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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 **CLOVUS M. SYKES¹**) Case No. 529645²

	<u>Year</u>	<u>Proposed</u> <u>Assessment³</u>
	2007	<u>Tax</u> <u>Penalties</u> \$3,170 \$1,585

17 Representing the Parties:

19 For Appellant: Clovus M. Sykes
20 For Franchise Tax Board: Susan M. Reyes, Specialist

22 ¹ In his appeal letter, appellant lists an address in Sacramento County, California.

23 ² This appeal was originally scheduled for the Board's November 17, 2010 oral hearing calendar. At appellant's request, this
24 appeal was postponed. This appeal is now scheduled for the Board's January 26-28, 2011 oral hearing calendar.

25 ³ On appeal, the Franchise Tax Board (FTB or respondent) has agreed to reduce the additional tax from \$3,319 to \$3,170. In
26 addition, the FTB has agreed to reduce the late filing penalty from \$829.75 to \$792.50 and the notice and demand (demand)
27 penalty from \$829.75 to \$792.50. Staff notes that the Notice of Action (NOA) shows a filing enforcement fee of \$119, but
28 the FTB's revised computations (i.e., exhibit G of the FTB's opening brief), does not list a filing enforcement fee. As
discussed below, on appeal, it is not clear whether the FTB has agreed to reduce the filing enforcement fee, given that the
FTB does not expressly state in its opening brief that it has agreed to reduce the filing enforcement fee. As indicated below,
once the filing enforcement fee is properly imposed, there is no language in the statute that would excuse the fee under any
circumstances, including for reasonable cause.

- 1 QUESTIONS: (1) Whether appellant has demonstrated error in the underlying tax assessment.
2 (2) Whether appellant has shown reasonable cause for the abatement of the late filing
3 penalty and/or the demand penalty.
4 (3) Whether the Board can grant relief from the filing enforcement fee.
5 (4) Whether the Board should impose a frivolous appeal penalty.⁴

6 HEARING SUMMARY

7 Background

8 Appellant has not filed a 2007 California income tax return. Through its Integrated Non-
9 Filer Compliance Program, the FTB discovered from the California Department of Insurance (CDI) that
10 in 2007 appellant was a licensed insurance provider who was approved by a number of insurance
11 companies.⁵ On March 9, 2009, the FTB issued a notice, demanding that appellant file a return or
12 explain why no return was required by April 8, 2009. When appellant neither filed a return nor
13 demonstrated why a return was not required by April 8, 2009, the FTB issued a Notice of Proposed
14 Assessment (NPA) on June 2, 2009.

15 Later, in July 2009, appellant responded to the FTB's demand by providing a cover letter
16 and the following documents: (i) an FTB Form 4600C (declaration of residency); (ii) substitute Form
17 1099s, showing zero income; and (iii) his personal affidavit. In his cover letter, appellant argued "[t]he
18 affirmations made within the affidavit supplant and rebut any *prima facie* evidence [the FTB] obtained
19 from third-party 'payers' and the Department of Insurance . . ." (emphasis provided in original.)

20 Next, in the following month, appellant timely protested the NPA, but he did not request
21

22 _____
23 ⁴ This is appellant's third appeal of this nature. In his first appeal (consolidated appeal for tax years 2001 and 2004, case nos.
24 492696 and 492702), the Board, on March 23, 2010, found against appellant and imposed frivolous appeal penalties of \$375
25 for 2001 and \$375 for 2004. In his second appeal (for 2006, case no. 512493), the Board, on July 13, 2010, found against
26 appellant and imposed a frivolous appeal penalty of \$750. According to the FTB, appellant has not filed a valid California
27 income tax return since the 1995 tax year.

