

**OFFICE OF TAX APPEALS
STATE OF CALIFORNIA**

In the Matter of the Appeal of:) OTA Case No. 18011795
)
ALEXANDER FERNANDEZ AND) Date Issued: June 13, 2018
)
CHARLENE FERNANDEZ)
_____)

OPINION

Representing the Parties:

For Appellants: Alexander Fernandez, Taxpayer
Charlene Fernandez, Taxpayer

For Respondent: Freddie C. Cauton, Legal Assistant

For Office of Tax Appeals: Andrew Jacobson, Tax Counsel III

KWEE, Administrative Law Judge: Pursuant to Revenue and Taxation Code section 19045,¹ Alexander Fernandez and Charlene Fernandez (appellants) appeal an action by the Franchise Tax Board (FTB or respondent) in denying appellants’ protest of a proposed assessment in the amount of \$1,187 in tax, plus accrued interest, for the 2012 tax year. This matter is being decided based on the written record because appellants waived their right to an oral hearing.

ISSUE

Have appellants established that FTB erred in proposing to assess additional tax against them based upon a final federal determination?

FACTUAL FINDINGS

1. On February 7, 2013, appellants timely filed a joint California Resident Income Tax Return for the 2012 tax year, reporting federal adjusted gross income (AGI) of \$104,652.

¹ Unless otherwise indicated, all further statutory references are to the California Revenue and Taxation Code.

The federal AGI consisted of \$70,346 in wage income, a \$620 taxable refund of state income taxes, and \$33,686 in social security benefits. After making California adjustments, appellants reported California AGI of \$70,346, consisting only of the wage income.

2. Appellants claimed a \$6,737 miscellaneous itemized deduction on their state and federal tax returns. Appellants also claimed a \$4,208 itemized deduction for state income tax paid on their federal return, which was not deducted for state tax purposes.
3. After applying tax credits and California income tax withholdings, appellants claimed an overpayment of \$2,364, which FTB refunded to appellants on February 26, 2013.
4. The Internal Revenue Service (IRS) received information that appellants failed to report \$22,975 in additional income on their federal tax return, resulting from a taxable distribution paid to appellants during 2012 and reported to appellant Alexander Fernandez by Charles Schwab Bank on IRS Form 1099-R (Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.).
5. Appellants also failed to report this distribution on their state tax return for 2012.
6. On the Form 1099-R, Charles Schwab Bank classified the entire \$22,975 distribution as a taxable distribution and withheld \$4,595 in federal tax (20 percent of the distribution). The IRS applied the withholding as a federal tax payment for the 2012 tax year, effective April 15, 2013.
7. Based on the unreported 1099-R income, the IRS increased appellants' federal AGI by \$22,975. In addition, the IRS decreased appellants' \$6,737 miscellaneous itemized deduction by two percent of \$22,975, resulting in the IRS disallowing \$460 of appellants' total claimed itemized deduction.
8. During the audit, the IRS made no change to the amount of appellants' claimed \$4,208 itemized deduction for state income taxes paid during 2012.
9. FTB subsequently obtained the above information from the IRS.² Based on that information, FTB proposed to increase appellants' AGI by \$22,975. FTB also proposed to decrease appellants' miscellaneous itemized deduction by \$460, the same as the IRS. The two proposed adjustments increased appellants' tax by \$1,527. FTB also proposed

² The record does not indicate the date that FTB received this information from the IRS. Appellants' IRS transcript indicates that the IRS assessed additional federal tax on November 10, 2014, and also that the IRS issued a notice to appellants on the same date.

to disallow a nonrefundable renter's credit in the amount of \$120, based on appellants' revised AGI.

10. In addition, FTB allowed a credit in appellants' favor of \$460 (two percent of the distribution) for "California income tax withheld." After reducing the tax liability by the amount of the \$460 credit, and increasing it by the amount of the \$120 disallowed renter's credit, FTB determined that additional tax was still due in the amount of \$1,187 (i.e., \$1,527 in tax, minus the \$460 credit, plus the \$120 disallowed renter's credit).
11. On February 25, 2016, FTB issued a Notice of Proposed Assessment (NPA) proposing to assess \$1,187 in additional tax, plus accrued interest, based on the federal adjustments.
12. In response, appellants submitted to FTB an undated letter protesting the proposed liability in its entirety. In their protest letter, appellants contend that FTB took over three years to assess the tax and that they "do not feel [it] is right" to assess them after so much time has passed, and that appellants are now both retired and unable to pay the liability. Appellants further ask what can be done to help them out.
13. On March 24, 2017, FTB issued a Notice of Action (NOA) to appellants, denying appellants' protest of the NPA.
14. By letter dated March 29, 2017, appellants timely filed the instant appeal. In the appeal letter, appellants essentially raise the same arguments that they raised in their protest.

DISCUSSION

Gross income means all income from whatever source derived, generally including annuities, pensions, life insurance contracts, and distributions from retirement accounts, unless specifically excluded. (§§ 17071, 17085; 26 U.S.C.A. (IRC), §§ 61(a)(8)-(10), 72, 408(d).) The taxpayer bears the burden of establishing entitlement to any deductions claimed. (*Appeal of Gilbert W. Janke*, 80-SBE-059, May 21, 1980; *Appeal of J. Walshe and M. Walshe*, 75-SBE-073, Oct. 20, 1975.)³ Subject to certain exceptions which are not relevant here, California law conforms to federal law with respect to deductions for miscellaneous itemized expenses.⁴

³ Pursuant to California Code of Regulations, title 18, section 30501(d)(3), precedential BOE opinions 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 viewable on BOE's website: www.boe.ca.gov/legal/legalopcont.htm.

