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BOARD OF EQUALIZATION

STATE OF CALIFORNIA

In the Matter of the Appeal of:	**HEARING SUMMARY**
	PERSONAL INCOME TAX APPEAL
YSIDRO MARTINEZ[1]	Case No. 479960[2]

Years	Claims For Refund Amounts
2005	$402.48[3]
2006	$466.26

Representing the Parties:

For Appellant: Rachael Callahan, Legal Intern
Tax Appeals Assistance Program (TAAP)[4]

For Franchise Tax Board: Bruce R. Langston, Tax Counsel IV

[1] Appellant resides in San Diego County.

[2] Upon the request of a Board member, this Hearing Summary was revised to address the following issues: (i) whether appellant has shown reasonable cause for refund of the late filing penalty that was assessed for the 2006 tax year, and (ii) whether appellant has shown that he is entitled to a refund of interest for the 2005 and/or 2006 tax years.

[3] The Opening Brief of the Franchise Tax Board (FTB or respondent) lists the amount at issue for 2005 as 402.48. However, Exhibit E of the FTB's Opening Brief indicates that the amount at issue for 2005 is $402.87. At the oral hearing, the FTB should clarify the amount at issue for 2005.

[4] Appellant was previously represented by Ms. Cristen Owens, and Mr. Peter Komorniczak, legal interns at TAAP.

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QUESTIONS: (1) Whether appellant is entitled to refunds of the self-assessed taxes he paid with married filing separate returns where his total income was below the "married" filing threshold amounts shown in the instructions of the FTB;

(2) Whether appellant has shown reasonable cause for refund of the late filing penalty that was assessed for the 2006 tax year;

(3) Whether appellant has shown that he is entitled to a refund of interest for the 2005 and/or 2006 tax years; and

(4) Whether appellant has shown that equitable estoppel applies to the facts at hand.

HEARING SUMMARY

Background

The facts in this case do not appear to be in dispute.

Tax Year 2005

Appellant filed a timely 2005 California income tax return, electing married filing separately (MFS) filing status and reporting a federal adjusted gross income (AGI) of $29,528. After claiming a California adjustment (subtraction) of $15,170 for social security benefits, in addition to a standard/itemized deduction of $3,254, appellant's California taxable income was $11,104. Appellant reported a $174 exemption credit, which resulted in zero tax due.

On March 10, 2008, the FTB issued a Notice of Proposed Assessment (NPA) for 2005, denying $11,132 of the $15,170 that appellant originally claimed as an adjustment for social security benefits. The FTB explained that appellant could only deduct the amount of social security benefits that were included in his federal AGI.

Appellant responded to the NPA by letter dated March 17, 2008, conceding that his income for 2005 was $22,236, but noting that his separate income was below the $34,870 threshold amount shown in the FTB's 2005 Personal Income Tax Booklet instructions for income of both spouses combined.

The FTB replied by letter dated July 15, 2008, explaining that there is a difference between having a filing requirement based on the income chart (as set forth in the Form 540A instructions) and owing tax. Appellant paid the amount allegedly owed to the FTB on July 15, 2008.

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Tax Year 2006

Appellant failed to file a timely California return for the 2006 tax year, and the FTB sent a request for tax return on March 3, 2008. Thereafter, appellant filed a 2006 California income tax return on March 14, 2008, electing MFS filing status and reporting a federal adjusted gross income (AGI) of $29,682. After claiming a California adjustment (subtraction) of $4,192 for social security benefits, in addition to a standard/itemized deduction of $3,410, appellant's California taxable income was $22,080. Appellant reported a $182 exemption credit, which resulted in tax due of $322. The FTB processed the 2006 return and assessed a $100 late filing penalty. On July 15, 2008, appellant made a payment, which satisfied his 2006 FTB liability in full.

Facts Common to Both 2005 and 2006

In August 2008, appellant corresponded with the FTB's Taxpayer Advocate Bureau, inquiring why he had to pay taxes in 2005 and 2006 when, according to his reading of the FTB's Personal Income Tax Booklet instructions for 2005 and 2006 (hereinafter "filing instructions"), he did not have a filing requirement for either 2005 or 2006. The FTB treated appellant's inquiries as claims for refund. After reviewing the matter further, the FTB denied the claims. Appellant then filed this timely appeal.