28 ⁵ For 2007, the FTB originally estimated appellant's income to be \$63,824, based on the following: (i) in 2007, appellant was
a licensed insurance provider and the average income amount of other individuals in appellant's line of work – i.e., \$59,351,
and (ii) Forms 1099s and/or W-2s showing that in 2007 appellant received the following payments: (a) \$2,898 from CA
Public Employees' Retirement System; (b) \$1,125 from American Servicing Company; and (c) \$450 from Larry A Medeiros
Financial & Ins Svcs. However, on appeal, the FTB states that to avoid duplicating income it will now modify its estimate of
income to exclude the income of \$1,125 from American Servicing Company and \$450 from Larry A Medeiros Financial &
Ins Svcs. In short, the FTB has agreed on appeal to reduce appellant's estimated income from \$63,824 to \$62,249.

1 a protest hearing.

2 Subsequently, after considering appellant's arguments and the documents set forth above,
3 the FTB affirmed its assessment in a NOA issued on March 12, 2010. Appellant then filed this timely
4 appeal.

5 Contentions

6 Appellant

7 Appellant makes four arguments: First, appellant admits that he was "domiciled" in
8 California in 2007, but appellant argues that the FTB cannot tax him because he was not a "resident" of
9 California in 2007. In this respect, appellant argues that the FTB erroneously presumes that appellant
10 was a resident of California in 2007. Appellant stresses that because he was not a resident of California
11 in 2007, the FTB cannot tax him, regardless of how reasonable and rational the FTB's assessment might
12 otherwise appear.

13 Second, appellant asserts that the FTB "has provided no dispute of Appellant's
14 declaration of domicile." (Appellant's Reply Brief (ARB), p. 8.)

15 Third, appellant argues that the late filing penalty and the demand penalty were
16 improperly imposed because the FTB's authority is "limited to entities that are 'residents' and are, thus,
17 'taxpayers.'" (ARB, p. 6.) In this respect, appellant asserts that "[a]s a California domicile, Appellant is
18 precluded by the facts and circumstances from any categorization of 'taxpayer.'" (*Id.*)

19 Finally, appellant argues that a frivolous appeal penalty is not appropriate because his
20 actions are "supported by the guidance of law, regulation, court decisions, and FTB publications . . ."
21 (*Id.* at p. 8.)

22 The FTB

23 The FTB contends that appellant should not prevail here because appellant has failed to
24 meet his burden of proof in demonstrating any error in the FTB's proposed assessment. The FTB asserts
25 that its use of income information from various sources to estimate appellant's taxable income, when
26 appellant failed to file a valid return, is a reasonable and rational method of establishing taxable income.

27 Next, the FTB contends that the late filing penalty and the demand penalty were properly
28 imposed and appellant has not presented evidence of reasonable cause to support abatement of those

1 penalties. Finally, the FTB contends that appellant is maintaining a frivolous appeal and requests the
2 Board impose a frivolous appeal penalty.

3 The FTB's opening brief does not specifically address the law of residency or expressly
4 state whether the FTB is conceding the filing enforcement fee on appeal.

5 Applicable Law

6 Residency

7 California residents are taxed upon their entire net income (regardless of source), while
8 non-residents are only taxed on income from California sources. (Rev. & Tax. Code, §§ 17041, subds.
9 (a), (b), and (i); 17951.) Part-year residents are taxed on their income earned while residents of this
10 state, as well as all income derived from California sources. (Rev. & Tax. Code, §§ 17041, subds. (b) &
11 (i).)

12 A California resident includes (i) every individual who is in this state for other than a
13 temporary or transitory purpose, and (ii) every individual domiciled in this state who is outside this state
14 for a temporary or transitory purpose. (Rev. & Tax. Code, § 17014.) The California Court of Appeal
15 and the FTB's regulations define "domicile" as the location where a person has the most settled and
16 permanent connection, and the place to which a person intends to return when absent. (*Whittell v.*
17 *Franchise Tax Board* (1964) 231 Cal.App.2d 278, 284; Cal. Code Regs., tit. 18, § 17014, subd. (c).)
18 Once acquired, a domicile is presumed to continue until it is shown to have changed. (See Cal. Code
19 Regs., title 18, § 17014, subd. (c); *Murphy v. Travelers Ins. Co.* (1949) 92 Cal.App.2d 582, 587.) If an
20 individual is domiciled in California, then he or she remains a resident of California unless he or she is
21 outside California for other than temporary or transitory purposes. (See Cal. Code Regs., title 18,
22 § 17014, subd. (a).)

