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BOARD OF EQUALIZATION
STATE OF CALIFORNIA

In the Matter of the Appeal of:) **HEARING SUMMARY**
) **PERSONAL INCOME TAX APPEAL**
WILLIAM BOWES¹) Case No. 559983

	<u>Year</u> 2008	<u>Proposed</u> <u>Assessment</u> \$1,600	<u>Penalties</u> <u>and Fee²</u> \$900
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Representing the Parties:

For Appellant: William Bowes
For Franchise Tax Board: Mary Yee, Tax Counsel

- QUESTIONS: (1) Whether appellant has demonstrated any error in the proposed assessment issued by respondent;
- (2) Whether appellant has established reasonable cause for the abatement of the late filing penalty;
- (3) Whether appellant has established reasonable cause for the abatement of the

¹ In his appeal, appellant listed an address in San Bernardino County.

² These amounts include the following: a \$400 late filing penalty, a \$400 notice and demand penalty, and a \$100 filing enforcement fee.

1 notice and demand penalty;

2 (4) Whether appellant has shown that the filing enforcement fee should be abated;
3 and

4 (5) Whether the Board should impose a frivolous appeal penalty under Revenue and
5 Taxation Code (R&TC) section 19714.

6 HEARING SUMMARY

7 Facts

8 Appellant did not file a 2008 California return by June 9, 2010. At that time, respondent
9 mailed appellant a “Demand for Tax Return” (Demand), requiring appellant to respond by July 14,
10 2010, either by filing a 2008 return or by explaining why a return was not required. (Resp. Op. Br., p. 2;
11 Ex. B.) Appellant did not file a return by July 14, 2010. (Resp. Op. Br., p. 2.)

12 As part of its automated Annual Integrated Non-Filer Compliance Program, respondent
13 receives information from professional and occupational licensing boards identifying the holders of
14 active professional and occupational licenses, who may have conducted business and earned sufficient
15 income during the tax year to prompt a return-filing requirement. For the appeal year, respondent
16 learned from the Contractor’s State License Board that appellant held a valid contractor’s license.
17 Respondent estimated business income of \$46,131 to appellant’s contractor’s license by using the
18 calculated average business income of contractors reporting their business activity under Standard
19 Industry Code 1521. Respondent calculated the average business income of contractors by using the
20 average of relevant business income amounts shown on the tax returns of contractors, which respondent
21 adjusted by the California Consumer Price Index percentage change for the year of the proposed
22 assessment. (Resp. Op. Br., pp. 1-2.)

23 Consequently, respondent issued a Notice of Proposed Assessment (NPA) based on a
24 total taxable income of \$42,439 and proposed tax of \$1,600. Respondent also imposed a late filing
25 penalty of \$400, a notice and demand penalty of \$400, and a filing enforcement fee of \$100. (Resp. Op.
26 Br., p. 2; Ex. C.) Appellant apparently protested the NPA, but the protest letter is not included in the
27 briefing. After reviewing the matter, respondent issued a Notice of Action (NOA) on December 9,

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1 2010, affirming the NPA. (App. Ltr., Ex. 1.)³

2 On February 3, 2011, the Board accepted the January correspondence received from
3 appellant as his appeal for the 2008 tax year. The Board also requested that each party address
4 appellant's filing history. According to federal records, appellant did not file a 2008 federal return.
5 (Resp. Op. Br., p. 2.)

6 This timely appeal followed.

7 Contentions

8 Appellant

9 In the appeal letter, appellant contends that California Personal Income Tax Laws do not
10 apply to him. (App. Ltr., p. 1.) Appellant asserts that he "constantly requested copies of documents
11 under Administrative law and the California records act from the FTB to state and identify where the
12 FTB has jurisdiction and more important the required personam jurisdiction over" him. (*Id.* at p. 3.)
13 Appellant contends that the inability of the Franchise Tax Board (FTB) to show where it has jurisdiction
14 over appellant is fatal and makes the NOA invalid as a matter of law, citing various cases, including
15 *Lowe v. Alexander*, 15 C 296, *People v. Board of S.F. Fire Department*, 14 C 479, *City Street Improv.*
16 *Co. v. Pearson*, 181 C 640, *O'Neill v. Department of Professional & Vocational Standards*, 7 CA2d
17 393, *McNutt v. G.M.*, 56 S.Ct. 789, *Griffins v. Matthews*, 310 Supp. 341, *Basso v. UPL*, 495 F.2d 906,
18 *Thomson v. Gaskiel*, 62 S.Ct. 673, and *Albrecht v. U.S.*, 273 U.S. 1. (*Id.* at p. 4.) Appellant contends
19 that R&TC section 17041 merely applies to residents of this state, but not to California residents as
20 defined in R&TC section 17018. (*Id.* at p. 5.) Appellant also contends that he does not reside in any
21 territorial area or insular protectorate of the United States as defined in R&TC section 17018. (*Id.* at
22 8-9.)

