

**OFFICE OF TAX APPEALS
STATE OF CALIFORNIA**

In the Matter of the Appeal of:) OTA Case No. 18011441
)
DENISE STENSON) Date Issued: June 13, 2018
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)
_____)

OPINION

Representing the Parties:

For Appellant: Andrew Forgy, Tax Appeals Assistance Program

For Respondent: Mira Patel, Tax Counsel

For Office of Tax Appeals: Sheriene Anne Ridenour, Tax Counsel III

HOSEY, Administrative Law Judge: Pursuant to California Revenue and Taxation Code section 19324,¹ Denise Stenson (appellant) appeals an action by the Franchise Tax Board (FTB or respondent) in proposing \$769 in additional tax² and a \$190.75 late-filing penalty, plus interest, for the 2011 tax year.

Appellant waived her right to an oral hearing and therefore the matter is being decided based on the written record.³

ISSUES

1. Has appellant demonstrated error in FTB’s assessment of an early distribution tax for 2011?

¹ Unless otherwise indicated, all section references are to sections of the California Revenue and Taxation Code.

² The entirety of the additional tax is an early distribution tax of \$769.

³Appellant had requested an oral hearing, which the Office of Tax Appeals (OTA) properly noticed for March 28, 2018, and to which appellant responded affirmatively. However, appellant failed to appear at the noticed time and place. As a result of appellant’s nonappearance, the OTA is deciding this matter based on the written record.

2. Is appellant liable for the late-filing penalty?

FACTUAL FINDINGS

1. On March 1, 2013, appellant filed an untimely 2011 California income tax return.
2. Subsequently, FTB received information from the Internal Revenue Service (IRS) indicating that appellant received an early distribution from a qualified retirement plan, which was subject to the 10 percent early distribution tax on her federal return.
3. Appellant's 2011 federal Wage and Income Transcript indicates that Thrift Savings Plan issued appellant a Form 1099-R ("Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.") showing that appellant received a \$30,767 early distribution from a qualified retirement plan. The transcript also indicated that no known exception to the early distribution tax was applicable to the distribution.
4. Upon a review of appellant's California tax return, FTB determined that appellant failed to report the corresponding 2.5 percent early distribution tax on her California return.
5. FTB issued appellant a Notice of Proposed Assessment (NPA), which proposed to assess the 2.5 percent tax on appellant's early distribution. The NPA calculated the additional tax as \$769 (i.e., \$30,768 x 2.5%). The NPA also proposed a late-filing penalty of \$190.75, plus applicable interest.
6. Appellant timely protested the NPA, contending that she is disabled, on social security, and unable to pay the outstanding liability. Appellant also contended that she was writing to avoid involuntary collection action and requested additional information on how to proceed and what forms she needed to complete.
7. Upon reviewing the information, FTB issued a Notice of Action (NOA), which affirmed the NPA. The NOA explained that, while appellant reported an early distribution from a qualified retirement plan on her federal return and paid the required 10 percent additional federal tax, appellant did not report the required 2.5 percent premature distribution tax on her state return.
8. Appellant filed this timely appeal.
9. FTB agreed to abate interest of \$44.90 for the 2011 tax year, for interest that accrued from February 23, 2015 (the date appellant filed her protest letter) to July 18, 2016 (the date FTB filed its opening brief).

DISCUSSION

Issue 1 - Has appellant demonstrated error in FTB's assessment of an early distribution tax for 2011?

Internal Revenue Code (IRC) § 72 governs the taxation of distributions from qualified retirement plans. IRC § 72(t)(1) imposes an additional tax (sometimes referred to as a penalty) of 10 percent of the amount of the distribution unless the distribution falls within an exception. There are exceptions to the tax for early distributions under certain circumstances, for example, where the employee is age 59-and-a-half on or after the date the distribution is made or the employee is totally disabled. (IRC § 72(t)(2)(A)(i) and (iii).) Section 17085 conforms to, but modifies, IRC § 72, by reducing the rate of tax imposed on an early distribution from 10 percent to 2.5 percent.

As relevant to this appeal, under IRC § 72(t)(2)(A)(iii), the early distribution tax will not apply when the distribution is attributable the recipient being disabled within the meaning of IRC § 72(m)(7). IRC § 72(m)(7) defines disabled as follows:

[A]n individual shall be considered to be disabled if he is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration. An individual shall not be considered to be disabled unless he furnishes proof of the existence thereof in such form and manner as the secretary may require.

Treasury Regulation § 1.72-17A(f)(2) describes the types of impairments that ordinarily will be considered as preventing substantial gainful activity. In addition, it states:

The existence of one or more of the impairments described in this subparagraph (or of an impairment of greater severity) will not, however, in and of itself always permit a finding that an individual is disabled as defined in [IRC §] 72(m)(7). Any impairment, whether of lesser or greater severity, must be evaluated in terms of whether it does in fact prevent the individual from engaging in his customary or any comparable substantial gainful activity.

