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OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **DAVID W. SWANSON AND CONNIE L. SWANSON**	OTA Case No. 18011807 Date Issued: January 29, 2019

OPINION

Representing the Parties:

For Appellants: Joe Alfred Izen, Jr.
Izen & Associates, P.C.

For Franchise Tax Board (FTB): Eric A. Yadao, Tax Counsel III

G. THOMPSON, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC) section 19045, David W. Swanson and Connie L. Swanson appeal actions by FTB on their protest against proposed assessments for the 1993, 1994 and 1995 tax years. For the 1993 tax year, FTB proposed $3,407.00 in additional tax, an accuracy-related penalty of $1,362.80 and a post-amnesty penalty of $3,054.58, plus accrued interest.[1] For the 1994 tax year, FTB proposed $23,868.00 in additional tax, an accuracy-related penalty of $9,547.20 and a post-amnesty penalty of $18,721.00, plus accrued interest. For the 1995 tax year, FTB proposed $43,012.00, in additional tax, an accuracy-related penalty of $17,204.80 and a post-amnesty penalty of $28,353.79, plus accrued interest.

Office of Tax Appeals (OTA) Administrative Law Judges Grant S. Thompson, Linda C. Cheng and Douglas Bramhall held an oral hearing in this matter on October 22, 2018. When the hearing concluded, Administrative Law Judge Grant S. Thompson closed the record and took the matter under submission.

[1] On appeal, FTB agreed to remove the accuracy-related penalty for the 1993 tax year because the understatement of California income tax is not a substantial understatement. (See R&TC, § 19164 [generally conforming to Int.Rev. Code (IRC) § 6662].)

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ISSUES

1. Whether appellants have shown error in FTB's proposed assessments of additional tax and accuracy-related penalties.
2. Whether OTA has jurisdiction to review the post-amnesty penalties and, if so, whether the post-amnesty penalties apply.
3. Whether appellants' offer in compromise (OIC) with the Internal Revenue Service (IRS) entitles appellants to a reduction in FTB's proposed assessments.
4. Whether OTA may consider the due process issues raised by appellants, and, if so, whether FTB provided due process.

FACTUAL FINDINGS

1. Prior to and during the tax years at issue, appellants operated a business, which they describe as an "invention business."
2. Appellants formed FSH Services (FSH), which they state is "a California business trust organization." Appellants operated the invention business through FSH.
3. Appellants filed timely joint California income tax returns for the 1993, 1994 and 1995 tax years reporting tax liabilities of $2,614, $2,305 and $2,680, respectively.
4. An IRS examination determined that appellants owed additional federal income tax, penalties and interest.
5. On October 12, 1999, the IRS sent a notice of deficiency to appellants for the tax years at issue.
6. In late 1999 or early 2000, appellants contested the IRS determination in the United States Tax Court.
7. On December 1, 2008, following a trial, the Tax Court issued its opinion. (*Swanson v. Commissioner*, T.C. Memo. 2008-265.) Following concessions by the IRS that reduced the amount of deficiencies and penalties, the Tax Court sustained the deficiencies and penalties determined by the IRS. The Tax Court also imposed a $12,500 penalty on appellants under IRC section 6673(a)(1).[2] Among other things, the Tax Court found that:

[2] This provision allows for a penalty when a taxpayer institutes or maintains a proceeding primarily for delay, advances a position that is frivolous or groundless, or unreasonably fails to pursue available administrative procedures.

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a. FSH paid personal expenses of appellants' family, such as family meals, health expenses and school tuition;
b. an IRS bank deposit analysis determined that appellants substantially understated their taxable income;
c. appellants obstructed the IRS examinations;
d. while appellants submitted voluminous testimony and exhibits, they "did not present credible evidence that [FSH] had economic substance";
e. appellants' claims were implausible and not credible;
f. contrary to appellants' claim that FSH had independent trustees, including an individual named Richard Evans, FSH was controlled by appellants;
g. while Mr. Evans may have diverted funds from FSH after the tax years at issue, appellants controlled the earnings of FSH during the years at issue and were liable for the income amounts at issue;
h. Mr. Evans "paid what he was told by [appellants] to pay and signed what he was told to sign"; and
i. the reduction in the amount of the deficiencies was not made based on any evidence or argument made by appellants and "would have probably occurred during the administrative process if petitioners had cooperated rather than obstructed the investigation."