23 In appellant's reply brief, appellant maintains that he does not have a filing requirement
24 as a California resident under California Personal Income Tax Laws. (App. Reply Br., p. 3.) Appellant
25 maintains that respondent repeatedly refused to give him the requested documents that identify the term
26 "of this state" in section 17041 as meaning a California resident. (*Id.* at p. 4.) As such, appellant
27 maintains that respondent may have subject matter jurisdiction over taxation, but not the required
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³ The NOA refers to a protest of the NPA.

1 personam jurisdiction over appellant. (*Id.* at p. 7.) Appellant further disputes respondent's
2 characterization of his arguments as frivolous and contends that the *Appeal of Fred Dauberger et al.*,
3 82-SBE-082, Mar. 31, 1982, is not relevant to the present matter.

4 Respondent

5 Respondent asserts that appellant refused to file a required valid 2008 return. Respondent
6 further contends that appellant attempts to avoid his tax liability through the assertion of frivolous
7 arguments which the Board, the Internal Revenue Service (IRS), respondent, and the courts have
8 consistently and emphatically rejected. Respondent notes that the IRS published a list of identified
9 frivolous positions, including the arguments asserted by appellant, in IRS Notice 2008-14, IRS Notice
10 2010-33, and the IRS publication, "The Truth About Frivolous Tax Arguments," section I(C)(4),⁴ and
11 that respondent followed the IRS's response to these frivolous positions. Respondent further asserts that
12 it identified as a frivolous position any claim or assertion that the Information Practices Act applies,
13 directly or indirectly, to the requirement to make and file a valid tax return or to the determination of the
14 existence, or the possible existence, of liability (or the amount thereof) of any person subject to
15 California's income tax laws. Respondent also contends that appellant failed to provide any specific,
16 credible, or relevant information to show that respondent's proposed assessment is incorrect. (Resp. Op.
17 Br., pp. 2-3.)

18 Respondent contends that the FTB has the authority to administer and enforce the
19 California Personal Income Tax Law under R&TC section 19501. Respondent contends that pursuant to
20 R&TC section 18501, every individual subject to tax under the California Personal Income Tax Law and
21 realizing a specified amount of gross income or adjusted gross income must make a return which
22 specifically states the items of gross income received from all sources and the allowable deductions and
23 credits. Respondent further notes that R&TC section 17041 imposes a tax upon all residents of
24 California. As such, respondent contends that appellant is a taxpayer residing in California who
25 received California taxable income. Respondent notes that appellant held an active contractor's license
26 in 2008 and that appellant used a California address when corresponding with the Board and respondent.
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⁴ See <http://www.irs.gov/taxpros/article/0,,id=159853,00.html>.

1 Respondent further notes that appellant does not allege to be a resident of any other state or country and
2 that appellant has a California driver's license. Thus, respondent contends that there is no reason to
3 conclude that appellant was not a resident of California or that appellant was not personally subject to
4 California's personal income tax laws. (Resp. Op. Br., p. 4.)

5 With respect to the late filing penalty, respondent contends that the penalty was properly
6 imposed pursuant to R&TC section 19131 and that appellant failed to demonstrate reasonable cause to
7 abate the late filing penalty. Respondent also contends that the demand penalty was properly imposed
8 pursuant to R&TC 19133 and that appellant has not presented evidence of reasonable cause to support
9 abatement of the demand penalty. Respondent notes that it issued a Demand for Return to appellant for
10 the 2007 tax year and, when appellant failed to respond, respondent issued an NPA for that year.
11 Respondent further asserts that the filing enforcement fee was properly imposed and that there is no
12 reasonable cause exception to the fee. (Resp. Op. Br., p. 5.)

13 Finally, the FTB contends that appellant is maintaining a frivolous appeal and requests
14 this Board impose a frivolous appeal penalty. Respondent notes that appellant has not filed a valid
15 California income tax return for any tax year. In addition, respondent notes that it issued filing
16 enforcement NPAs against appellant for the 1994, 1995, 1996, 1997, 1998, 2000, 2002, 2005, and 2007
17 tax years, all of which are final. (Resp. Op. Br., pp. 5-6.)

18 Applicable Law

19 Proposed Assessment

20 R&TC section 17041 imposes a tax “. . . upon the entire taxable income of every resident
21 of this state”⁵ R&TC section 18501 requires every individual subject to the Personal Income Tax
22 to make and file a return with the FTB “stating specifically the items of the individual's gross income
23 from all sources and the deductions and credits allowable” R&TC section 19087, subdivision (a),
24 provides:

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

28 ⁵ It appears undisputed that appellant resided in California during the 2008 tax year.

