

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 18011355
)
RICHARD P. POINTER AND) Date Issued: April 9, 2019
THERESA KRONEMEYER)
)
_____)

OPINION

Representing the Parties:

For Appellants: Dorothy Dupre, EA

For Respondent: Meghan McEvilly, Tax Counsel III

Office of Tax Appeals: William J. Stafford, Tax Counsel III

J. ANGEJA, Administrative Law Judge: This appeal is made pursuant to section 19045 of the Revenue and Taxation Code¹ by Richard P. Pointer and Theresa Kronemeyer (appellants) from the action of the Franchise Tax Board (FTB) proposing to assess additional tax of \$19,133 and an accuracy-related penalty of \$3,826.60 for the 2011 tax year.

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

ISSUES

1. Whether appellants have demonstrated error in the proposed assessment of additional tax, which is based upon federal adjustments.
2. Whether appellants have shown that the accuracy-related penalty should be abated.

¹ All undesignated “section” or “§” references are to the Revenue and Taxation Code unless otherwise indicated.

FACTUAL FINDINGS

A. *Appellants' California Tax Return*

1. Appellants filed a timely joint 2011 California Resident Income Tax return, reporting a federal adjusted gross income (AGI) of \$148,586, a California AGI of \$137,112, itemized deductions of \$60,690, and taxable income of \$76,422. After listing credits, withholdings, and contributions, appellants reported a refund due of \$24,544, which the FTB issued on May 15, 2012.

B. *Finalized Notice of Proposed Assessment dated July 15, 2015*
(Not at issue in this Appeal)

2. The FTB subsequently received a federal STARS Report from the Internal Revenue Service (IRS) indicating that the 2011 tax return amounts appellants reported to the IRS differed from the 2011 tax return amounts appellants reported to the FTB.
3. Based on the federal STARS Report, the FTB issued a Notice of Proposed Assessment (NPA) dated July 15, 2015, that adjusted appellants' California reporting to match what appellants reported to the IRS. Those adjustments increased appellants' California taxable income from the reported \$76,422 to \$100,393. The NPA set forth an additional tax of \$2,850.00 and interest of \$279.57, for a total amount due of \$3,129.57. On August 5, 2015, appellants made a payment of the additional tax plus interest of \$3,129.57. Due to a slight overpayment, the FTB issued a refund of \$6.17 to appellants on October 5, 2015.
4. Appellants did not protest the NPA dated July 15, 2015, and therefore that proposed assessment became final.

C. *Notice of Proposed Assessment at Issue in This Appeal*

5. On September 8, 2014, the FTB received information from the IRS (a Form 870-AD) showing that the IRS examined appellants' 2011 federal return and made adjustments. Specifically, the IRS attributed \$164,000 in Schedule E guaranteed payments as income, and increased the flow-through income by \$8,879, for a total adjustment of \$172,879 to appellants' Schedule E. In addition, the IRS disallowed all of the \$21,049 in Schedule C expenses that appellants reported. Further, the IRS decreased appellants' itemized

deductions by \$13,909. These IRS adjustments resulted in a \$207,837 increase in taxable income (before taking into account the self-employment tax deduction). Based on the foregoing adjustments, the IRS assessed an additional tax of \$70,328. The IRS also imposed a 10 percent accuracy-related penalty.²

6. On April 22, 2016, the FTB issued an NPA that conformed to the federal adjustments, as applicable under California law. The NPA increased appellants' California taxable income from \$100,393 to \$306,116. The NPA set forth an additional tax of \$19,133, plus applicable interest. The NPA also set forth an accuracy-related penalty of \$3,826.60. The NPA listed a total amount due of \$25,402.36.
7. Appellants filed a timely protest dated June 19, 2016, asserting that the total amount set forth in the NPA dated April 22, 2016, should be reduced by the previously paid amount of \$3,129.57. FTB issued a Notice of Action dated June 7, 2017, which affirmed the NPA. This timely appeal followed.

DISCUSSION

Issue 1: Whether appellants have demonstrated error in the proposed assessment of additional tax, which was based upon federal adjustments.

Section 18622(a) provides that when the IRS makes a change or correction to a taxpayer's federal account that results in an increase in the amount of state tax payable, the taxpayer must either concede the accuracy of the federal determination or state wherein it is erroneous. A state deficiency assessment based on a federal audit report is presumptively correct and the taxpayer bears the burden of proving that the determination is erroneous. (*Appeal of Brockett*, 86-SBE-109, June 18, 1986.)³

Appellants assert that some of the adjustments in the April 22, 2016 NPA merely duplicate the adjustments reflected in the July 15, 2015 NPA. Appellants argue that the NPA dated April 22, 2016, should be reduced by the previously paid \$3,129.57, to remedy what appellants contend is a double assessment.