8. Appellants appealed the Tax Court's decision to the United States Court of Appeal for the Ninth Circuit.

9. On November 19, 2009, the IRS informed FTB that its determination increased appellants' taxable income for the 1993, 1994 and 1995 tax years by $32,613, $250,514 and $433,886, respectively.

10. On June 15, 2011, the Ninth Circuit affirmed the decision of the Tax Court, in an unpublished decision. (*Swanson v. Commissioner*, 438 Fed. Appx. 582, 2011 WL 2356790.) Among other things, the Ninth Circuit found that:
    a. the Tax Court did not err in determining that the burden of proof remained on the appellants as they failed to introduce credible evidence and failed to cooperate with the IRS; and

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b. the Tax Court's determination that certain personal expenses were not business expenses was not contrary to the parties' stipulation.

11. Also on June 15, 2011, FTB issued notices of proposed assessment (NPAs) that were based on the federal determinations for the years at issue and reflected the tax and penalties at issue in this appeal (which are listed in the first paragraph of this opinion).[3] For the 1993, 1994 and 1995, the NPAs proposed total tax of $6,021, $26,173 and $45,692, respectively. After taking into account the amount of tax reported by appellants, the NPAs proposed additional tax of $3,407, $23,868 and $43,012 for 1993, 1994 and 1995, respectively.

12. On July 13, 2011, appellants asked that the NPAs be withdrawn on the ground that no remand had been issued in their case "currently pending" before the Ninth Circuit.

13. On August 14, 2011, appellants timely protested the NPAs.

14. On October 3, 2011, FTB responded to the protest and requested that, if appellants disagreed with FTB's position, they provide any new information that supports their position. FTB stated that it intended to affirm the NPAs if appellants did not provide any new information supporting their position by November 1, 2011.

15. On October 13, 2011, appellants replied to FTB's letter by requesting detailed audit workpapers and an audit narrative.

16. On May 24, 2012, FTB notified appellants that it was deferring further action on appellants' account for the years at issue in anticipation of their final settlement with the IRS.

17. During the period from 2012 to 2016, FTB deferred protest proceedings pending settlement discussions between appellants and the IRS.

18. By letter dated September 29, 2016, appellants advised FTB that the IRS had approved their OIC, which offered to pay $165,196.07. The OIC states it was based on "Doubt as to Collectibility – I have insufficient assets and income to pay the full amount." Appellants argued that their California tax liability should be reduced based on the federal OIC.

19. On March 2, 2017, FTB issued NOAs affirming the assessments proposed in the NPAs.

[3] The NPAs were timely under Section 19059 as they were issued within two years of FTB's receipt of notice of the final federal determination.

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20. On March 6, 2017, FTB advised appellants that, while it would consider any IRS revisions to specific items of income or deductions, FTB was not bound by the federal OIC as "[i]t is merely a settlement of the amount due." FTB stated that "acceptance of a Federal [OIC] has no effect on the collection of the [FTB] assessment." FTB provided appellants with information on its OIC program and installment payment options.

21. On April 3, 2017, appellants filed this timely appeal. Appellants' appeal letter outlines the procedural history and includes the following arguments and assertions:

    a. Richard Evans had "ultimate control of the day-to-day operations of FSH and . . . controlled all of its bank accounts";

    b. Mr. Evans, a trust promoter, had misapplied most of FSH's income during the years at issue;

    c. appellants never received or beneficially enjoyed the income at issue because funds were misapplied by Mr. Evans;

    d. the proposed assessments were premature because FTB had not conducted an audit;

    e. FTB accepted the federal OIC by asking appellants to provide details about their ultimate settlement with the IRS; and

    f. the appeal should be resolved with appellants paying an amount of approximately $18,000, "which represents California's percent under California law of the IRS OIC settlement with [appellants]."

