

**OFFICE OF TAX APPEALS**  
**STATE OF CALIFORNIA**

In the Matter of the Consolidated Appeals of:	)	OTA Case No. 18011123
<b>HEVIN ZADA AND</b>	)	Date Issued: April 11, 2019
<b>CAMERON ZADA (DECEASED)</b>	)	
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**OPINION**

Representing the Parties:

For Appellant: Richard Carpenter, Attorney

For Respondent: Nathan H. Hall, Tax Counsel III

For Office of Tax Appeals: Joshua Lambert, Tax Counsel

N. DANG, Administrative Law Judge: Pursuant to Revenue and Taxation Code section 19045,<sup>1</sup> Hevin Zada and Cameron Zada<sup>2</sup> (appellants) appeal an action by respondent Franchise Tax Board (FTB) denying appellants’ request for abatement of the \$14,370 penalty included in FTB’s proposed assessment for the 2012 tax year.

We decide this matter based on the written record because appellants waived their right to an oral hearing.

**ISSUE**

Whether abatement of the section 19164 (accuracy-related) penalty is warranted due to reasonable cause and good faith.

**FACTUAL FINDINGS**

1. Appellants, a husband and wife couple, purchased a property in California (the Property) in 2009 for \$475,000, which they sold for \$2,250,000 in 2012.

<sup>1</sup> Unless otherwise specified, all undesignated statutory references are to the Revenue and Taxation Code.

<sup>2</sup> Mr. Zada passed away prior to the filing of the appeal letter, and this appeal was filed by his attorney on behalf of Mr. Zada’s estate.

2. Appellants incurred expenses of \$124,201 in connection with their sale of the Property.
3. On their 2012 tax return, appellants reported an adjusted basis in the Property of \$1,954,766 and net long-term capital gain of \$295,234.
4. FTB audited appellants' 2012 return, requesting that appellants provide documentation to substantiate their reported adjusted basis in the Property.
5. Appellants provided invoices, receipts, handwritten notes, and typed schedules which show \$1,070,814 in capital expenditures. FTB reviewed these documents, allowing \$749,767 of that amount. FTB disallowed the remaining amount predominately because appellant failed to produce evidence that the expenses were in fact incurred, or that they were incurred with respect to the Property. In addition, FTB disallowed a \$24,453 expense incurred in 2014, which occurred after the sale of the Property, and duplicate expenses totaling \$31,143.
6. FTB calculated appellants' gain from the sale of the Property to be \$901,032 (\$2,250,000 sales price – [\$749,767 allowed capital expenditures + \$475,000 cost basis + \$124,201 sale expenses]), resulting in additional tax of \$70,811.
7. FTB also proposed a section 17043 (mental health services) tax of \$1,037, which is a 1 percent tax on income in excess of one million dollars.
8. FTB further determined that the proposed additional tax of \$71,848, resulted in a “substantial understatement” of tax within the meaning of Internal Revenue Code (IRC) section 6662(d)(1).
9. Thereafter, FTB issued a Notice of Proposed Assessment (NPA) to appellants for \$71,848 additional tax, plus interest, and an accuracy-related penalty of \$14,370.
10. Appellants protested the NPA, disputing FTB's calculation of gain from the sale of the Property and requesting penalty abatement.
11. In response, FTB issued a Notice of Action denying appellants' protest.
12. On appeal, appellants stated that they no longer dispute FTB's proposed calculation of gain from the sale of the Property. Therefore, the only remaining issue in dispute is whether the accuracy-related penalty should be abated.

### DISCUSSION

Appellants assert that the penalty should be abated because they made a reasonable and good faith effort to compute their reported adjusted basis in the Property. Specifically,

appellants contend that appellant-husband retained all the receipts and invoices necessary to fully substantiate appellants' capital expenditures relating to the Property, and that he provided those documents to his certified public accountant (CPA) who used them to compute appellants' adjusted basis in the Property. Appellants further contend that while they made every effort to locate and provide all those documents to FTB during the audit, appellant-wife was unable to locate some of those documents because she was not involved in the family finances. Appellants also contend that appellant-husband was unable to locate all those documents because he was suffering from Crohn's disease and Hodgkin's lymphoma, which led to his eventual passing in 2017.

