

Note: This handout is intended only for purposes of facilitating discussion at the Interested Parties Meeting scheduled for November 13, 2019.

Explanation of Discussion Draft for Proposed Amendments to California Code of Regulations, Title 18, Section 19133

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, FTB staff reviewed the Regulation language and discovered a potential ambiguity, as explained in the following discussion.

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 individual taxpayers 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 preceding the subject taxable 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.

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 individual taxpayers to whom the FTB issued an NPA following a taxpayer's failure to file a return in response to a request or demand by FTB for one of the four taxable years 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 ensuring all subsections of the regulation are consistent. The proposed amendments do not alter how the FTB interprets and applies the regulation.

The explanations for the proposed amendments to the Regulation are set forth below:

(b)(2) This subsection is proposed to be amended by replacing the words "at any time during" with the words "for any taxable year that is within." This proposed amendment ensures that the demand penalty is imposed when a taxpayer fails to respond to a Request for Tax Return or Demand for Tax Return for one of the four-taxable-year periods preceding the subject taxable year. Without this proposed amendment, it may not be clear to taxpayers which previous taxable years can trigger the Demand Penalty.

(d) This subsection is proposed to be amended by making it clear in Example 2 that the FTB issues a Demand for Tax Return because the taxpayer received an NPA for not filing a tax return for the 1999 taxable year, one of the four previous taxable years. The proposed amendment to Example 2 is necessary to make it clear which taxable year triggered the Demand for Tax Return.

(e) This subsection is proposed to be added to provide that the amendments to subsections (b) and (d) of the Regulation are applicable to demand penalties issued on NPAs on and after January 1, 2020.