² Internal Revenue Code section 6662(a) imposes an accuracy-related penalty of 20 percent. It appears that the IRS reduced the penalty to a 10 percent penalty as a result of a settlement agreement or compromise with appellants.

³ Board of Equalization (BOE) opinions are generally available for viewing on the BOE's website: <<http://www.boe.ca.gov/legal/legalopcont.htm#boeopinion>>.

Contrary to appellants' assertion, the adjustments in the NPA dated April 22, 2016, are *additional* adjustments, not duplicate adjustments. As relevant here, the July 15, 2015 NPA corrected appellants' reported federal AGI of \$148,586 on their state tax return so that this information matched appellants' reported federal AGI of \$171,975 on their federal return filed with the IRS, and increased appellants' taxable income from \$76,422 to \$100,393. Subsequently, the April 22, 2016 NPA started with the taxable income of \$100,393 (as adjusted by the prior NPA) and added *additional* adjustments based on the subsequent federal adjustments. The April 22, 2016 NPA increased appellants' taxable income from \$100,393 to \$306,116. The FTB's use of information from the IRS is both reasonable and rational. (See *Appeal of Brockett, supra*; *Appeal of Magidow*, 82-SBE-274, Nov. 17, 1982.) We note that appellants agreed to the above adjustments as reflected in the Form 870-AD. Appellants have not provided any evidence demonstrating error in these federal adjustments or FTB's assessment based on these federal adjustments. Further, appellants have not shown that the amounts set forth in the April 22, 2016 NPA are repetitive and should be reduced by the previously paid amount of \$3,129.57.⁴

Issue 2: Whether appellants have shown that the accuracy-related penalty should be abated.

Section 19164, which generally incorporates the provisions of Internal Revenue Code (IRC) section 6662, provides for an accuracy-related penalty of 20 percent of the applicable underpayment of tax. As relevant here, the penalty applies to the portion of the underpayment attributable to: (1) negligence or disregard of rules and regulations, or (2) any substantial understatement of income tax. (IRC, § 6662(b).) For an individual, there is a "substantial understatement of income tax" when the amount of the understatement for a taxable year exceeds the greater of 10 percent of the tax required to be shown on the return, or \$5,000.⁵ (IRC, § 6662(d)(1).) In determining whether there is a substantial understatement, the taxpayer excludes any portion of the understatement for which: (1) there is substantial authority for the treatment of the position, or (2) the position was adequately disclosed in the tax return (or a

⁴ The Office of Tax Appeals (OTA) requested that appellants file an additional brief addressing the additional tax, but appellants declined to do so.

⁵ The FTB states that because the federal understatement in this appeal is substantial under IRC section 6662(d)(1), it appears that the IRS imposed the accuracy-related penalty based on a substantial understatement of income tax.

statement attached to the return) and there is a reasonable basis for treatment of the item. (IRC, § 6662(d)(2)(B).) Even if an understatement is found to be substantial, the penalty shall not be imposed to the extent the taxpayer can show reasonable cause and good faith. (§ 19164(d); IRC, § 6664(c)(1).) Appellants made no showing of substantial authority, adequate disclosure, or reasonable cause in this appeal.


Here, the accuracy-related penalty of \$3,826.60 was properly computed as 20 percent of the underpayment of tax (\$19,133 x 20% = \$3,826.60). Appellants have asserted no facts or legal authority to establish any of the applicable defenses to the accuracy-related penalty, and we find no such evidence in the appeal record.⁶ Further, we note that appellants' 2011 federal account transcript shows no indication that the federal accuracy-related penalty was revised or abated. Thus, there is no basis on which to abate the accuracy-related penalty.

HOLDINGS


1. Appellants have not demonstrated error in the proposed assessment of additional tax, which was based upon federal adjustments.
2. Appellants have not shown that the accuracy-related penalty should be abated.


DISPOSITION

The FTB's action is sustained.

DocuSigned by:

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 Jeffrey G. Angeja
 Administrative Law Judge

We concur:

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 0C90542BE88D4E7...
 Tommy Leung
 Administrative Law Judge

DocuSigned by:

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 Daniel K. Cho
 Administrative Law Judge

⁶ The OTA requested that appellants file an additional brief addressing the accuracy-related penalty, but appellants declined to do so.