the year for which the current Demand for Tax Return is being issued. (Cal. Code
15 Regs., tit. 18, § 19133, subd. (b)(1) and (2).)⁶ The notice and demand penalty was designed to
16 penalize the taxpayer’s failure to respond to the notice and demand, and not the taxpayer’s failure to
17 pay the proper tax. (*Appeal of Robert Scott*, 83-SBE-009, Jan. 3, 1983.)

18 The FTB’s determination with respect to tax and penalties are presumed to be correct
19 and the taxpayer has the burden of proving them erroneous. (*Appeal of Robert Scott, supra; Appeal of*
20 *David A. and Barbara L. Beadling*, 77-SBE-21, Feb. 3, 1977.) The burden of proving “reasonable
21 cause” for failure to file upon demand is on the taxpayer. (*Appeal of David A. and Barbara L.*
22 *Beadling, supra.*) To establish reasonable cause, a taxpayer must demonstrate that he exercised
23 ordinary business care and prudence. (*Appeal of Stephen C. Bieneman*, 82-SBE-148, July 26, 1982.)

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26 ⁵ Internal Revenue Code section 6641(b) specifically provides that the penalty is imposed in the amount of tax shown on the
27 return reduced by the amount of tax paid as of the due date and any credits to which the taxpayer is entitled, whereas R&TC
28 section 19133 does not so provide.

⁶ Regulation 19133 became operative on December 23, 2004.

1 Neither ignorance of the law, the theft of some of the taxpayer's financial records, nor the taxpayer's
2 busy work schedule constitutes reasonable cause for the abatement of the notice and demand penalty.
3 (*Appeal of Elmer R. and Barbara Malakoff, supra.*) Similarly, we have determined that reasonable
4 cause for the abatement of the notice and demand penalty was not established by job changes, several
5 moves, marital separation, no access to necessary financial information, and uncertainty about the
6 proper manner for reporting specific income items. (*Appeal of Terry R. Lash, 86-SBE-021, Feb. 4,*
7 *1986.*) A taxpayer's belief that he owed no tax and was entitled to a refund does not constitute
8 reasonable cause for failure to file a timely return upon notice and demand. (*Appeal of Sal J.*
9 *Cardinalli, 81-SBE-018, Mar. 2, 1981.*) The fact that the taxpayer was ultimately determined to be
10 entitled to a refund does not alter the fact that he failed to comply with the notice and demand. (*Ibid.*)
11 Significant medical or family problems might constitute reasonable cause for failing to comply under
12 some circumstances; however, a taxpayer must demonstrate a relationship between the events and the
13 failure to comply. (*Appeal of Michael J. and Diane M. Halaburka, 85-SBE-025, Apr. 9, 1985; Appeal*
14 *of Kerry and Cheryl James, 83-SBE-009, Jan. 3, 1983.*)

15 Staff Comments

16 It appears that the "Denial of Claim for Refund" dated December 8, 2008, was
17 erroneously issued for a late filing penalty, rather than a notice and demand penalty. (App. Opening
18 Br., Attachment.) Respondent concedes that it should have indicated that the penalty was denied
19 because appellant failed to file a return or furnish information as requested, but asserts that the refund
20 claim was still denied. (Resp. Opening Br., p. 3, fn. 2.) It appears that respondent complied with
21 R&TC section 19323 by notifying appellant that it denied his claim for refund and providing an
22 (erroneous) explanation for the disallowance. Because appellant filed a timely appeal of respondent's
23 denial of his claim for refund, it appears that this Board has jurisdiction to hear this appeal of
24 respondent's denial of appellant's claim for refund of the notice and demand penalty. (Rev. & Tax.
25 Code, § 19333.)

26 With respect to the imposition requirements set forth in California Code of Regulations,
27 title 18, section (Regulation) 19133, subdivision (b), which are discussed above, it is not yet clear
28 whether respondent met the requirement that it issued a proposed assessment of tax pursuant to R&TC

1 section 19087, subdivision (a), after appellant's failure to respond to the 2002 and 2003 demand
2 notices. Thus, respondent should be prepared to clarify whether it did so issue proposed assessments
3 for 2002 and 2003, so that the current demand penalty for 2005 is properly imposed.