The regulations emphasize that the “substantial gainful activity” to which IRC § 72(m)(7) refers is the activity, or a comparable activity, in which the individual customarily engaged prior to the disability. (Treas. Reg. § 1.72-17A(f)(1).)

Respondent's determination is presumed correct and the taxpayer has the burden of proving the determination to be wrong. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Michael E. Myers*, 2001-SBE-001, May 31, 2001.)⁴ Unsupported assertions are not sufficient to satisfy an appellant's burden of proof. (*Appeal of Aaron and Eloise Magidow*, 82-SBE-274, Nov. 17, 1982.)

Appellant received a distribution from a qualified retirement plan in 2011. Appellant's Form 1099-R information from Thrift Savings Plan indicated that the early distribution was made with no known exception to the early distribution tax. Based on appellant's 2011 federal Account Transcript, it appears that appellant reported and paid the federal early distribution tax on her federal return. However, appellant did not report the corresponding 2.5 percent early distribution tax on her 2011 California return.

Appellant contends that she is disabled within the meaning of IRC § 72(m)(7) and, therefore, the early distribution tax does not apply. Appellant asserts that, prior to the early distribution, she was laid off from employment, was suffering numerous chronic and serious medical conditions, and that she used the early distribution funds to pay for medical and living expenses until she became eligible to receive Supplemental Security Income (SSI) payments.

In support of her contentions, appellant submitted: (1) a letter to appellant dated August 30, 2013, from the Social Security Administration (SSA) notifying appellant that SSA determined that appellant's disability for SSA purposes commenced in May 2013 (five months before she became entitled to receive disability payments in October of 2013); (2) a printout from a pharmacy listing medication prescribed to appellant during the period from January 1, 2015 to July 6, 2016; (3) a copy of appellant's Medicare card, effective October 1, 2015; and (4) a declaration, dated November 7, 2016, signed by Pamela G. Wesley under penalty of perjury. Ms. Wesley declares that she is a former colleague of appellant who has known her for approximately 30 years and, due to taking appellant to numerous doctor appointments over the years, can attest that appellant's medical conditions included hypertension, heart problems, kidney disease, stomach problems, and migraine headaches.

⁴ Published precedential decisions of the State Board of Equalization (BOE), designated by "SBE," may be found on the BOE's website: <http://www.boe.ca.gov/legal/legalopcont.htm#boeopinion>. The Office of Tax Appeals (OTA) is the successor-in-interest to the BOE with regard to income tax appeals. Therefore, precedential BOE opinions that were adopted prior to January 1, 2018, are precedential authority before the OTA. (Cal. Code Regs., tit. 18, § 30501(d)(3).)

We have reviewed the documentation and information provided and find that appellant has not met her burden of demonstrating that she was disabled within the meaning of IRC § 72(m)(7) for the 2011 tax year. The declaration appellant provided concerning her medical condition was from her friend and former colleague, not from a medical professional. The Medicare card and the prescribed medication list appellant provided pertain to 2015 and 2016, several years after the tax year at issue. Finally, the August 30, 2013, letter from SSA indicates that SSA determined appellant to have become disabled in May of 2013, which is two years after the tax year at issue. Therefore, none of appellant's documents support her claim that she was disabled within the meaning of IRC § 72(m)(7) during the 2011 tax year.

Accordingly, we conclude that appellant has failed to establish error in FTB's assessment of an early distribution tax for 2011.

Issue 2 - Is appellant liable for the late-filing penalty?

Taxpayers have until April 15th of the year following the tax year to timely file their personal income tax return. (§ 18566.) If taxpayers file by October 15th, they receive an automatic extension and their return will be treated as having been timely filed. (Cal. Code Regs., tit. 18, § 18567(a).) However, "[i]f the return is not filed within six months of the original due date, no extension is allowed." (*Ibid.*) Appellant's 2011 return was due on April 17, 2012.⁵ Appellant filed her 2011 return on March 1, 2013, nearly one year late.

Section 19131 provides that a late-filing penalty shall be imposed when a taxpayer fails to file a tax return on or before its due date, unless the taxpayer establishes that the late filing was due to reasonable cause and was not due to willful neglect. To establish reasonable cause, a taxpayer "must show that the failure to file timely returns occurred despite the exercise of ordinary business care and prudence, or that cause existed as would prompt an ordinary intelligent and prudent businessman to have so acted under similar circumstances." (*Appeal of Howard G. and Mary Tons*, 79-SBE-027, Jan. 9, 1979.)