22. Appellants' appeal letter also asserted that appellants could not provide evidence to support their claim that they are not taxable on the income amounts at issue because "[p]roduction of such records would be overburdensome."

23. On May 16, 2017, the Board of Equalization (BOE), which is our predecessor with regard to tax appeals, advised appellants that this appeal is an "entirely new proceeding" and that, if they had not already done so, appellants should, when they file their reply brief, "submit all documents that [they] rely upon to support [their] case."

24. On August 14, 2017, FTB filed its opening brief. FTB argued, among other things, that appellants had not shown error in its proposed assessments and that the federal OIC did not entitle appellants to a reduction of their California tax liability.

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25. On October 17, 2017, appellants filed their reply brief. Appellants argued, among other things, that FTB had denied appellants due process and that FTB was required to apply the federal OIC in determining appellants' California tax liability. Despite the BOE's request that appellants provide any supporting evidence with their reply brief, appellants provided no evidence with their reply brief.

26. On May 9, 2018, OTA ordered, among other things, that, if either party had additional evidence to offer, the party should provide such evidence by June 8, 2018.

27. FTB provided additional documents by the June 8, 2018 deadline.

28. By letter dated June 6, 2018, appellants responded to the order. Rather than providing any documents or evidence, appellants asserted that they had "difficulty complying" with the order to provide any additional exhibits that they wish to provide.

29. On October 9, 2018, OTA directed that FTB provide updated copies of appellants' federal transcripts but advised that "[a]s the parties previously had the opportunity to present documentary evidence during the appeal process, the record is otherwise closed to the submission of any further exhibits."[4]

DISCUSSION

1. Whether appellants have shown error in FTB's proposed assessments of additional tax and accuracy-related penalties.

When the IRS makes changes or corrections to an individual's tax return and the changes increase the amount of tax owed, the taxpayer must either concede the accuracy of the federal determination or prove that the federal adjustments are erroneous. (R&TC, § 18622(a).) An FTB deficiency assessment that is based on a federal audit report is presumed to be correct. (*Appeal of Magidow*, 82-SBE-274, Nov. 17, 1982.)[5]

[4] Despite this order, Mr. Swanson requested at the oral hearing that he be allowed to introduce documentary evidence that he brought with him to the hearing. Allowing the production of such evidence, without prior notice to the other party and OTA, when the record had previously been closed, would have constituted an unfair surprise and irregularity. Accordingly, Mr. Swanson's request was denied. Mr. Swanson's counsel later conceded that he had been given the option of producing records. However, he stated, he chose not to provide the records on the ground that they were too voluminous.

[5] BOE opinions (which are designated by "SBE" in the citation) are generally available for viewing on the BOE's website: <http://www.boe.ca.gov/legal/legalopcont.htm#boeopinion>.

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Here, FTB's changes and corrections to appellants' tax returns are based on the determinations of the IRS, as modified by the IRS during Tax Court proceedings. The Tax Court affirmed the modified IRS determinations, and the Ninth Circuit affirmed the Tax Court's decision. Accordingly, appellants have the burden of providing evidence to show error in FTB's determinations.

A. Additional Tax

With respect to FTB's imposition of additional tax, appellants have failed to meet that burden. They have provided no documentary evidence to show error in FTB's determinations. Appellants could have provided such evidence with their opening brief but failed to do so. The BOE requested that appellants provide such evidence with their reply brief, but appellants failed to do so. After the close of the briefing process, OTA then provided appellants with a further opportunity to provide documentary evidence, but again appellants failed to do so. Accordingly, despite the opportunity to provide documentary evidence, appellants have not provided any records that might show error in FTB's determination. The failure to provide such evidence causes us to believe that such evidence, if provided, would have been unfavorable to appellants' position. (See, e.g., *Appeal of James C. Coleman Psychological Corp., et al.*, 85-SBE-028, Apr. 9, 1985.)