An accuracy-related penalty shall not be imposed with respect to any portion of an underpayment if it is shown that there was reasonable cause and the taxpayer acted in good faith with respect to such portion. (§ 19164(d), incorporating by reference IRC, § 6664(c)(1); Cal. Code Regs., tit. 18, § 19164, subd. (a); Treas. Reg. § 1.664-4(a).) A determination of whether the taxpayer acted with reasonable cause and in good faith is made on a case-by-case basis, and depends on the pertinent facts and circumstances, taking into consideration the taxpayer's knowledge and experience and the extent to which the taxpayer relied on the advice of a tax professional. (Treas. Reg. § 1.6664-4(b)(1).) "Generally, the most important factor is the extent of the taxpayer's effort to assess the taxpayer's proper tax liability." (*Id.*) The kinds of activities that show a reasonable attempt to comply with the tax law are maintaining records sufficient to support an entitlement to claimed deductions, conducting tax research, and discussing the situation with the taxing agency or tax advisors. (*Goode v. Commissioner*, T.C. Memo. 2006-48; *Gomez v. Commissioner*, T.C. Memo. 1999-94.)

Here, the understatement was predominately a result of appellants overstating their adjusted basis in the Property. Appellants have not produced any evidence showing specifically how this amount was calculated, or what documents were relied upon in doing so. The record also lacks any evidence from which we might infer how this amount was computed. While appellants contend that this amount was computed using invoices and receipts sufficient to reasonably support their reported adjusted basis in the Property, there is no evidence supporting

such a claim, and unsupported assertions are insufficient to satisfy a taxpayer's burden of proof. (*Appeal of Scanlon*, 2018-OTA-075P, July 25, 2018.)<sup>3</sup>

Without this critical information, we are unable to determine whether appellants' reporting error was due to reasonable cause and good faith. And regarding the documents appellants produced upon audit (which were allegedly used by appellants' CPA in computing their adjusted basis in the Property), we note that they include obvious errors, such as an expense incurred after the sale of the Property and numerous duplicate expenses, which tend to suggest that the amount computed from those documents might not be reliable.

Appellants' contention that, for various reasons, they were unable to fully substantiate their reported capital expenditures in the Property upon audit, is unrelated to whether they made a reasonable and good faith attempt to comply with the tax law in *reporting* that amount on their return; thus, it is not a basis for penalty abatement. Further, there is no "reasonable cause" exception to the well-established rule that taxpayers are required to substantiate their reported capital expenditures. (*INDOPCO, Inc. v. Commissioner* (1992) 503 U.S. 79, 84.) Even in cases where substantiating these expenses would result in extreme difficulty or impossibility, the taxpayer is not relieved of this burden. (*Burnet v. Houston* (1931) 283 U.S. 223, 228.) Therefore, appellants' reasons for failing to provide the evidence necessary to substantiate their reported adjusted basis in the Property are unavailing here.

Finally, appellants provide no argument or evidence pertaining to their failure to report a \$1,037 mental health services tax.

Based on the foregoing, we find that appellants have not met their burden of establishing that there was reasonable cause for the understatement.

#### HOLDING

Abatement of the accuracy-related penalty is not warranted.

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<sup>3</sup> Office of Tax Appeals' (OTA's) opinions are viewable on OTA's website at: <[www.ota.ca.gov/opinions](http://www.ota.ca.gov/opinions)>.

DISPOSITION

Respondent's action is sustained.

DocuSigned by:  
*Nguyen Dang*  
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Nguyen Dang  
Administrative Law Judge

We concur:

DocuSigned by:  
*Amanda Vassigh*  
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Amanda Vassigh  
Administrative Law Judge

DocuSigned by:  
*Alberto T. Rosas*  
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Alberto T. Rosas  
Administrative Law Judge