23 The key question under either facet of the "resident" definition is whether the individual
24 is present in California, or absent from California, for a temporary or transitory purpose. (*Appeal of*
25 *Stephen D. Bragg*, 2003-SBE-002, May 28, 2003.)⁶ This determination cannot be based on the
26 individual's subjective intent, but must instead be based on objective facts. (*Appeal Anthony V. and*
27

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

1 *Beverly Zupanovich*, 76-SBE-002, Jan. 6, 1976.) In situations where an individual has significant
2 contacts with more than one state, the state with which the individual maintains the closest connections
3 during the taxable year is the state of residence. (Cal. Code Regs., tit. 18, § 17014, subd. (b); *Appeal of*
4 *Raymond H. and Margaret R. Berner*, 2001-SBE-006-A, Aug. 1, 2002.) In the *Appeal of Stephen D.*
5 *Bragg, supra*, the Board compiled a non-exhaustive list of objective factors used to determine with
6 which state an individual maintains his closest connections. Those factors include:

- 7 • The location of all of the taxpayer's residential real property, and the approximate sizes and
8 values of each of the residences;
- 9 • The state wherein the taxpayer's spouse and children reside;
- 10 • The state wherein the taxpayer's children attend school;
- 11 • The state wherein the taxpayer claims the homeowner's property tax exemption on a
12 residence;
- 13 • The number of days the taxpayer spends in California versus the number of days the taxpayer
14 spends in other states, and the general purpose of such days (i.e., vacation, business, etc.);
- 15 • The location where the taxpayer files his tax returns, both federal and state, and the state of
16 residence claimed by the taxpayer on such returns;
- 17 • The location of the taxpayer's bank and savings accounts;
- 18 • The state wherein the taxpayer maintains memberships in social, religious, and professional
19 organizations;
- 20 • The state wherein the taxpayer registers his automobiles;
- 21 • The state wherein the taxpayer maintains a driver's license;
- 22 • The state wherein the taxpayer maintains voter registration, and the taxpayer's voting
23 participation history;
- 24 • The state wherein the taxpayer obtains professional services, such as doctors, dentists,
25 accountants, and attorneys;
- 26 • The state wherein the taxpayer is employed;
- 27 • The state wherein the taxpayer maintains or owns business interests;
- 28 • The indications in affidavits from various individuals discussing the taxpayer's residency;

- 1 • The taxpayer's telephone records (i.e., the origination point of taxpayer's telephone calls);
- 2 • The origination point of checking account transactions and credit card transactions;
- 3 • The state wherein the taxpayer holds a professional license or licenses; and
- 4 • The state wherein the taxpayer owns investment real property.

5 The FTB's determination of residency is presumptively correct. (*Appeals of John R.*
6 *Young*, 86-SBE-199, Nov. 19, 1986.) Unsupported assertions are not sufficient to satisfy appellant's
7 burden of proof. (*Appeal of Aaron and Eloise Magidow*, 82-SBE-274, Nov. 17, 1982.)

8 Proposed Assessment

9 R&TC section 19087, subdivision (a), provides:

10 If any taxpayer fails to file a return, or files a false or fraudulent return with intent to
11 evade the tax, for any taxable year, the Franchise Tax Board, at any time, may require a
12 return or an amended return under penalties of perjury or may make an estimate of the net
13 income, from any available information, and may propose to assess the amount of tax,
14 interest, and penalties due.