1 interest, and penalties due.

2 If the FTB makes a tax assessment based on an estimate of income, the FTB's initial
3 burden is to show why its assessment is reasonable and rational. (*Todd v. McColgan* (1949) 89
4 Cal.App.2d 509; *Appeal of Michael E. Myers*, 2001-SBE-001, May 31, 2001.) Federal courts have held
5 that the taxing agency need only introduce some evidence linking the taxpayer with the unreported
6 income. (See *Rapp v. Commissioner* (9th Cir. 1985) 774 F.2d 932.) When a taxpayer fails to file a valid
7 return, respondent's use of income information from various sources to estimate a taxpayer's taxable
8 income is a reasonable and rational method of estimating taxable income. (See *Palmer v. Internal*
9 *Revenue Service*, (9th Cir. 1997) 116 F.3d 1309, 1313; *Andrews v. Commissioner*, T.C. Memo 1998-
10 316; *Giddio v. Commissioner*, (1970) 54 T.C. 1530, 1533; *Appeals of Walter R. Bailey*, 92-SBE-001,
11 Feb. 20, 1992; *Appeals of R. and Sonja J. Tonsberg*, 85-SBE-034, Apr. 9, 1985.)

12 Once the FTB has met its initial burden, the assessment is presumed correct and an
13 appellant has the burden of proving it to be wrong. (*Todd v. McColgan, supra; Appeal of Michael E.*
14 *Myers, supra.*) Unsupported assertions are not sufficient to satisfy an appellant's burden of proof.
15 (*Appeal of Aaron and Eloise Magidow*, 82-SBE-274, Nov. 17, 1982.) In the absence of uncontradicted,
16 credible, competent, and relevant evidence showing error in the FTB's determinations, respondent's
17 proposed assessments must be upheld. (*Appeal of Oscar D. and Agatha E. Seltzer*, 80-SBE-154,
18 Nov. 18, 1980.) A taxpayer's failure to produce evidence that is within his control gives rise to a
19 presumption that such evidence is unfavorable to his case. (*Appeal of Don A. Cookston*, 83-SBE-048,
20 Jan. 3, 1983.)

21 Constitutional/Due Process Issues

22 The Board is precluded from determining the constitutional validity of California statutes,
23 and has an established policy of declining to consider constitutional issues. (Cal. Const., art III, § 3.5;
24 *Appeal of Aimor Corp.*, 83-SBE-221, Oct. 26, 1983; *Appeals of Walter R. Bailey, supra.*) In *Bailey*,
25 *supra*, the Board stated:

26 [D]ue process is satisfied with respect to tax matters so long as an opportunity is given to
27 question the validity of a tax at some stage of the proceedings. It has long been held that
28 more summary proceedings are permitted in the field of taxation because taxes are the
lifeblood of government and their prompt collection is critical.

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1 Information Practices Act

2 R&TC section 19570 prohibits the application of the IPA to the determination of any
3 liability under the Personal Income Tax Law. Moreover, in the *Appeals of Fred R. Dauberger*,
4 82-SBE-082, decided March 31, 1982, this Board held that “the only power that this Board has is to
5 determine the correct amount of an appellants’ California personal income tax liability for the appeal
6 years.”

7 In *Bates v. Franchise Tax Board* (2004) 124 Cal. App.4th 367, the court discussed
8 whether alleged IPA violations could be used to defeat a proposed tax assessment. The *Bates* court held
9 that the R&TC provisions governing the estimation of income for persons who do not file tax returns,
10 and the related provisions for the assessment and collection of taxes, are not superseded by the IPA.
11 (See also *Appeals of Robert E. Wesley, et al.*, 2005-SBE-002, Nov. 15, 2005.)

12 Late Filing Penalty

13 R&TC section 19131 provides that a late filing penalty shall be imposed when a taxpayer
14 fails to file a tax return on or before its due date, unless the taxpayer establishes that the late filing was
15 due to reasonable cause and not due to willful neglect. When the FTB imposes a late filing penalty, the
16 law presumes that the penalty was imposed correctly. (*Todd v. McColgan, supra; Appeal of Yvonne M.*
17 *Goodwin, 97-SBE-003*, Mar. 19, 1997.) 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.) To establish reasonable cause, a taxpayer must show that the failure to file a return
20 occurred despite the exercise of ordinary business care. (*Appeal of Howard G. and Mary Tons*,
21 *79-SBE-027*, Jan. 9, 1979; *Appeal of Stephen C. Bieneman, 82-SBE-148*, July 26, 1982.) The
22 taxpayer’s reason for failing to file must be such that an ordinarily intelligent and prudent business
23 person would have acted similarly under the circumstances. (*Appeal of Joseph W. and Elsie M.*
24 *Cummings, 60-SBE-040.*)

