OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **MARJORIE L. MCCAMEY**	OTA Case No. 18011069 Date Issued: June 21, 2018

OPINION

Representing the Parties:

For Appellant: Maya L. Munro

For Respondent: Ann Mazur, Specialist

For Office of Tax Appeals: William Stafford, Tax Counsel III

G. THOMPSON, Administrative Law Judge: Pursuant to Revenue and Taxation Code[1] section 19045, Marjorie L. McCamey (appellant) appeals from actions by the Franchise Tax Board (FTB or respondent) proposing $1,078.65 in additional tax, an accuracy-related penalty of $215.73, and a late-filing penalty of $196.91, plus applicable interest, for the 2008 tax year; $575.00 in additional tax and an accuracy-related penalty of $115.00, plus applicable interest, for the 2010 tax year; and $2,138 in additional tax, plus applicable interest, for the 2011 tax year.[2]

Appellant did not request an oral hearing or respond to correspondence asking whether she wished to request one. Therefore, the matter is being decided based on the written record.

ISSUE

Is appellant liable for the proposed assessments, which were based on federal assessments?

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[1] Unless otherwise indicated, all statutory references are to sections of the Revenue and Taxation Code.

[2] Pursuant to Assembly Bill 102, the Taxpayer Transparency and Fairness Act of 2017, the duty of processing administrative appeals from actions of FTB was transferred from the California State Board of Equalization (BOE) to the newly created Office of Tax Appeals.

FACTUAL FINDINGS

1. Appellant filed her 2008 and 2010 California tax returns late (on April 15, 2011, and January 11, 2012, respectively). Appellant timely filed her 2011 California tax return.
2. Appellant's 2008, 2010, and 2011 California returns reflected the deductions reported on her federal tax returns, to the extent applicable under California law.
3. On her 2008 federal return, appellant reported adjusted gross income of $57,677. After taking into account deductions, adjustments and exemptions, she reported taxable income of $28,604, and tax of $3,721.
4. On her 2010 federal return, appellant reported adjusted gross income of $48,638. After taking into account deductions, adjustments and exemptions, she reported taxable income of $23,582, and tax of $2,939.
5. On her 2011 federal return, appellant reported adjusted gross income of $119,244. After taking into account deductions, adjustments and exemptions, she reported taxable income of $82,991, and tax of $17,749.
6. During 2013 and 2014, the Internal Revenue Service (IRS) reported to FTB that it had audited appellant's 2008, 2010, and 2011 tax returns. The audits increased appellant's taxable income by $25,636 for 2008, $9,175 for 2010, and $22,998 for 2011. The audits resulted in additional federal income tax of $10,240[3] for 2008, $1,380 for 2010, and $6,665 for 2011.
7. As relevant here:
    a. For 2008, the federal audit added $48 of unreported interest income and disallowed Schedule C depreciation and Internal Revenue Code (IRC) section 179[4] expense totaling $6,862, Schedule C travel expenses of $7,262, a medical and dental deduction of $6,809 (rounded), and miscellaneous deductions of $296.[5]

[3] The federal account transcript shows additional tax assessed of $10,240. After the IRS adjusted credits, the balance due for federal purposes was $10,600. These federal credit adjustments are not at issue.

[4] Where it applies, IRC section 179 allows costs incurred to purchase business equipment to be deducted in the year the property is placed in use, rather than depreciated over time. With various modifications, California conforms to IRC section 179. (§§17201, 17255.)

[5] For each year on appeal, the IRS adjustments increased appellant's Schedule C income, and, as result, also increased the amount of self-employment tax due and her deduction for self-employment tax.

b. For 2010, the IRS disallowed deductions for Schedule C depreciation and IRC section 179 expense totaling $1,506, Schedule C travel expenses of $2,547, Schedule C car and truck expenses of $4,501, and a $622 (rounded) deduction for medical expenses.

c. For 2011, the IRS disallowed Schedule C depreciation and IRC section 179 expense totaling $1,922, Schedule C travel expenses of $11,601, Schedule C car and truck expenses of $8,160, and a medical expense deduction of $1,605.

d. The IRS also imposed accuracy-related penalties for each year. The IRS information does not state whether the federal accuracy-related penalties were imposed based on negligence, or based on the existence of a substantial understatement.[6] However, for 2010, it appears that the IRS imposed the penalty based on negligence, as the understatement was not substantial in amount. The federal adjustments for 2008 and 2011 resulted in substantial understatements, but the IRS information does not show whether the accuracy-related penalty for these years was based on negligence, or the existence of substantial understatements of federal tax.