15 In *Palmer v. Internal Revenue Service* (9th Cir. 1997) 116 F.3d 1309, 1313, the court
16 stated that when a taxpayer fails to report any income, the FTB may reconstruct the taxpayer's income
17 based on statistics and the "evidentiary foundation necessary for the presumption of correctness to
18 attach is minimal."

19 If the FTB makes a tax assessment based on an estimate of income, the FTB's initial
20 burden is to show why its assessment is reasonable and rational. (*Todd v. McColgan* (1949) 89
21 Cal.App.2d 509; *Appeal of Michael E. Myers*, 2001-SBE-001, May 31, 2001.) Federal courts have held
22 that the taxing agency need only introduce some evidence linking the taxpayer with the unreported
23 income. (See *Rapp v. Commissioner* (9th Cir. 1985) 774 F.2d 932.) The FTB's use of income
24 information from various sources to estimate a taxpayer's taxable income, when a taxpayer fails to file a
25 valid return, is a reasonable and rational method of estimating taxable income. (See *Palmer v. Internal*
26 *Revenue Service, supra*; *Andrews v. Commissioner*, T.C. Memo 1998-316; *Giddio v. Commissioner*,
27 (1970) 54 T.C. 1530, 1533; *Appeals of Walter R. Bailey*, 92-SBE-001, Feb. 20, 1992; *Appeals of R. and*
28 *Sonja J. Tonsberg*, 85-SBE-034, Apr. 9, 1985.)

Once the FTB has met its initial burden, the assessment is presumed correct and appellant
has the burden of proving it to be wrong. (*Todd v. McColgan, supra*; *Appeal of Michael E. Myers*,

1 *supra.*) Unsupported assertions are not sufficient to satisfy appellant’s burden of proof. (*Appeal of*
2 *Aaron and Eloise Magidow, supra.*) In the absence of uncontradicted, credible, competent, and relevant
3 evidence showing error in the FTB’s determinations, they must be upheld. (*Appeal of Oscar D. and*
4 *Agatha E. Seltzer, 80-SBE-154, Nov. 18, 1980.*) A taxpayer’s failure to produce evidence that is within
5 his control gives rise to a presumption that such evidence is unfavorable to his case. (*Appeal of Don A.*
6 *Cookston, 83-SBE-048, Jan. 3, 1983.*)

7 Late Filing Penalty

8 California imposes a penalty for the failure to file a return on or before the due date,
9 unless it is shown that the failure is due to reasonable cause and not due to willful neglect. (Rev. & Tax.
10 Code, § 19131.) To establish reasonable cause, the taxpayer “must show that the failure to file timely
11 returns occurred despite the exercise of ordinary business care and prudence, or that cause existed as
12 would prompt an ordinary intelligent and prudent businessman to have so acted under similar
13 circumstances.” (*Appeal of Howard G. and Mary Tons, 79-SBE-027, Jan. 9, 1979.*)

14 Demand Penalty

15 California imposes a penalty for the failure to file a return or provide information upon
16 the FTB’s demand to do so, unless reasonable cause prevented the taxpayer from responding to the
17 request. (Rev. & Tax. Code, § 19133.) The burden is on the taxpayer to prove that reasonable cause
18 prevented him from responding to the demand. (*Appeal of Kerry and Cheryl James, 83-SBE-009,*
19 *Jan. 3, 1983.*) The FTB will only impose a demand penalty if the taxpayer fails to respond to a current
20 Demand for Tax Return and the FTB issued an NPA under the authority of R&TC section 19087,
21 subdivision (a), after the taxpayer failed to timely respond to a Request for Tax Return or a Demand for
22 Tax Return at any time during the four-taxable-years preceding the year for which the current Demand
23 for Tax Return is being issued. (Cal. Code Regs., tit. 18, § 19133, subd. (b).)