Appellants provided testimony at the oral hearing, but we do not find their testimony probative or reliable. Mr. Swanson spent most of his testimony recounting the lengthy procedural history, including the volumes of documents considered by the IRS and the Tax Court, the litigation at the Tax Court and the Ninth Circuit, and the process of obtaining acceptance of appellants' federal OIC. This portion of the testimony appears to primarily relate to appellants' arguments that they were denied due process and that FTB must follow the federal OIC, and we address these arguments later in this opinion. It does not address whether appellants earned the taxable income determined by the IRS, the Tax Court, and FTB. It also does not address whether there is a basis to abate the accuracy-related penalties. Thus, it does not show error in FTB's determination.

Mr. Swanson was asked about Mr. Evans embezzling money, and whether the Swansons ever bought anything or signed checks on behalf of FSH. Mr. Swanson stated that he signed the "operating account check only" but did not sign all the checks. He asserted that many of the disallowed deductions were on checks that the trustee (apparently referring to Mr. Evans) wrote.

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We do not find this testimony reliable as it is contradicted by the Tax Court's findings. As noted above, the Tax Court found that, for the years at issue, appellants controlled the issuance of checks, and further found that Mr. Evans did not embezzle money until after the tax years at issue. Moreover, the testimony is not supported by any corroborating documents. Accordingly, we do not find this testimony credible or reliable.

Mr. Swanson also asserted that, after the Tax Court case, "more light" had been shed on how Mr. Evans embezzled money. He stated, "we issued – the new trustee issued a [Form] 1099-C of $470,000 and none of that has been challenged by any of the parties, the parties who received, and that's the actual 1099-C is the principal, not the return, not the interest due."[6] Mr. Swanson argued that the Form 1099-C shows that appellants did not benefit from the income. Later in his testimony, Mr. Swanson testified that he believed multiple Form 1099-Cs were issued from 2010 to 2015.

We are not persuaded by Mr. Swanson's testimony with regard to any Form 1099-Cs. Appellants did not provide us with any such documents. While appellants argued that it would have been overburdensome to provide documents, we believe they could have and would have provided any such Form 1099-Cs with their briefing if such documents would have been helpful to their appeal. However, appellants' briefing does not directly reference or provide any Form 1099-Cs. Moreover, appellants have not explained precisely how any Form 1099-Cs would support their argument.[7]

Mr. Swanson also testified that the Tax Court "argued against" stipulations that the parties had reached during the litigation at the Tax Court. He stated that he had brought 197 stipulations to the oral hearing before this panel, along with other related documents, and asked to provide those documents to this panel for the first time at the oral hearing. However, as noted previously, appellants had ample opportunity to provide any such documents during and following the briefing process, but failed to do so, and OTA had closed the record to the submission of further documentary evidence. Mr. Swanson's last-minute request to provide documents was contrary to OTA's prior order and, if granted, would have created an unfair

[6] A Form 1099-C is issued to report the cancellation of debt.

[7] Mr. Swanson's initial statement that "we" issued a Form 1099-C suggests that he may have had a role in the issuance of any such document, rather than it being issued by an independent entity. Thus, it suggests that, if there is any such document, it may be, essentially, a self-serving document that Mr. Swanson created or caused to be created after the Tax Court decision.

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surprise, and caused delay and confusion. If such documents were helpful to appellants' case, we believe the documents would have been timely provided during the briefing process or when OTA requested that any such documents be provided. However, appellants' briefing never directly referenced or provided such stipulations.

Appellants appear to have advanced a similar argument to the Ninth Circuit. However, the Ninth Circuit rejected the argument and found that the Tax Court's determination that certain personal expenses were not business expenses was not contrary to the parties' stipulation.

We will not further elaborate here on Mr. Swanson's testimony. In sum, we have carefully considered his testimony and find that it lacks credibility.

Mrs. Swanson also provided testimony. Most of her testimony appeared to be directed to appellants' argument that FTB must reduce its proposed assessment based on the federal OIC, and we address this argument later in this opinion. She also testified that FSH still existed but was not doing any business. To the extent that her testimony might be viewed as implying that FSH was an independent entity, we find the testimony to be unsupported and contradicted by the Tax Court's findings.

Based on our review of the record, including appellants' testimony, we find appellants failed to show error in FTB's determination of additional tax.

