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7 **BOARD OF EQUALIZATION**
8 **STATE OF CALIFORNIA**
9

10 In the Matter of the Appeal of:) **HEARING SUMMARY**
11) **PERSONAL INCOME TAX APPEAL**
12 **CORT R. SCHULTZ AND**) Case No. 556764
13 **MARGARET P. KRINSKY¹**)
14 _____)

| | <u>Years</u> | <u>Proposed Assessments²</u> |
|--|--------------|-----------------------------------------|
| | 2006 | \$2,470.75 |
| | 2007 | \$3,037.50 |

18 Representing the Parties:

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20 For Appellants: Harold Lippa, Lippa Associates, Inc.
21 For Franchise Tax Board: Anjali Balasingham, Tax Counsel
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23 **QUESTION:** Whether appellants have established reasonable cause for the abatement of the notice
24 and demand penalty.
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26 ¹ Appellants reside in Encinitas, San Diego County.

27 ² The amounts listed here represent the amounts in the December 22, 2010 denial of appellants' claims for refund for the
28 2006 and 2007 tax years. An earlier denial letter was issued on September 16, 2010, incorrectly listing the penalty amount for 2006 as being \$1,526. (Appeal Letter attachments; Resp. Op. Br., p. 1, fn. 1 & exhibit Q.)

1 HEARING SUMMARY

2 Background

3 The parties are in dispute as to whether appellants filed timely state tax returns for 2006
4 and 2007. Appellants assert they filed timely returns but respondent misplaced them. (Appeal Letter,
5 p. 1.) Respondent asserts it has no record of timely returns being filed for these years at issue, and states
6 its automated Integrated Non-filer Compliance (INC) program led it to discover Mr. Schultz was a
7 member of the California State Bar and a licensed attorney for 2006 and 2007. (Resp. Op. Br., p. 1.)
8 Based on the industry average income for practicing attorneys, respondent determined Mr. Schultz had a
9 filing requirement for both tax years and issued Demands for Tax Returns (Demands) on March 3, 2008,
10 for the 2006 tax year and on March 9, 2009, for the 2007 tax year. (*Id.* at exhibit A.) The Demands
11 were sent to a N El Camino Real address,³ and required that Mr. Schultz, within 30 days of the issuance
12 of the Demands, either file a tax return, show that a return already had been filed, or explain why a
13 return was not necessary. When no timely responses were received, respondent issued Notices of
14 Proposed Assessment (NPAs) for 2006 and 2007 on May 5, 2008, and June 2, 2009, respectively. (*Id.* at
15 exhibit B.)

16 The 2006 proposed assessment for Mr. Schultz was determined by estimating income in
17 the amount of \$92,864, which was based on the average income of a licensed attorney in California for
18 that year. (Resp. Op. Br., exhibit B, p. 1.) Respondent then applied a standard deduction of \$3,410,
19 based on a single individual with no dependents. The resulting taxable income of \$89,454 led to a
20 proposed assessment of tax of \$6,195, which was reduced by a \$91 personal exemption to find a final
21 tax liability of \$6,104. The NPA also imposed penalties for late filing and failure to file upon demand
22 (demand penalty) of \$1,526 each, a filing enforcement fee of \$122, and applicable interest on the
23 amount due. (*Ibid.*) The 2007 proposed assessment was determined by estimating income in the
24 amount of \$94,879, to which respondent applied a standard deduction of \$3,516 to reach a taxable
25 income of \$91,363, and a tax of \$6,306. (*Id.* at exhibit B, p. 3.) The NPA deducted \$94 for a personal
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28 ³ There appear to be two addresses involved in this appeal. There is an address on N El Camino Real and a Sage Canyon Drive address, both in Encinitas, California. More specific details of these addresses have been redacted for privacy concerns. Appellants also reference a P.O. Box mailing address in their brief, but no specific details have been provided regarding this location.

1 exemption to find a final tax liability of \$6,212. The NPA also imposed late filing and demand penalties
2 for \$1,553 each, a filing enforcement fee of \$119, and applicable interest on the amount due. (*Ibid.*)
3 The NPAs stated that unless Mr. Schultz filed timely protests of the NPAs, they were due and payable
4 on July 7, 2008, for 2006 and August 3, 2009, for 2007. (*Id.* at exhibit B, pp. 1 & 3.)