⁴ §§ 17024.5 [conformity dates]; 17076 [miscellaneous itemized expenses]; 17201 [itemized deductions and general conformity with IRC sections 161-222 and 261-280H].

Miscellaneous itemized expenses have an AGI threshold for deductibility which is specified in IRC section 67, to which California conforms. Specifically, for the 2012 tax year, both federal and state law provide that miscellaneous itemized expenses are only deductible to the extent that the aggregate of those expenses exceeds two percent of the taxpayer's AGI. (§ 17076 [incorporating IRC section 67]; IRC, § 67(a) (2012).)

Section 17053.5 authorizes a nonrefundable California renter's tax credit for certain persons, subject to AGI limitations. As further explained in the instructions for the California Forms 540 and 540A tax returns, the California AGI limit for the nonrefundable renter's credit was \$72,674 for the 2012 tax year. (§ 17053.5 (2012).)

The law further provides, in pertinent part, that if the IRS makes a correction or adjustment to any item of gross income or deduction (federal correction), the taxpayer must report each federal correction to FTB within six months after the date of each final federal determination related thereto, and shall concede the accuracy of the federal determination or state wherein it is erroneous. (§ 18622(a).) An NPA issued by FTB based on such a federal action is presumed correct, and the taxpayer bears the burden of proving error. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509, 514; *Appeal of S. Brockett and H. Brockett*, 86-SBE-109, Jun. 18, 1986.)

As a general matter, FTB has four years from the date a return was filed to issue a notice of proposed deficiency assessment (i.e., the NPA). (§ 19057(a).) For taxpayers who file an income tax return on or before the due date, the return is deemed filed on the due date, which date is determined without regard to any extension of time for filing the return. (§ 19066(a).) The statute may be tolled or extended in the case of a federal correction. (§§ 19059, 19060; *Appeal of Don L. and Marilu Eddlemon*, 95-SBE-015, Dec. 12, 1995 [defining final federal determination for purposes of the statute of limitations].)

As a preliminary matter, appellants expressed concerns about the timeliness of the NPA. FTB issued the NPA on February 25, 2016, which is less than three years from the April 15, 2013, due date for the 2012 tax return. Therefore, the NPA was timely issued within the four-year statute of limitations period of section 19057(a).⁵

This appeal involves three separate adjustments made by FTB which we address in turn:

⁵ We make no finding with respect to whether the statute may have been tolled indefinitely pursuant to section 19060(a), which applies to certain cases where neither the taxpayer nor the IRS report a federal correction to FTB. Thus, we do not decide whether a request for information submitted to the IRS and initiated by FTB would be sufficient to trigger the benefit of the four-year statute in section 19060(b).

(1) the inclusion of the \$22,975 distribution in income; (2) the reduction of appellants' itemized deduction by \$460; and (3) the disallowance of the \$120 state tax renter's credit.

With respect to the first adjustment, the facts establish that during 2012, appellant Alex Fernandez received a \$22,975 distribution from Charles Schwab Bank (payor), which was reported by the payor as a taxable distribution on a Form 1099-R issued to appellant Alex Fernandez. Appellants do not dispute that the distribution was taxable, or that they received the distribution during 2012. When appellants filed a federal tax return for 2012 that failed to include this distribution, the IRS made corrections to appellants' federal tax return and issued a final federal determination to appellants for failing to report the distribution. Because federal and state law are the same on this issue, FTB did not err in making a California adjustment that corresponds to the federal change.

Second, miscellaneous itemized expenses are only deductible to the extent they exceed two percent of a taxpayer's AGI. After increasing appellants' AGI by \$22,975, the IRS determined it was necessary to decrease appellants' itemized deduction by \$460 to account for the statutory two percent threshold, and appellants do not contend that the federal correction was erroneous. Because federal and state law are the same on this issue, we find that FTB properly reduced appellants' itemized deduction by \$460.

Third, including the \$22,975 distribution in appellant's income increases their California AGI from \$70,346 to \$93,321, which exceeds the statutory maximum for claiming the California renter's credit. (§ 17053.5 (2012).) Therefore, we find that appellants are not eligible for the California renter's credit.

Appellants indicate that they are unable to pay the liability. While we are cognizant that a taxpayer's financial situation may ultimately render a liability uncollectible, the question of ability to pay versus that of determining the correct amount of the tax liability are two separate and distinct concepts. We lack authority to make discretionary adjustments to the amount of a tax assessment based on a taxpayer's ability to pay. (*Appeal of Estate of R. Luebbert, Deceased, and V. Luebbert*, 71-SBE-028, Sep. 13, 1971.) Our function at this stage in the appeals process is to determine the correct amount of the taxpayer's California income tax liability. (*Appeal of Fred R. Dauberger, et al.*, 82-SBE-082, Mar. 31, 1982.)

We note, however, that FTB offers an offer in compromise program, under which FTB may consider a taxpayer's ability to pay in determining how much to collect on certain liabilities

once they have gone final.⁶ (§ 19443.) Taxpayers also may apply to enter into an installment payment agreement with FTB.⁷ While either of these programs may be an option for appellants, appellants would have to contact FTB for further information because OTA has no jurisdiction over, or involvement in, either of these programs.


For the reasons stated above, we have no legal basis upon which we can make any adjustments to the amount of the proposed assessment.

HOLDING


Appellants failed to establish error in the final federal determination or that respondent's proposed assessment was otherwise overstated or invalid.


DISPOSITION

Respondent's action in denying appellants' protest is sustained in full.

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Andrew J. Kwee
Administrative Law Judge

We concur:

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Neil Robinson
Administrative Law Judge

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Teresa A. Stanley
Administrative Law Judge

⁶ See: https://www.ftb.ca.gov/bills_and_notices/OIC.shtml.

⁷ See: <https://www.ftb.ca.gov/online/eIA/index.asp>.