24 Filing Enforcement Fee

25 R&TC section 19254 authorizes imposition of a filing enforcement fee when the FTB
26 mailed notice to a taxpayer that the continued failure to file a return may result in imposition of the fee.
27 Once the fee is properly imposed, there is no language in the statute that would excuse the fee under any
28 circumstances, including for reasonable cause. (*See Appeal of Michael E. Myers, supra.*)

1 Frivolous Appeal Penalty

2 The Board may impose a penalty of up to \$5,000 whenever it appears to the Board that
3 proceedings before it have been instituted or maintained primarily for delay or that the position is
4 frivolous or groundless. (Rev. & Tax. Code, § 19714; Cal. Code Regs., tit., 18, § 5454.) The following
5 factors are considered in determining whether, and in what amount, to impose the penalty: (1) whether
6 appellant is making arguments that have been previously rejected by the Board in a Formal Opinion or
7 by courts, (2) whether appellant is repeating arguments that he or she made in prior appeals, (3) whether
8 appellant filed the appeal with the intent of delaying legitimate tax proceedings or the legitimate
9 collection of tax owed, and (4) whether appellant has a history of filing frivolous appeals or failing to
10 comply with California's tax laws. (Cal. Code Regs., title 18, § 5454.) The Board may consider other
11 relevant factors in addition to the factors listed above. (*Id.*)

12 STAFF COMMENTS

13 Residency

14 It appears undisputed that appellant lived and worked in California during 2007, and has
15 lived in Sacramento, California, for more than 12 years. Appellant raised similar arguments in his
16 appeal for the 2006 tax year, in which the Board sustained FTB and imposed a frivolous appeal penalty
17 of \$750.

18 Proposed Assessment

19 Here, other than the statements appellant makes in his substitute Form 1099s, his
20 declaration of residency, and his affidavit, appellant has not provided any evidence (such as a signed
21 2007 California tax return or a declaration from the California Public Employees' Retirement System,
22 etc.) showing that the income information the FTB used is incorrect or appellant had no filing
23 requirement for the 2007 tax year.

24 Late Filing Penalty and the Demand Penalty

25 It does not appear that appellant has as yet shown reasonable cause for relief from the late
26 filing penalty and/or the demand penalty. In relation to the demand penalty, staff notes that the FTB
27 apparently complied with the provisions of California Code of Regulations, title 18, section 19133,
28 subdivision (b), given that the FTB imposed a demand penalty for the 2006 tax year, which was upheld

1 by the Board in a hearing on July 13, 2010.

2 Filing Enforcement Fee

3 Staff notes that the NOA shows a filing enforcement fee of \$119, but the FTB's revised
4 computations (i.e., exhibit G of the FTB's opening brief) do not list a filing enforcement fee. As
5 discussed above, once the filing enforcement fee is properly imposed, there is no language in the statute
6 that would excuse the fee under any circumstances, including for reasonable cause. (See *Appeal of*
7 *Michael E. Myers, supra.*) At the oral hearing, FTB should be prepared to explain its revised
8 computations and clarify the status of the filing enforcement fee.

9 Frivolous Appeal Penalty

10 The parties should be prepared to discuss whether the Board should impose a frivolous
11 penalty and, if so, the amount of that penalty.

12 *Filing History:* As noted above in footnote three, this is appellant's third appeal of this
13 nature. In his first appeal (consolidated appeal for tax years 2001 and 2004, case nos. 492696 and
14 492702), the Board, on March 23, 2010, found against appellant and imposed frivolous appeal penalties
15 of \$375 for 2001 and \$375 for 2004. In his second appeal (for 2006, case no. 512493), the Board, on
16 July 13, 2010, found against appellant and imposed a frivolous appeal penalty of \$750. According to the
17 FTB, appellant has not filed a valid California income tax return since the 1995 tax year. Appellant was
18 notified that the Board may impose a frivolous appeal penalty in the NOA and in a letter from Board
19 staff dated April 16, 2010.

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