DocuSign Envelope ID: 077A5A23-DDC9-423D-834F-C4D7494170E6

2019 – OTA – 083
Nonprecedential

OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	)	OTA Case No. 18010869
	)	
RICK HINSON AND ELIZABETH HINSON	)	Date Issued: February 25, 2019
	)	
	)	
	)	

OPINION

Representing the Parties:

For Appellants:	Rick Hinson and Elizabeth Hinson
For Respondent:	Meghan McEvilly, Tax Counsel III
For Office of Tax Appeals:	Andrea Long, Tax Counsel

J. JOHNSON, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19047, Rick Hinson and Elizabeth Hinson (appellants) appeal an action by respondent Franchise Tax Board (FTB) proposing $10,331.00 of additional tax, an accuracy-related penalty of $2,066.20, and applicable interest, for the 2010 tax year.

Appellants waived their right to an oral hearing, and therefore the matter is being decided based on the written record.

ISSUES

1. Whether appellants have shown error in FTB's proposed assessment, which is based on adjustments made by the Internal Revenue Service (IRS).
2. Whether appellants have established that the accuracy-related penalty should be abated.

FACTUAL FINDINGS

1. Appellants filed a timely 2010 joint California income tax return reporting a federal adjusted gross income of $73,503, less itemized deductions of $19,985 for a taxable income of $53,518. Appellants self-assessed a total tax of $1,063.
2. Subsequently, FTB received information from the IRS in the form of a FEDSTAR IRS Data Sheet indicating that the IRS adjusted appellants' 2010 federal return. As a result of

DocuSign Envelope ID: 077A5A23-DDC9-423D-834F-C4D7494170E6

these adjustments, the IRS increased appellants' federal taxable income by $117,905 and decreased their itemized deductions by $7,000. The IRS proposed additional tax due and imposed an accuracy-related penalty.

3. Based on the information provided by the IRS, FTB made corresponding adjustments to appellants' California tax account to the extent applicable, and issued a Notice of Proposed Assessment (NPA) dated December 2, 2014. The NPA increased appellants' taxable income by $117,905,[1] from $53,518 to $171,423. The NPA proposed additional tax of $10,331.00, plus applicable interest, and imposed an accuracy-related penalty of $2,066.20.
4. Appellants timely protested the NPA, stating that they were appealing the federal audit determination concerning their 2010 return. FTB responded by letter, asking appellants to provide any documentation showing that the IRS was reconsidering its audit determination.[2]
5. When appellants did not provide further information, FTB issued a Notice of Action affirming the NPA. This timely appeal followed.

DISCUSSION

Issue 1 – Whether appellants have shown error in FTB's proposed assessment, which is based on federal adjustments by the IRS.

R&TC section 18622(a), provides that taxpayers shall either concede the accuracy of a federal determination or state wherein it is erroneous. It is well-settled that a deficiency assessment based on a federal audit report is presumptively correct and that taxpayers bear the

[1] The increase in taxable income was calculated based on the addition of $107,619 (disallowed Schedule C expenses) + $11,193 (disallowed Schedule D long-term gain/loss) + $7,000 (disallowed home mortgage interest) - $7,907 (one-half self-employment tax adjustment). These adjustments match the adjustments made at the federal level by the IRS.

[2] As discussed below, appellants received a letter from the IRS in April 2015 in response to a request from appellants to reconsider the audit results for the 2010 tax year. This IRS letter was received by appellants prior to respondent's request for documentation during the protest period, but was apparently not provided to respondent until appellants filed this appeal.

DocuSign Envelope ID: 077A5A23-DDC9-423D-834F-C4D7494170E6

burden of proving that the determination is erroneous. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Brockett*, 86-SBE-109, June 18, 1986.)[3]

Appellants assert that they disagree with the proposed assessment, but do not provide evidence or argument demonstrating error in the proposed assessment of additional tax for the 2010 tax year. Instead, appellants' sole argument is that the IRS is still reviewing the tax year at issue, and therefore the federal audit determination is not final and FTB's proposed assessment is premature. In support of their position, appellants provided, with their appeal, a letter from the IRS dated April 13, 2015, which indicates that the IRS received a request for reconsideration of appellants' 2010 tax year audit.[4] This letter directed appellants to submit additional information to begin the audit reconsideration process. This letter does not indicate that the IRS was reexamining the 2010 tax year, and no subsequent letter was provided showing that a reconsideration of the 2010 audit actually was initiated. The letter does reveal, however, that the federal examination of appellants' 2010 tax year was in a closed status as of the date of the letter.