Contentions

Appellant argues that under his reading of the FTB's filing instructions, he did not have a filing requirement for either 2005 or 2006 and, therefore, should not owe taxes, penalties, and/or interest for the years at issue.

On appeal, FTB makes three arguments: First, the FTB argues that appellant's payments for 2005 and 2006 (as set forth above) are correct, and therefore, appellant is not entitled to any refunds.

Second, the FTB notes that Revenue and Taxation Code (R&TC) section 18501 establishes various income thresholds, which mandate when an individual taxpayer must file a return. The FTB takes the position, however, that an individual might have to file a return even if his or her income is below the threshold amounts set forth in R&TC section 18501. The FTB's contends that R&TC section 18501 merely lists some circumstances (income thresholds) under which a taxpayer must file a return. The FTB contends that in other circumstances, if a taxpayer would owe tax under any

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provision of the R&TC, then the taxpayer has to file a return even if his or her income is below the threshold amounts set forth in R&TC section 18501, as required by R&TC section 18407. The FTB explains that an example where this may happen is when one spouse has primarily non-community property separate income and the other spouse has little or no taxable income.

Third, the FTB asserts that appellant is (apparently) making an equitable estoppel argument. As such, the FTB notes that equitable estoppel is applied against the government only in rare and unusual circumstances and when its application is necessary to prevent manifest injustice. The FTB asserts, however, that appellant suffered no injury by paying the taxes he properly owed. In addition, the FTB argues that it is an administrative agency, and therefore, it does not have legal authority to interpret a statute in such a way as to change the statute's meaning or effect. Accordingly, the FTB argues that if its filing instructions for 2005 and 2006 are incorrect, a taxpayer must follow the law and not its instructions.[5]

Finally, we note that the FTB's Opening Brief does not directly address the law and appellant's arguments regarding (i) a refund of the late filing penalty that was assessed for the 2006 tax year, and (ii) relief of interest for the 2005 and 2006 tax years.

Applicable Law

Burden of Proof

The FTB's determination of tax is presumed to be correct, and a taxpayer has the burden of proving error. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Michael E. Myers*, 2001-SBE-001, May 31, 2001.)[6]

R&TC section 18501

R&TC section 18501 establishes various income thresholds, which mandate when an individual taxpayer must file a return. The amounts set forth in R&TC section 18501 are indexed annually for inflation. In Technical Advice Memorandum 2008-1, the FTB takes the position that an individual might have to file a return even if his or her income is below the threshold amounts set forth

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[5] In footnote 1 of its Opening Brief, the FTB states that its current instructions and forms (for 2008 and forward) have been revised to address this issue.

[6] Board of Equalization cases are generally available for viewing on the Board's website (www.boe.ca.gov).

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in R&TC section 18501:

> RTC section 18501 establishes thresholds which require an individual taxpayer to file a return. It does not state that an individual taxpayer does not have to file a return if the taxpayer's gross income or adjusted gross income is below those thresholds. If a tax would be due under the tax rates or brackets set forth in RTC section 17041 based on the filing status used by the taxpayer, or under other code sections, a tax is due under the law and must be shown on a tax return under RTC section 18407.

R&TC section 17041 imposes a tax on the entire taxable income of every resident of this state at specified rates, indexed annually for inflation. In turn, R&TC section 18407, incorporating Internal Revenue Code (IRC) section 6011, and modifying IRC section 6011(a), provides in subdivision (a) that "any person liable for a tax imposed by Part 10 (commencing with section 17001) . . . or this part . . . shall make a return or statement according to forms and regulations prescribed by [the FTB]. Every person required to make a return or statement shall include therein the information required by such forms or regulations."