4 Next, there appears to be a factual dispute as to the date when the 2005 return was filed.
5 Appellant contends that it was filed on July 2, 2007 (App. Opening Br., p. 1), whereas respondent
6 contends it was filed on April 15, 2007 (Resp. Opening Br., p. 2). Board staff notes that the 2005
7 return is signed by appellant and his wife and dated July 6, 2007 (Resp. Opening Br., Exhibit C) and
8 the notice and demand penalty was reduced to \$43,295.50, effective on April 2, 2007 (*Id.*, Exhibit D.)
9 The date difference is not determinative here.

10 Although appellant contends that he did not "appreciate the importance of timely filing
11 the return itself" because he knew he overpaid his 2005 tax liability and was due a refund (App.
12 Opening Br., p. 1), Board staff notes that appellant is not contesting the tax aspect of respondent's
13 assessment (\$10,734) in this appeal, including the \$404.80 of estimated income using a percentage of
14 the proceeds reported from Charles Schwab & Co., Inc. on a federal Form 1099-B. Appellant is
15 apparently arguing that the notice and demand penalty should not apply to him because he is an honest
16 taxpayer who pays all of his taxes. Appellant is apparently confused because the purpose of the notice
17 and demand penalty is to penalize his failure to respond to the notice and demand, rather than his
18 failure to pay the proper tax. (*Appeal of Robert Scott, supra.*)

19 In his September 18, 2007, letter to respondent requesting abatement of the penalty,
20 appellant stated, "I can assure you that I am now clear on California tax issues, and this will never
21 happen again." (App. Reply Br., Attachment.) According to respondent, however, appellant waited
22 until December 15, 2007, to file a 2006 return. (Resp. Opening Br., p. 5.) It appears that appellant
23 was also delinquent in filing returns and responding to notices and demands prior to the deaths of Mr.
24 Hebel in late 2006 and appellant's grandfather in early 2007. Respondent's records further indicate
25 that appellant did not file a 2002 return until April 15, 2005, which was more than one year after the
26 March 10, 2004, deadline imposed in a Request for Tax Return, and he did not file a 2003 return until
27 April 15, 2005, which was approximately one month after the March 16, 2005, deadline imposed in a
28 Demand for Tax Return.

1 While ignorance of the law does not constitute reasonable cause, it appears that
2 appellant is too sophisticated and educated to claim that he did not understand the January 22, 2007,
3 notice and demand when he received it. Board staff notes that in an eBay interview posted on
4 April 15, 2009, appellant stated that he obtained a bachelor's degree in business administration
5 ("BBA") at the University of Texas and attended the Kellogg Graduate School of Management at
6 Northwestern University.⁷ Board staff further notes that DailyFinance posted an article on August 6,
7 2009, which identifies appellant as Senior Director of Seller Development of eBay Inc.⁸ While
8 appellant contends that he assumed most of Mr. Hebler's responsibilities at eBay Inc. as a result of
9 Mr. Hebler's tragic death in late 2006, appellant was identified as eBay Inc.'s Senior Director of
10 Seller Development in a press release dated April 10, 2006.⁹ Board staff notes that eBay Inc. is a
11 publicly-traded Fortune 500 corporation.¹⁰

12 While the death or illness of a third party may constitute reasonable cause if it can be
13 shown that the taxpayer was completely prevented from complying with respondent's notice and
14 demand, it appears that appellant has not yet provided evidence to show that the circumstances of Mr.
15 Hebler and appellant's grandfather's deaths, as well as appellant's work pressures, were such as to
16 prevent compliance with respondent's notice and demand. In this regard, there is no dispute that
17 appellant was employed and working full-time at the time he received the January 22, 2007, notice and
18 demand. The parties should be prepared to discuss at the oral hearing whether appellant's failure to
19 file a 2005 return within 30 days of the January 22, 2007, notice and demand was due to reasonable
20 cause and not willful neglect.

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25 ⁷ <http://ebayinkblog.com/2009/04/15/changes-to-ebay-marketplace-5-minutes-with-todd-lutwak/>

26 ⁸ (www.dailyfinance.com/story/company-news/ebay-responds-to-critics-qanda-with-exec-todd-black/19121855.)

27 ⁹ (<http://www.auctionrover.com/news/2006/pr060410.html>.)

28 ¹⁰ (<http://www.zoominfo.com/Search/CompanyDetail.aspx?CompanyID=12272288&cs=QEu0KgyA>.)