5 Respondent also received information that Ms. Krinsky received sufficient income in
6 2006 and 2007 to prompt a filing requirement, and issued a Request for Tax Return (Request) for 2006
7 on February 6, 2008. (Resp. Op. Br., exhibit C; see also Resp. Op. Br., exhibit D, p. 2.) When
8 Ms. Krinsky did not respond by the date indicated on the Request, respondent issued an NPA based on
9 \$163,200 in wages reported by Hitachi Data Systems Corp. (Hitachi) and \$31 in dividend income
10 reported by General Electric Company. (*Id.* at exhibit D.) The NPA applied the standard deduction of
11 \$3,410, based on a single individual with no dependents. The resulting taxable income of \$159,821 led
12 to a tax of \$12,735, which was reduced by a \$61 personal exemption to find a tax liability of \$12,674.
13 The NPA applied \$12,092 in withholding credits and proposed a tax liability of \$582. The NPA also
14 imposed a late filing penalty of \$145 and applicable interest on the amount due. (*Ibid.*) Respondent also
15 issued a Demand to Ms. Krinsky for 2007 on February 24, 2009, and requested a response in 30 days.
16 When Ms. Krinsky failed to respond respondent issued an NPA based on \$179,424 in wages reported by
17 Hitachi and \$101 in interest income reported by Bank of America. (*Id.* at exhibits E & F.) The NPA
18 applied the standard deduction of \$3,516, based on a single individual with no dependents. The
19 resulting taxable income of \$176,009 led to a tax of \$14,174, which was reduced by a \$34 personal
20 exemption to find a tax liability of \$14,140. The NPA applied \$13,320 in withholding credits and
21 proposed a tax liability of \$820. The NPA also imposed a \$205 penalty for late filing and a demand
22 penalty of \$3,535, a filing enforcement fee of \$119, and applicable interest on the amount due. (*Id.* at
23 exhibit F.) The Request, Demand, and NPAs for Ms. Krinsky were mailed to her address at Sage
24 Canyon Drive.

25 Appellants state they did not receive the Request, Demands, or NPAs, and became aware
26 of the proposed assessments when they discovered a lien was placed on their house by respondent.
27 Appellants then filed a joint 2006 California income tax return on October 15, 2009 (dated October 2,
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1 2009), and a joint 2007 return on February 2, 2010 (dated October 1, 2009).⁴ (Resp. Op. Br., exhibits
2 G & H; see also Resp. Op. Br., exhibit I.) Respondent accepted the returns as filed and revised the
3 penalty amounts.⁵ (*Id.* at exhibits J & K.) Appellants listed the Sage Canyon Drive address on their
4 state returns. Appellants' federal account records show their federal returns for 2006 and 2007 were
5 received on October 6, 2009. (*Id.* at exhibits L & M.) Appellants filed claims for refund on June 7,
6 2010, for the amounts of \$1,526.00 for 2006 and \$3,037.50 for 2007, asserting the demand penalties
7 should be abated because the demands were not sent to appellants' last-known address.⁶ (Appeal Letter
8 attachments.) Respondent denied appellants' claims for refund in a letter issued September 16, 2010,
9 stating appellants have not established reasonable cause, and sent a revised denial letter on December
10 22, 2010, to properly reflect the full amounts of the demand penalties. (Appeal Letter attachments;
11 Resp. Op. Br., exhibit Q.) This timely appeal followed.

12 Contentions

13 Appellants assert they filed timely returns for 2006 and 2007, but respondent mishandled
14 their returns and lost them. (Appeal Letter.) Appellants contend respondent's notices and demands for
15 tax returns were not sent to the last-known address, and were sent to a P.O. Box instead of their home
16 address. Appellants assert they became aware of problems with their 2006 and 2007 accounts when
17 they were refinancing their home in October of 2009 and discovered there was a lien on their home from
18 FTB. Appellants assert they then immediately paid the balance and resubmitted their returns, which
19 they contend respondent again mishandled. Appellants state they discovered a wage garnishment notice
20 was sent to Ms. Krinsky's employer on February 18, 2010, and responded by again sending copies of
21 their returns. Appellants assert it was at this time that they received respondent's old letters regarding
22 the demand penalties. Appellants contend respondent's mishandling of their returns constitutes
23 reasonable cause for the abatement of the demand penalties, they were ultimately owed a refund on their
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26 ⁴ Respondent asserts this was appellants' first filing of their returns. Appellants, conversely, state that they filed timely
returns and resubmitted them both in October of 2009.