Late Filing Penalty

California imposes a penalty for failure to file a return by its due date, unless the failure to file was due to reasonable cause and not due to willful neglect. (Rev. & Tax. Code, § 19131.) To establish reasonable cause, a taxpayer "must show that the failure to file timely returns occurred despite the exercise of ordinary business care and prudence, or that cause existed as would prompt an ordinary intelligent and prudent businessman to have so acted under similar circumstances." (*Appeal of Howard G. and Mary Tons*, 79-SBE-027, Jan. 9, 1979.) Ignorance of a filing requirement or a misunderstanding of the law generally does not excuse a late filing. (*Appeal of Diebold, Incorporated*, 83-SBE-002, Jan. 3, 1983.) Several federal cases indicate that a taxpayer who fails to consult with a tax advisor is proceeding at his or her own risk when the taxpayer comes to the conclusion that a return does not have to be filed. (See *Shomaker v. Commissioner* (1962) 38 T.C. 192, 202; *Ellabban v. Commissioner*, T.C. Memo 1996-382.)

Refund of Interest

Interest is required to be assessed from the date when payment of tax is due, through the date that it is paid. (Rev. & Tax. Code, § 19101.) Imposition of interest is mandatory; it is not a

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penalty, but is compensation for appellant's use of money after it should have been paid to the state. (*Appeal of Amy M. Yamachi*, 77-SBE-095, June 28, 1977.) There is no reasonable cause exception to the imposition of interest. (*Appeal of Audrey C. Jaegle*, 76-SBE-070, June 22, 1976.)

To obtain relief from interest, appellant must qualify under one of three statutes: R&TC sections 19104, 19112 or 21012. R&TC section 21012 is not applicable, because there has been no reliance on any written advice requested of the FTB. R&TC section 19112 requires a showing of extreme financial hardship caused by significant disability or other catastrophic circumstance. However, there is no provision in R&TC section 19112 or other law that gives the Board jurisdiction to determine whether R&TC section 19112 applies in this instance. (However, the Legislature did provide the Board jurisdiction over appeals of denied interest abatement requests under R&TC section 19104, as discussed below.)

Under R&TC section 19104, for tax years beginning on or after January 1, 1998, this Board may only abate or refund interest on appeal.

> [T]o the extent that interest is attributable in whole or in part to any unreasonable error or delay by an officer or employee of the Franchise Tax Board (acting in his or her official capacity) in performing <u>a ministerial or managerial act.</u>

(Rev. & Tax. Code, § 19104, subd. (a)(1) [emphasis added].)

Further, the error or delay can be taken into account only if no significant aspect is attributable to the taxpayer, and the error or delay occurred <u>after</u> the FTB contacted the taxpayer in writing about the underlying deficiency. (Rev. & Tax. Code, § 19104, subd. (b)(1).) For 2005, the first contact was March 10, 2008, when the FTB issued its NPA. For 2006, the first contract occurred on March 3, 2008. In the *Appeal of Michael and Sonia Kishner* (99-SBE-007), decided on September 29, 1999, the Board adopted the language from Treasury Regulation section 301.6404-2 (b)(2), defining a "ministerial act" as:

> A procedural or mechanical act that does not involve the exercise of judgment or discretion, and that occurs during the processing of a taxpayer's case after all prerequisites to the act, such as conferences and review by supervisors, have taken place. A decision concerning the proper application of federal tax law (or other federal or state law) is not a ministerial act.

This Board has not yet adopted a definition for the term "managerial act." However,

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when a California statute is substantially identical to a federal statute (such as, with the interest abatement statute in this case), we may consider federal law interpreting the federal statute as highly persuasive. (*Douglas v. State of California* (1942) 48 Cal.App.2d 835.) In this regard, Treasury Regulations section 301.6404-2 (b)(1) defines a "managerial act" as:

> [A]n administrative act that occurs during the processing of a taxpayer's case involving the temporary or permanent loss of records or the exercise of judgment or discretion relating to management of personnel. A decision concerning the proper application of federal tax law (or other federal or state law) is not a managerial act.

