

**REQUEST FOR PERMISSION
TO PROCEED WITH THE FORMAL REGULATORY PROCESS
TO ADOPT AMENDMENTS TO CALIFORNIA CODE OF REGULATIONS,
TITLE 18, SECTION 19133, RELATING TO PENALTY FOR FAILURE TO FILE
RETURN UPON NOTICE AND DEMAND**

Background

Pursuant to Revenue and Taxation Code (RTC) section 19133, if any taxpayer fails to file a tax return upon notice and demand by the Franchise Tax Board (FTB), the FTB may impose a penalty of 25 percent of the amount of tax. The corresponding regulation at California Code of Regulations, title 18, section 19133 (Regulation) provides a framework for the FTB to impose the notice and demand penalty (Demand Penalty) on individual taxpayers. Recently, a potential ambiguity was discovered in the Regulation language.

RTC section 19133 gives the FTB discretion in imposing the Demand Penalty. In order to uniformly exercise that discretion, in 2004, the FTB promulgated the Regulation to provide clarity and guidance on how the FTB will administer the Demand Penalty. Since 2004, the FTB consistently imposes the Demand Penalty on an individual taxpayer for a given taxable year if that taxpayer fails to file a tax return in response to a request or demand by FTB and receives a Notice of Proposed Assessment (NPA) for one of the four taxable years immediately preceding the given year. Subsection (b) of the Regulation provides the regulatory framework that controls the FTB's consistent application of the Regulation, as detailed in the examples at subsection (d) of the Regulation.

Purpose and Explanation of Proposed Amendments

A recent interpretation of the plain meaning of subsection (b) of the Regulation demonstrates an inconsistency with subsection (d). Subsection (d) reflects the FTB's original intent in promulgating the Regulation and the FTB's long-standing practice of imposing the Demand Penalty on an individual taxpayer to whom the FTB issued an NPA following that taxpayer's failure to file a return in response to a request or demand by FTB for one of the four taxable years immediately preceding the subject taxable year. Subsection (b) can be interpreted to apply to any taxable year as long as the NPA is issued in one of the four preceding taxable years.

The proposed amendments to the Regulation provide clarification by removing ambiguity in the Regulation. The proposed amendments do not alter how the FTB interprets and applies the Regulation.

Interested Parties Meeting

Staff held an interested parties meeting (IPM) on November 13, 2019, to discuss the proposed amendments to the Regulation. At that meeting, staff presented the proposed amendments to the Regulation with an explanation. During the IPM, staff did not receive any concerns or suggested changes to the proposed amendments to the Regulation.

Staff did not receive any comments or concerns about the proposed amendments to the Regulation by the expiration of the comment period.

Ancillary Changes

Following the IPM, staff reviewed the proposed amendments to the Regulation and determined two additional non-substantive changes were necessary to improve clarity with respect to the proposed amendments. The first change inserted the word "immediately" in subsection (b)(2), before the word "preceding." The second change removed the word "previous" and inserted the phrase "immediately preceding the 2001 taxable year" in subsection (d) at Example 2, before the phrase "the FTB issues a Demand for Tax Return for the 2001 taxable year."

Request for Permission

Staff believes the proposed amendments to the Regulation provide appropriate guidance for the exercise of FTB's discretion when imposing the Demand Penalty on an individual taxpayer, as provided for in RTC section 19133.

Staff now requests permission to commence with the formal regulatory process under the Administrative Procedure Act.

FRANCHISE TAX BOARD

CALIFORNIA CODE OF REGULATIONS TITLE 18, DIVISION 3, CHAPTER 2.6, SUBCHAPTER 4, ARTICLE 7, SECTION 19133, REGARDING PENALTY FOR FAILURE TO FILE UPON RETURN AND DEMAND

Section 19133 is amended to read:

(a) In general. Revenue and Taxation Code section 19133 provides that if any taxpayer fails or refuses to file a return upon notice and demand by the Franchise Tax Board (FTB), unless the failure is due to reasonable cause and not willful neglect, the FTB may add a penalty of 25 percent of the amount of tax assessed pursuant to Revenue and Taxation Code section 19087 or of any deficiency tax assessed by the FTB concerning the assessment for which the return was required.

(b) Imposition of Penalty. For individuals subject to tax under Part 10 (Personal Income Tax Law), the notice and demand penalty under Revenue and Taxation Code section 19133 will only be imposed by the FTB if:

(1) the taxpayer fails to timely respond to a current Demand for Tax Return in the manner prescribed, and

(2) the FTB has proposed an assessment of tax under the authority of Revenue and Taxation Code section 19087, subdivision (a), after the taxpayer failed to timely respond to a Request for Tax Return or a Demand for Tax Return in the manner prescribed, ~~at any time during~~ for any taxable year that is within the four-taxable-year period immediately preceding the taxable year for which the current Demand for Tax Return is issued.

(c) Definitions. For purposes of this regulation, the following definitions shall apply:

(1) Demand for Tax Return. A "Demand for Tax Return" means a written notice and demand for a return from the FTB, which advises the taxpayer that failure to respond in the manner provided and within the time prescribed will make the taxpayer liable for a penalty under Revenue and Taxation Code section 19133 for failure to file upon notice and demand.

(2) Request for Tax Return. A "Request for Tax Return" means a written notice and request for a return from the FTB, which does not advise the taxpayer that failure to respond in the manner provided and within the time prescribed and will make the taxpayer liable for a penalty under Revenue and Taxation Code section 19133 for failure to file upon notice and demand.

(3) Timely Response. A "timely response" shall mean a response within the time period specified in the Demand for Tax Return or Request for Tax Return.

(d) Examples. The following examples are intended to illustrate the provisions of this regulation:

Example 1. Assume Taxpayer X has not filed a California personal income tax return for the 1999 taxable year. This is the first time that X has not filed a timely California personal income tax return. As a result of X's non-filing, the FTB mails a Request for Tax Return to X on January 15, 2001. When X does not timely respond to the Request for Tax Return, the FTB issues a Notice of Proposed Assessment (NPA) on March 20, 2001, assessing tax, a late filing penalty, and interest, but the NPA does not include a notice and demand penalty under Revenue and Taxation Code section 19133.

Example 2. Assume the same facts as in Example 1, and X does not file a California personal income tax return for the 2001 taxable year. Because X received an NPA for not filing a return for 1999, within one of the previous four taxable years immediately preceding the 2001 taxable year, the FTB issues a Demand for Tax Return for the 2001 taxable year. If X fails to timely respond to the Demand for Tax Return, the FTB will issue an NPA that includes tax, a late filing penalty, interest, and a notice and demand penalty under Revenue and Taxation Code section 19133.

(e) Applicability Date. The amendments to subsections (b) and (d) of this regulation are applicable for notice and demand penalties imposed on a proposed assessment of tax under the authority of Revenue and Taxation Code section 19087, on or after January 1, 2020.

Note: Authority cited: Section 19503, Revenue and Taxation Code.
Reference: Section 19133, Revenue and Taxation Code.