8. Appellant did not notify FTB of the federal adjustments.

9. During 2014, FTB issued Notices of Proposed Assessments (NPAs) reflecting the federal adjustments to tax, to the extent that California and federal law were the same regarding the adjustments. The NPAs proposed additional California income tax of $1,078.65 for 2008, $575 for 2010, and $2,138 for 2011.[7]

10. The NPA for 2008 imposed a late-filing penalty in the amount of $196.91.[8] Although appellant's 2010 California tax return was filed late, FTB did not impose a late-filing

[6] As relevant here, under IRC section 6662, the accuracy-related penalty may be imposed for negligence or for a substantial understatement. For individual taxpayers, an understatement is substantial if it exceeds the greater of 10 percent of the tax required to be shown on the return, or $5,000. California generally conforms to IRC section 6662 pursuant to Section 19164.

[7] The NPA for 2010 lists a disallowed Schedule C expense amount of $4,053. This amount is the total of disallowed depreciation and IRC section 179 expense of $1,506, and disallowed Schedule C travel expenses of $2,547.

[8] As appellant has not contested the late-filing penalty, and it appears it was properly imposed, we do not address it further.

penalty. Appellant's 2011 California tax return was timely filed, so no late-filing penalty was imposed.

11. None of the NPAs reflect substantial understatements of California income tax for purposes of the accuracy-related penalty.[9]

12. The NPAs proposed accuracy-related penalties for 2008 and 2010, based on the federal imposition of accuracy-related penalties for those years, but did not impose an accuracy-related penalty for 2011.[10]

13. Appellant timely protested the NPAs, arguing that the IRS was reconsidering the federal adjustments. Subsequently, when FTB did not receive any further information, it issued Notices of Action that affirmed the NPAs. This timely appeal followed.

14. Starting on November 3, 2015, the appeal was deferred numerous times in order to allow appellant time to seek IRS reconsideration of its adjustments. On October 13, 2016, appellant was notified that the deferral would end on April 11, 2017, unless appellant or FTB provided documents showing that a protest was pending with the IRS. Appellant did not respond, and no documentation of a pending proceeding with the IRS was provided. As a result, the appeal was reactivated on April 21, 2017.

15. On July 19, 2017, FTB filed its brief and provided federal account transcripts. The transcripts do not show any change to the federal adjustments, and do not indicate that the IRS is reconsidering its adjustments.[11]

DISCUSSION

When the IRS makes final changes or corrections to a taxpayer's return, the taxpayer must either concede the accuracy of the federal determination or prove that the federal adjustments are erroneous. (Section 18622(a).) An FTB deficiency assessment that is based on a federal audit report is presumed to be correct. (*Appeal of Aaron and Eloise Magidow*, 82-SBE-

[9] As noted above, for individual taxpayers an understatement is substantial if it exceeds the greater of $5,000 or 10 percent of the tax required to be shown on the return.

[10] FTB asserts that it did not impose the accuracy-related penalty for 2011 due to an oversight. However, the record does not show whether the penalty was not imposed due to an oversight by FTB, or because there was no finding of negligence reflected in the federal assessment for 2011.

[11] The transcripts show that, for a time, appellant participated in an installment payment plan with the IRS.

274, Nov. 17, 1982.)[12]

While appellant has argued generally that the federal adjustments were incorrect, she has provided no specific arguments or evidence to support this assertion. Also, appellant has not provided any argument or evidence to show that FTB's proposed assessment of additional tax is incorrect. While appellant has stated that she is seeking to have the IRS reconsider its assessments, there is no indication that the IRS is reviewing any of its determinations, and it appears the IRS adjustments have become final. Accordingly, we have no basis to reverse FTB's imposition of additional tax based on the federal determinations.

With regard to the accuracy-related penalties, Section 19164 generally incorporates the provisions of IRC section 6662 and imposes an accuracy-related penalty of 20 percent of the applicable underpayment. As relevant here, the penalty applies to any portion of an underpayment attributable to negligence or disregard of rules and regulations, or any substantial understatement of income tax. (IRC, § 6662(b)(1) & (2).)

The accuracy-related penalty may be reduced or abated in some circumstances. It will be reduced by the portion of the understatement attributable to a tax treatment of any item if there is or was substantial authority for such treatment. (IRC, § 6662(d)(2)(B)(i).) The penalty also will be reduced by the portion of the understatement attributable to a tax treatment of any item if the relevant facts affecting the item's tax treatment were adequately disclosed in the return and there is or was a reasonable basis for the tax treatment of such item. (IRC, § 6662(d)(2)(B)(ii).) Also, the penalty will not be imposed to the extent that the taxpayer can show the underpayment was due to reasonable cause and that he or she acted in good faith. (IRC, § 6664(c)(1); Treas. Regs. §§ 1.6664-1(b)(2) & 1.6664-4.)