In determining whether reasonable cause exists, a taxpayer must demonstrate a relationship between the alleged hardship and the failure to timely file. (*Appeal of Michael J. and Diane M. Halaburka*, 85-SBE-025, Apr. 9, 1985; *Appeal of Allen L. and Jacqueline M. Seaman*, 75-SBE-080, Dec. 16, 1975.) Generally, financial difficulties do not constitute

⁵ See: <https://www.irs.gov/newsroom/irs-kicks-off-2012-tax-season-with-deadline-extended-to-april-17>

reasonable cause for failing to file a timely tax return. (*Barber v. Commissioner*, T.C. Memo. 1997-206.)

To show reasonable cause by reason of illness, the taxpayer must present credible and competent proof that the circumstances of the illness prevented either the preparation or the signing of a timely return. (*Appeal of Allen L. and Jacqueline M. Seaman, supra.*) “The type of illness or debilitation that might create reasonable cause is one that because of severity or timing makes it virtually impossible for the taxpayer to comply - things like emergency hospitalization or other incapacity occurring around tax time.” (*Carlson v. United States* (7th Cir. 1997) 126 F.3d 915.) Illness or other personal difficulties do not constitute reasonable cause when the difficulties simply caused the taxpayer to sacrifice the timeliness of one matter so that other matters could be pursued. (*Appeal of Michael J. and Diane M. Halaburka, supra; Appeal of William T. and Joy P. Orr*, 68-SBE-010, Feb. 5, 1968.) Serious illness has been found not to meet the reasonable cause standard when the duration of the illness did not approximate that of the failure to timely file. (*Wright v. Commissioner*, T.C. Memo. 1998-224; *Stine v. United States* (2012) 106 Fed.Cl. 586.) To establish reasonable cause, the disability must render the taxpayer unable to meet her obligation to timely file during the overall time period relevant to the filing obligation. (*Tabbi v. Commissioner*, T.C. Memo. 1995-463; *Harbour v. Commissioner*, T.C. Memo. 1991-532 [reasonable cause was found when a taxpayer was hospitalized during the tax filing period].)

Appellant has the burden of proving that difficulties she experienced prevented her from complying with her tax obligations. (*Appeal of Michael E. Myers, supra; Appeal of Kerry and Cheryl James*, 83-SBE-009, Jan. 3, 1983; see also *Stine v. United States* (2012) 106 Fed.Cl. 586 [requiring a showing of “continuous incapacity”]; *Appeal of Michael J. and Diane M. Halaburka, supra* [requiring “continuously prevented”].) Appellant asserts that her chronic medical condition and severe financial hardship prevented her from timely filing her 2011 tax return. Financial difficulties generally do not constitute reasonable cause for failing to file a timely tax return. (*Barber v. Commissioner, supra.*) In addition, appellant has provided no evidence demonstrating that the circumstances of her illness or hardship prevented the filing of a timely return. (See *Appeal of Allen L. and Jacqueline M. Seaman, supra.*) As discussed above, appellant’s proffered evidence of her illness is either inadequate or not pertinent to the tax year at issue. Appellant has not demonstrated a relationship between the alleged hardship and the

failure to comply. (*Appeal of Michael J. and Diane M. Halaburka, supra; Appeal of Allen L. and Jacqueline M. Seaman, supra.*) If illness or other personal difficulties simply cause a taxpayer to sacrifice the timeliness of one aspect of its affairs to pursue other aspects, the taxpayer must bear the consequences of that choice. (*Appeal of William T. and Joy P. Orr, supra.*) Appellant has provided no evidence demonstrating that she was continuously prevented during the relevant time period from timely filing her 2011 tax return. (*Appeal of Michael J. and Diane M. Halaburka, supra.*) We therefore conclude that appellant has not shown that her failure to timely file her 2011 tax return was due to reasonable cause.

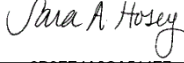
With respect to appellant's contention that she is experiencing financial difficulties, OTA's jurisdiction is limited to determining the correct amount of appellant's California personal income tax liability. (*Appeal of Fred R. Dauberger, et. al., 82-SBE-082, Mar. 31, 1982.*) OTA does not have the authority to adjust a taxpayer's tax liability based on a taxpayer's inability to pay. (*Appeal of Estate of Richard Luebbert, Deceased, and Verla Luebbert, 71-SBE-028, Sept. 13, 1971.*) Once the decision in this appeal becomes final, appellant may contact FTB to determine whether she is eligible to participate in the Offer in Compromise program or whether she can enter into an installment payment agreement with FTB.

HOLDINGS


1. Appellant failed to establish error in FTB's assessment of an early distribution tax for 2011.
2. Appellant failed to establish that her failure to timely file her 2011 tax return was due to reasonable cause and she is therefore liable for the late-filing penalty.

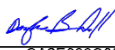
DISPOSITION

Respondent's action is modified, in accordance with respondent's concession on appeal, to abate interest that accrued from February 23, 2015 to July 18, 2016, but is otherwise sustained.

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Sara A. Hosey
Administrative Law Judge

We concur:

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Linda C. Cheng
Administrative Law Judge

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Douglas Bramhall
Administrative Law Judge