Equitable Estoppel

Equitable estoppel is applied against the government only in rare and unusual circumstances and when its application is necessary to prevent manifest injustice. (See *Appeal of Richard R. and Diane K. Smith*, 91-SBE-005, Oct. 9, 1991.) The four elements of equitable estoppel are: (1) the government agency must be shown to have been aware of the actual facts; (2) the government agency must be shown to have made an incorrect or inaccurate representation to the relying party and intended that its incorrect or inaccurate representation would be acted upon by the relying party or have acted in such a way that the relying party had a right to believe that the representation was so intended; (3) the relying party must be shown to have been ignorant of the actual facts; and (4) the relying party must be shown to have detrimentally relied upon the representations or conduct of the government agency. (*Appeal of Western Colorprint*, 78-SBE-071, Aug. 15, 1978.) Where one of these elements is missing, there can be no estoppel. (*Hersch v. Citizens Savings & Loan Assn.* (1983) 146 Cal.App.3d 1002, 1011.) The burden of proving estoppel is on the party asserting estoppel. (*Appeal of Priscilla L. Campbell*, 79-SBE-035, Feb. 8, 1979.)

The FTB is an administrative agency, and it does not have the legal authority to interpret a statute in such a way as to change its meaning or effect. (*Appeal of Melvin D. Collamore*, 72-SBE-031, Oct. 24, 1972.) Thus, when the FTB's instructions or online programs are alleged to be misleading, taxpayers must follow the law, rather than the instructions. (*Ibid.*) To show detriment a taxpayer must show that he or she relied on the FTB's instructions to plan his or her income and/or tax situation, and that his or her reliance resulted in an increased tax liability. That a taxpayer merely relied on the FTB's tax instructions to prepare a tax return, after the fact, does not show detriment. Further, the general rule

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with respect to applying equitable estoppel in tax matters is that the state cannot be estopped because of acts of its employees (in providing erroneous administrative tax rulings) from collecting the tax due from the taxpayer. (See *Market S.R. Co. v. Cal. Bd. of Equalization* (1955) 137 Cal.App.2d 87, 103; *La Societe Francaise de Bienfaisance Mutuelle v. Cal. Employment Com.* (1943) 56 Cal.App.2d 534, 555.)

STAFF COMMENTS

At the oral hearing, the parties should discuss the application of R&TC sections 18501 and 18407 to this appeal.

In addition, the parties should discuss whether the late filing penalty that was assessed for the 2006 tax year should be refunded on the basis of reasonable cause. To establish reasonable cause, appellant must show that his failure to file a timely 2006 return occurred despite the exercise of ordinary business care and prudence, or that cause existed as would prompt an ordinary intelligent and prudent businessman to have so acted under similar circumstances. Appellant should explain why he filed his 2006 tax return on March 14, 2008 (i.e., approximately 11 months late) and only after being contacted by the FTB.

Next, the parties should discuss whether interest should be refunded for the 2005 and/or 2006 tax years under R&TC section 19104. Specifically, the parties should discuss whether the FTB's publication of the filing instructions constitutes a ministerial or managerial act with respect to appellant's filing of his 2005 and 2006 returns. Furthermore, as stated above, the error or delay can be taken into account only if no significant aspect is attributable to appellant, and the error or delay occurred after the FTB contacted the appellant in writing about the underlying deficiency. Accordingly, for interest accrued on the late filing penalty, appellant should again explain why he filed his 2006 tax return on March 14, 2008 (i.e., approximately 11 months late) and only after being contacted by the FTB. Also, appellant should explain why he paid his 2005 and 2006 tax liabilities in full on July 15, 2008 (i.e., approximately 27 months late for the 2005 tax year and 15 months late for the 2006 tax year) and only after being contacted by the FTB.

In addition, the parties should be prepared to discuss whether appellant relied on the FTB's instructions on April 15, 2007, when he chose not to file his 2006 return. Staff notes that it

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appears appellant did not rely on his interpretation of the FTB's instructions for the 2005 tax year since he timely filed a MFS tax return.

Finally, the parties should discuss whether equitable estoppel applies here in light of the fact that it appears appellant may have properly had tax liabilities in 2005 and 2006.

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