27 ⁵ Respondent's exhibit J, page 2, line 12 and exhibit K, page 1, line 8 show the revised penalty amounts.

28 ⁶ As noted in footnote 2, the actual amounts of the penalties are \$2,470.75 for 2006 and \$3,037.50 for 2007. These amounts
are twenty-five percent of appellants' total tax liabilities of \$9,883 for 2006 and \$12,150 for 2007.

1 returns, and respondent did not use the last-known address to issue the notices and demands. (*Ibid.*)

2 Respondent contends the proposed penalties are properly imposed. Respondent asserts
3 there is no evidence showing appellants timely filed state returns, but it will review any evidence
4 appellants can provide showing timely returns were filed. Respondent contends the evidence shows
5 appellants filed their 2006 return on October 15, 2009, and their 2007 return on February 2, 2010.
6 Respondent also note that even if their 2007 return was filed with the 2006 return in October of 2009, it
7 is still beyond the filing deadline provided for in the demand letter for 2007, and therefore the penalty
8 would still apply. Respondent provides documents from the Internal Revenue Service (IRS) showing
9 appellants' 2006 and 2007 federal returns were received on October 6, 2009, and contends that since
10 state returns are based on federal return information, state returns are usually filed after federal returns
11 have been prepared. (Resp. Op. Br., exhibits L & M.) Respondent argues, therefore, that it would have
12 been difficult for appellants to have timely filed their state returns when their federal returns were filed
13 much later.⁷ (*Id.* at p. 4.)

14 Respondent asserts the Demands were sent to appellants' last-known addresses. (Resp.
15 Op. Br., p. 5.) Respondent contends the address used for the Request, Demand and NPAs sent to
16 Ms. Krinsky was the Sage Canyon Drive address, which is the address appellants used for their 2005
17 through 2009 returns, and the address they still use as their current mailing address and as Mr. Schultz's
18 legal office address listed with the California State Bar. (*Id.* at p. 4 & exhibits C-F, P & S.) Respondent
19 sent the Demands and NPAs issued to Mr. Schultz to the N El Camino Real address that he provided to
20 the California State Bar as his mailing address for years 2006 through 2009. (*Id.* at exhibits A & B.)
21 Respondent notes that the N El Camino Real address was also used by Mr. Schultz on his federal return
22 Schedule C forms for 2006, 2007, and 2008. (*Id.* at p. 5; exhibit G, p. 11; exhibit H, p. 12; and exhibit
23 O.) Respondent asserts the Demands and NPAs were sent to the last-known addresses, it has no record
24 of the mailings being returned by the United States Postal Service, and, contrary to appellants' claims,
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26 ⁷ Respondent states appellants filed federal returns for both years on November 9, 2009. (Resp. Op. Br., p. 3.) However,
27 staff notes that appellants' federal returns were processed on that date, but were actually received by the IRS on October 6,
28 2009. (*Id.* at exhibits L & M.) Appellants assert they filed timely California returns for both years, which would mean their
state returns predated their federal filings by approximately two years and six months for 2006 and one year and six months
for 2007.

1 the Request, Demands and NPAs for 2006 and 2007 were not sent to a P.O. Box. (*Id.* at p. 6.)
2 Respondent states it will consider a sworn statement made under penalty of perjury by Mr. Schultz
3 declaring he did not receive the Demand letter or NPA for 2006 sent to his office address, and review
4 the 2006 demand penalty. (*Ibid.*) Respondent contends that its imposition of demand penalties carry a
5 presumption of correctness, and the burden is on the taxpayers to provide credible and competent
6 evidence to overcome the presumption. (*Id.* at p. 4.)