B. Accuracy-Related Penalties

The law generally imposes a 20-percent accuracy-related penalty on any underpayment attributable to, among other things, a substantial understatement of income tax. (R&TC, § 19164(a)(1)(A) [generally conforming to IRC, § 6662(b)(2)].) As discussed further below, in some circumstances, the penalty may be increased to 40 percent of the underpayment of tax.

We will first address whether the penalty is applicable and whether there are grounds to abate or reduce the penalty. We will then address whether FTB correctly determined that the penalty should be increased to 40 percent of the underpayments of tax for the years at issue.

For noncorporate taxpayers, an understatement is substantial if it exceeds the greater of $5,000 or 10 percent of the tax required to be shown on the return. (IRC, § 6662(d)(1)(A).) Here, the understatements for 1994 and 1995 are clearly substantial.[8] For 1994, appellants reported tax of $2,305 when the tax required to be shown on the return is $26,173. Appellants

[8] As noted previously, the understatement for 1993 is not substantial, and FTB agreed to remove it.

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thereby understated the tax required to be shown on their return by $23,868. For 1995, appellants reported tax of $2,680 when the tax required to be shown on their return is $45,692. Appellants thereby understated their tax by $43,012. Thus, the understatements are substantial because they exceeded $5,000, and were greater than 10 percent of the tax required to be shown on the return. Accordingly, FTB correctly determined that accuracy-related penalties are applicable for the 1994 and 1995 tax years.

There are three provisions that may provide relief from the imposition of the penalty. First, IRC section 6662(d)(2)(B)(i) provides that the amount of the understatement of tax is reduced by the portion of the understatement that is attributable to the tax treatment of any item by the taxpayer if there is, or was, "substantial authority" for such treatment. Second, IRC section 6662(d)(2)(B)(ii) provides, in pertinent part, that the amount of the understatement of tax is also reduced by the portion of the understatement that is attributable to any item if (a) the relevant facts affecting the item's tax treatment are "adequately disclosed" in the return or in a statement attached to the return and (b) there is a "reasonable basis" for the tax treatment of such item by the taxpayer. Third, IRC section 6664(c)(1) provides, in pertinent part, that no penalty shall be imposed under IRC section 6662 with respect to any portion of an underpayment if it is shown that there was a reasonable cause for such portion and that the taxpayer acted in good faith with regard to that portion. There is no evidence that any of these provisions are applicable here.

The next issue is whether FTB correctly determined that the amount of the accuracy-related penalties should be increased to 40 percent of the underpayment. As noted by FTB, R&TC section 19164(a)(1)(B)(i) generally increases the penalty to 40 percent where the tax year at issue is a year covered by the FTB's amnesty program and the proposed deficiency assessment was issued after the last date of the amnesty period. The amnesty program applied for tax years prior to January 1, 2003, and the amnesty period began on February 1, 2005 and ended on March 31, 2005. (R&TC, § 19731.) The tax years at issue here preceded January 1, 2003, and the proposed deficiency assessments were issued after March 31, 2005. Accordingly, these requirements are satisfied.

However, R&TC section 19164(a)(1)(B)(ii) provides that the penalty will not be increased to 40 percent if, as of the start date of the amnesty program (February 1, 2005), the taxpayer is under audit, is protesting or appealing the assessment, is participating in FTB's

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settlement program, or, "the taxpayer has a pending judicial proceeding in any court of this state *or in any federal court* relating to the tax liability of the taxpayer for that taxable year." (Emphasis added.) Thus, the issue here is whether, as of February 1, 2005, appellants were in a pending judicial proceeding in federal court relating to their tax liability for the taxable years at issue.

FTB argued that there was no indication that a judicial proceeding for the appeal years was pending as of February 1, 2005. Appellants argued that there was a judicial proceeding pending in Tax Court with regard to the tax years at issue. Appellants argued that this proceeding had been deferred pending the criminal trial of Richard Evans, which did not conclude until 2006. On this basis, appellants argued that, if the accuracy-related penalties are found to apply, they should be reduced to 20 percent.