Here, neither of appellant's understatements of California income tax for 2008 and 2010 constitute a substantial understatement of California income tax, because each understatement of tax is less than $5,000. Accordingly, the accuracy-related penalty is only applicable for

[12] Pursuant to the Office of Tax Appeals Rules for Tax Appeals, California Code of Regulations, tit. 18, § 30501(d)(3), precedential opinions of the BOE that were adopted prior to January 1, 2018, may be cited as precedential authority to the Office of Tax Appeals unless a panel removes, in whole or in part, the precedential status of the opinion. BOE's precedential opinions are available for viewing on the BOE's website: http://www.boe.ca.gov/legal/legalopcont.htm.

California purposes if it can be imposed on the basis of negligence.[13]

For 2010, it appears FTB reasonably determined that the federal imposition was based on negligence because the federal understatement was not large enough to have been a substantial understatement. Accordingly, on the basis of the federal determination for 2010, FTB properly determined that the penalty also applied for California purposes on the basis of negligence. As appellant has not provided any evidence or argument to rebut this determination, we sustain FTB's imposition of the accuracy-related penalty for 2010.

Unlike the understatement of federal income tax for 2010 (which was not substantial in amount), the understatement of federal income tax for 2008 was a substantial understatement, so the IRS may well have imposed the penalty on this basis. However, imposing the penalty for 2008 based on negligence would have required the IRS to make an additional finding of negligence. There is no evidence in the record to show that the IRS made this additional finding, and it is not clear why the IRS would have sought to make this additional finding when the penalty would apply based on the substantial understatement regardless of any such additional finding. In the absence of any evidence that the IRS imposed the penalty for 2008 based on negligence, it seems more likely that the IRS imposed the penalty for 2008 based on the substantial understatement than that the IRS made an additional finding of negligence that was not needed to sustain its proposed penalty.

On appeal, FTB states that it presumes the IRS imposed the accuracy-related penalty for 2010 based on negligence because the federal adjustments for each tax year were comparable. FTB then infers from its presumption of negligence in 2010 that the IRS also imposed the penalty based on negligence in the 2008 and 2011 tax years.

On this record, we do not find FTB's argument persuasive. FTB's argument is undermined by the fact that its actions are inconsistent with its legal theory on appeal, as it did not impose the negligence penalty for 2011 even though the penalty would be applicable in that year under FTB's theory on appeal. Moreover, while the categories of disallowed deductions in each year were similar, each tax year generally must be examined individually and considered on its own merits. (See *Appeal of Duane H. Laude*, 76-SBE-096, Oct. 6, 1976; see also *Appeal of*

[13] While the accuracy-related penalty may be imposed on various bases, such as an overstatement of pension liabilities, the only basis for the accuracy-related penalty that appears potentially relevant here is negligence.

Helen Cantor, et al., 2002-SBE-096, Nov. 13, 2002, fn. 4.) For the foregoing reasons, we reverse FTB's imposition of the negligence penalty for 2008.

We note that appellant entered a payment program with the IRS. Following this appeal, if appellant wishes to learn about payment programs offered by FTB, she may wish to contact FTB.[14]

HOLDING

For 2010 and 2011, appellant is liable for the proposed assessments (including the accuracy-related penalty imposed for 2010), which were based on federal assessments. For 2008, appellant is liable for the proposed assessment of additional tax, which was based on federal adjustments, and for the late-filing penalty. However, appellant is not liable for the accuracy-related penalty for 2008, because the record does not show an IRS or FTB finding of negligence for 2008 or other basis for imposition of the penalty for the 2008 year.

DISPOSITION

FTB's actions for 2010 and 2011 are sustained. For 2008, its action is modified to remove the accuracy-related penalty and otherwise sustained.

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Grant S. Thompson
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Grant S. Thompson
Administrative Law Judge

We concur:

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Tommy Leung
Administrative Law Judge

DocuSigned by:
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Teresa A. Stanley
Administrative Law Judge

[14] FTB will only consider such matters once this appeal becomes final. For more information about FTB's payment plans, see https://www.ftb.ca.gov/online/eia/index.asp?WT.mc_id=Ind_Pay_eIA or call FTB at (800) 689-4776.