7 Applicable Law

8 Demand Penalty

9 California imposes a penalty for the failure to file a return or provide information upon
10 the FTB's demand to do so, unless reasonable cause prevented the taxpayer from responding to the
11 request. (Rev. & Tax. Code, § 19133.) The penalty is computed as 25 percent of the total tax,
12 determined without regard to timely payments or other credits. (*Appeal of Elmer R. and Barbara*
13 *Malakoff, supra; Appeal of Frank E and Lilia Z. Hublou, supra.*) The FTB will only impose a demand
14 penalty if two conditions are met: (1) the taxpayer fails to respond to a current Demand for Tax Return
15 and (2) at any time during the four taxable years preceding the year for which the current Demand for
16 Tax Return is being issued, the FTB had issued an NPA under the authority of Revenue and Taxation
17 Code (R&TC) section 19087, subdivision (a), after the taxpayer failed to timely respond to a Request for
18 Tax Return or a Demand for Tax Return. (Cal. Code Regs., tit. 18, § 19133, subd. (b).)

19 The demand penalty is designed to penalize the failure of the taxpayers to respond to a
20 notice and demand, and not the taxpayers' failure to pay the proper tax. (*Appeal of W. L. Bryant,*
21 *83-SBE-180, Aug. 17, 1983; Appeal of Frank E and Lilia Z. Hublou, supra.*) The burden is on the
22 taxpayers to prove that reasonable cause prevented them from timely responding to the demand.
23 (*Appeal of Kerry and Cheryl James, supra.*) To overcome the presumed correctness of respondent's
24 assessment of the notice and demand penalty, taxpayers must produce credible and competent evidence
25 supporting their contentions. (*Appeal of Yvonne M. Goodwin, 97-SBE-003, Mar. 19, 1997.*)

26 Demand penalties may be abated if the taxpayers' failure to provide information or to file
27 a return is due to reasonable cause and not willful neglect. (Rev. & Tax. Code, § 19133.) Without
28 evidence to the contrary, it is presumed that respondent's determinations of penalties are correct.

1 (*Appeal of Robert Scott*, 83-SBE-094, Apr. 5, 1983.) Appellants bear the burden of showing that
2 imposition of a penalty was improper. (*Appeal of Kerry and Cheryl James*, 83-SBE-009, Jan. 3, 1983.)

3 To establish reasonable cause for abatement of a demand penalty, the taxpayers must
4 show the failure to properly respond “occurred despite the exercise of ordinary business care and
5 prudence, or that cause existed as would prompt an ordinary intelligent and prudent businessman to have
6 so acted under similar circumstances.” (*Appeal of Howard G. and Mary Tons*, 79-SBE-027, Jan. 9,
7 1979; see also *Appeal of Elmer R. and Barbara Malakoff*, 83-SBE-140, June 21, 1983.) Illness and
8 other personal difficulties that prevent taxpayers from timely responding to a demand notice may
9 constitute reasonable cause under some circumstances. However, taxpayers must be prevented from
10 timely providing information, and not merely sacrificing the timeliness of one aspect of the taxpayers’
11 affairs to pursue other aspects. (*Appeal of Michael J. and Diane M. Halaburka*, 85-SBE-025, April 9,
12 1985; *Appeal of William T. and Joy P. Orr*, 68-SBE-10, Feb. 5, 1968.) In addition, this Board has held
13 that taxpayers’ belief that no penalties will apply because no tax was due does not constitute reasonable
14 cause for the failure to respond timely to a notice and demand letter. (*Appeal of Frank E. and Lilia Z.*
15 *Hublou*, 77-SBE-102, July 26, 1977.)

16 Last-known Address

17 The Board has long recognized a presumption in favor of respondent arising from the
18 “last-known address rule.” Under this rule, the Board presumes respondent’s mailing of a statutory
19 notification to a taxpayer provides adequate legal notice to the taxpayer, so long as respondent mailed
20 the notification to the taxpayer’s last-known address, even if the taxpayer did not receive the notice.
21 (*Appeal of Yvonne M. Goodwin*, 97-SBE-003, Mar. 19, 1997; *Appeal of Jon W. and Antoinette O.*
22 *Johnston*, 83-SBE-238, Oct. 26, 1983.) The taxpayer’s last-known address is the address shown on the
23 taxpayer’s most recently filed return, unless respondent is given clear and concise written or electronic
24 notice of a different address or respondent has an address that it has reason to believe is the most current
25 address for the taxpayer. (Rev. & Tax. Code, § 18416, subd. (c).) Respondent must exercise reasonable
26 care and due diligence in determining the correct address for mailing of a notice, and the relevant
27 inquiry is to respondent’s knowledge of the taxpayer’s last-known address, rather than what may in fact
28 be the taxpayer’s most current address. (*Reding v. Commissioner* (1990) 59 T.C. 793.) The purpose of