The federal account transcript provided by FTB shows that the IRS closed the examination of appellants' 2010 tax year on March 25, 2013. The IRS thereafter imposed a late payment penalty, sent billing notices, and charged interest related to the outstanding balance for the 2010 tax year. The IRS did not reopen the examination of appellants' 2010 tax year after March 25, 2013.[5] Therefore, the record reflects that the federal determination is final, and respondent's proposed assessment was issued in accordance with that final federal determination.

Appellants did not provide any argument or evidence establishing that the federal determination, which is final, is erroneous. Appellants did not provide any argument that FTB's proposed assessment is erroneous, other than asserting it was untimely. Therefore, appellants have not met their burden of proving that FTB's proposed assessment, which is based on the federal adjustments, is erroneous.

---

[3] Board of Equalization formal opinions may generally be found at: <http://www.boe.ca.gov/legal/legalopcont.htm>.

[4] Appellants provided two other letters that they received from the IRS in 2015, but these letters concerned the 2011 tax year, which is not at issue in this appeal.

[5] The transcript reflects that there was a "claim pending" as of May 2016, but an entry of "resolved claim" followed in December 2016, without any change in liability or other adjustment to appellants' 2010 tax year account.

DocuSign Envelope ID: 077A5A23-DDC9-423D-834F-C4D7494170E6

Issue 2 – Whether appellants have established that the accuracy-related penalty for the tax year at issue should be abated.

Internal Revenue Code (IRC) section 6662, incorporated by R&TC section 19164, provides for an accuracy-related penalty of 20 percent of the applicable underpayment. IRC section 6662(b) provides, in relevant part, that the penalty applies to the portion of the underpayment attributable to any substantial understatement of income tax. A substantial understatement of tax exists if the understated amount exceeds the greater of 10 percent of the tax required to be shown on the return or $5,000. (Int.Rev. Code, § 6662(d)(1).) An "understatement" is defined as the excess of the amount of tax required to be shown on the return for the tax year over the amount of the tax imposed which is shown on the return, reduced by any rebate. (Int.Rev. Code, § 6662(d)(2).)

The proposed assessment provides a revised total tax of $11,394, while appellants reported tax of $1,063. The understatement of $10,331 (i.e., $11,394 - $1,063) exceeds both 10 percent of the tax required to be shown on the return and $5,000. Accordingly, the penalty is properly imposed based on the substantial understatement of tax.

While there are exceptions that allow for the accuracy-related penalty to be reduced or eliminated,[6] appellants bear the burden of proving any such defenses to the imposition of the accuracy-related penalty. (*Recovery Group, Inc. v. Commissioner*, T.C. Memo. 2010-76.) Appellants do not provide any argument or evidence establishing that any of the exceptions apply. Accordingly, appellants fail to show that the accuracy-related penalty should be abated.

HOLDINGS

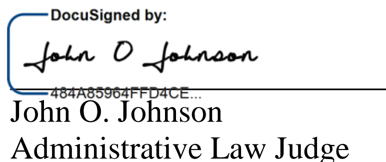
1. Appellants have not established error in the proposed assessment of additional tax.
2. Appellants have failed to establish that the accuracy-related penalty should be abated.

[6] Taxpayers may reduce or eliminate the understatement if they successfully demonstrate one of three exceptions: (1) the taxpayers had substantial authority for their treatment of any item giving rise to the understatement; (2) the relevant facts affecting the item's tax treatment were adequately disclosed and there is a reasonable basis for the tax treatment of such item; or (3) the underpayment of any portion of the underpayment was due to reasonable cause and the taxpayers acted in good faith with respect to such portion of the underpayment. (Int.Rev. Code, §§ 6662(d)(2)(B); 6664(c)(1).)

DocuSign Envelope ID: 077A5A23-DDC9-423D-834F-C4D7494170E6

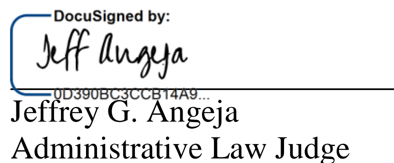
DISPOSITION

FTB's actions are sustained in full.

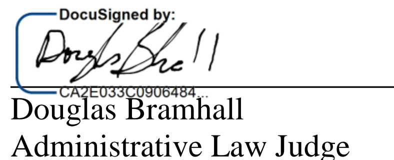


John O. Johnson
Administrative Law Judge

We concur:



Jeffrey G. Angeja
Administrative Law Judge



Douglas Bramhall
Administrative Law Judge