25 Demand Penalty

26 California imposes a penalty for the failure to file a return or to provide information upon
27 the FTB’s demand to do so, unless reasonable cause prevented the taxpayer from responding to the
28 demand. (Rev. & Tax. Code, § 19133.) The FTB will only impose a demand penalty if the taxpayer

1 fails to respond to a current Demand for Tax Return and the FTB issues an NPA under the authority of
2 R&TC section 19087, subdivision (a), after the taxpayer failed to timely respond to a Request for Tax
3 Return or a Demand for Tax Return at any time during the four-taxable-years preceding the year for
4 which the current Demand for Tax Return is being issued. (Cal. Code Regs., tit. 18, § 19133, subd.
5 (b).)⁶ When the FTB imposes a demand penalty, the law presumes that the penalty was imposed
6 correctly. (*Todd v. McColgan, supra; Appeal of Yvonne M. Goodwin, supra.*) The burden is on the
7 taxpayer to prove that reasonable cause prevented him from responding to the demand. (*Appeal of*
8 *Kerry and Cheryl James, supra.*) To establish reasonable cause, a taxpayer must show that the failure to
9 respond to a demand occurred despite the exercise of ordinary business care. (*Appeal of Stephen C.*
10 *Bieneman, supra.*) The taxpayer's reason for failing to respond must be such that an ordinarily
11 intelligent and prudent business person would have acted similarly under the circumstances. (*Appeal of*
12 *Joseph W. and Elsie M. Cummings, supra.*)

13 Filing Enforcement Fee

14 R&TC section 19254 provides that if the FTB mails a formal legal demand for a tax
15 return to a taxpayer, a filing enforcement cost recovery fee is required to be imposed when the taxpayer
16 fails or refuses to file the return within the 25-day period. Once properly imposed, there is no provision
17 in the R&TC which would excuse the FTB from imposing the filing enforcement cost recovery fee for
18 any circumstances, including reasonable cause. (Rev. & Tax. Code, § 19254.)

19 Frivolous Appeal Penalty

20 The Board may impose a penalty of up to \$5,000 whenever it appears to the Board that
21 proceedings before it have been instituted or maintained primarily for delay or that the position is
22 frivolous or groundless. (Rev. & Tax. Code, § 19714; Cal. Code Regs., tit., 18, § 5454.) The
23 following factors are considered in determining whether, and in what amount, to impose the penalty:
24 (1) whether appellant is making arguments that have been previously rejected by the Board in a
25 Formal Opinion or by courts, (2) whether appellant is repeating arguments that he or she made in prior
26 appeals, (3) whether appellant filed the appeal with the intent of delaying legitimate tax proceedings or
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28 ⁶ Regulation 19133 became operative on December 23, 2004.

1 the legitimate collection of tax owed, and (4) whether appellant has a history of filing frivolous
2 appeals or failing to comply with California's tax laws. (Cal. Code Regs., title 18, § 5454.) The
3 Board may consider other relevant factors in addition to the factors listed above. (*Id.*) A taxpayer's
4 prior pattern and practice of conduct is relevant when determining whether to impose a frivolous
5 appeal penalty and in what amount. (*Appeal of Alfons Castillo*, 92-SBE-020, July 20, 1992.)

6 STAFF COMMENTS

7 At the hearing, appellant should be prepared to provide evidence that demonstrates
8 error in the FTB's determination and reasonable cause to abate the late filing and demand penalties.
9 Additionally, both parties should be prepared to discuss whether, and in what amount, a frivolous
10 appeal penalty should be imposed, as the Board has the authority under the R&TC to determine
11 whether, and in what amount, to impose such a penalty.

12 Staff notes that appellant's argument that he is not a resident of this state for purposes
13 of income tax has been consistently rejected by the IRS, the federal courts, respondent, and the Board,
14 over long periods of time. (See *Appeal of Michael E. Myers, supra.*) Appellant was notified that the
15 Board may impose a frivolous appeal penalty in the NOA and in a letter from Board staff dated
16 February 3, 2011. It appears to staff that this is appellant's first appeal of this nature. However, staff
17 also notes that respondent's records indicate that appellant has not filed a valid California income tax
18 return for any tax year and respondent issued filing enforcement NPAs against appellant for the 1994,
19 1995, 1996, 1997, 1998, 2000, 2002, 2005, and 2007 tax years, all of which are final. Based upon the
20 facts and circumstances present in this appeal, staff suggests that the Board may wish to consider a
21 frivolous appeal penalty of \$750. However, whether, and in what amount, to impose this penalty is
22 entirely in the Board's discretion under section 5454 of the Board's Rules for Tax Appeals.

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