1 this rule is to protect the taxing agency and the statutory scheme of assessment and appeal from a failure
2 by the taxpayer to inform the taxing agency of a change in address. (*Delman v. Commissioner* (3rd Cir.
3 1967) 384 F.2d 929, 933.) The presumption in the last-known address rule in favor of respondent is not
4 absolute. A taxpayer may overcome the presumption by proving by a preponderance of the evidence
5 that respondent failed to send the required notices to the taxpayer's last-known address. (See Cal. Code
6 Regs., tit. 18, § 5080.)

7 STAFF COMMENTS

8 Appellants assert they filed timely returns and that respondent mishandled and lost these
9 returns. Respondent asserts it has no record of appellants filing 2006 or 2007 returns until the late
10 returns received in October of 2009 and February of 2010. These returns were signed by appellants and
11 dated early October of 2009. Appellants should provide any evidence of earlier returns being filed.⁸

12 The Sage Canyon Drive address respondent used on the Request, Demand, and NPAs
13 issued to Ms. Krinsky was the address used on appellants' 2005 through 2009 returns, and the apparent
14 current home and home office address of appellants. Appellants should address whether they resided at
15 this address during the tax years at issue and during February of 2008 and February of 2009 when the
16 Request and Demand were mailed to Ms. Krinsky.

17 From the information provided by respondent, it appears Mr. Schultz used the
18 N El Camino Real address as his business address with the California State Bar during the tax years at
19 issue and during the period when the Demands and NPAs were issued. Appellants should explain
20 whether they received mail at this address during 2006 and 2007, and when the Demands were issued in
21 March of 2008 and March of 2009. Appellants should state which address was their last-known address
22 when the Demands were issued. Respondent should explain how it determined that the mailing
23 addresses were the last known addresses for appellants.

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26 ⁸ Appeals Division staff notes that even if appellants can show they timely filed returns for 2006 and 2007, the demand
27 penalties may still be properly imposed if it is found that they were received or mailed to the last-known address. The
28 demand penalty is imposed when a taxpayer fails to respond to the Demand, regardless of whether he or she has timely filed
a return. The Demands indicate an appropriate response in such a situation is to inform respondent that returns have been
filed.

1 According to California regulation, respondent may only impose a demand penalty if a
2 taxpayer failed to respond to the current Demand, and respondent has previously issued an NPA after
3 the taxpayer failed to timely respond to a Request or Demand "...at any time during the four-taxable-
4 year period preceding the taxable year for which the current Demand for Tax Return is issued." (Cal.
5 Code Regs., tit. 18, § 19133, subd. (b).) Respondent states it also issued a Request to Mr. Schultz for the
6 2002 tax year and a Demand for the 2003 tax year, and when Mr. Schultz did not timely respond, NPAs
7 were issued.⁹ (Resp. Op. Br., p. 4.) Thus, respondent properly imposed the demand penalties for
8 Mr. Schultz in this appeal as prescribed by that regulation. Respondent issued a Request to Ms. Krinsky
9 for the 2006 year on February 6, 2008, followed by the NPA on April 14, 2008, and subsequently issued
10 the Demand for 2007 on February 24, 2009, and the NPA for 2007 with the demand penalty shortly
11 thereafter. Thus, the demand penalty imposed for Ms. Krinsky for the 2007 tax year also follows the
12 regulation. If appellants wish to challenge the penalties on this basis, they should be prepared to present
13 evidence and argument at the hearing to establish that the necessary conditions for imposition of the
14 penalties were not met.

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28 ⁹ After the close of briefing, respondent provided the 2002 Request, dated December 29, 2003; the 2003 Demand, dated
January 24, 2005; and the 2002 and 2003 NPA's dated March 8, 2004, and March 28, 2005, respectively. All four letters
were mailed to an address on 2nd Avenue in San Diego, California. These letters were mailed approximately three years
prior to the earliest notices mailed in this appeal.