Based on our review of the appeal record, appellants are correct. The Tax Court opinion states that the IRS issued the notice of deficiency for the tax years at issue on October 12, 1999. Under IRC section 6213, taxpayers generally have only 90 days to contest a notice of deficiency in Tax Court.[9] Therefore, appellants must have filed their petition in the Tax Court in late 1999 or early 2000. The Tax Court did not issue its opinion until 2008. Accordingly, the record shows that the tax years at issue were subject to a pending judicial proceeding in federal court as of February 1, 2005, which was the beginning of the amnesty period. Thus, we find that FTB erred in determining that the amount of the accuracy-related penalties should be increased to 40 percent of the underpayments.

Based on the foregoing, we find that accuracy-related penalties are applicable for 1994 and 1995. However, we find that the accuracy-related penalties must be reduced to 20 percent of the underpayments.

2. Whether OTA has jurisdiction to review the post-amnesty penalties and, if so, whether the post-amnesty penalties apply.

R&TC sections 19730 through 19738 set forth the tax amnesty program for taxpayers subject to the Personal Income Tax Law and the Corporation Tax Law. As noted previously, the amnesty program was conducted during the period beginning February 1, 2005, and ending March 31, 2005, and applied to tax liabilities for taxable years beginning before January 1, 2003.

[9] Where the notice is addressed outside of the United States, the taxpayer has 150 days.

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If an eligible taxpayer fully paid the taxpayer's unpaid tax obligations and met all the other requirements of the amnesty program, FTB waived all unpaid penalties and fees imposed, and no criminal action would be brought against the taxpayer for years subject to the amnesty program.

The amnesty program provided an opportunity for a taxpayer to identify and pay unpaid tax obligations and, in return, obtain a waiver of penalties and fees that might otherwise have been imposed. However, if a taxpayer underpaid his or her taxes during a period prior to January 1, 2003, and failed to participate in the amnesty program, R&TC section 19777.5 imposes an amnesty penalty.

When the amnesty penalty relates to amounts assessed after the last date of the amnesty period, it is often referred to as the post-amnesty penalty. R&TC section 19777.5 generally provides that, for each tax year for which amnesty could have been requested by the taxpayer, the amnesty penalty will be imposed in an amount equal to 50 percent of the interest accrued on the unpaid tax as of the last day of the amnesty period (March 31, 2005).

The amnesty provisions give FTB no discretion to determine whether the amnesty penalty should be imposed and provide no exceptions for taxpayers who may have acted in good faith or had reasonable cause for failing to participate in the amnesty program. In addition, the amnesty provisions strictly limit our review of FTB's imposition of the amnesty penalty.

As relevant here, our authority to review final actions of FTB (as the successor to the BOE in reviewing income tax appeals) stems from two statutory provisions: (i) R&TC section 19045, which provides us with jurisdiction to review FTB's actions on a taxpayer's protest of an unpaid assessment, and (ii), R&TC section 19324, which provides us with jurisdiction to review FTB's action on a taxpayer's refund claim.[10]

With respect to the amnesty penalty, subdivision (d) of R&TC section 19777.5 eliminates the first potential basis for our jurisdiction: our authority under R&TC section 19045 to review FTB's action on a taxpayer's protest of unpaid assessments. Subdivision (d) of R&TC section 19777.5 states that "Article 3 (commencing with [R&TC] section 19031), (relating to deficiency assessments) shall not apply with respect to the assessment or collection of [the amnesty

[10] With certain exceptions not relevant to this appeal, OTA "is the successor to, and is vested with, all of the duties, powers, and responsibilities of the State Board of Equalization necessary or appropriate to conduct appeals hearings." (Gov. Code, § 15672(a).) OTA has authority to "conduct all appeals hearings for those duties, powers, and responsibilities transferred to the office pursuant to Section 15672." (Gov. Code, § 15674(a)(1).) R&TC section 20 provides that statutory references to "board" generally mean "OTA" with respect to appeals for which authority has been transferred to OTA.

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penalty].” Article 3 sets forth the procedure for a taxpayer to protest a proposed assessment. Thus, subdivision (d) of R&TC section 19777.5 provides that a taxpayer may not contest the assessment of the amnesty penalty by FTB under the protest procedures that are applicable to deficiency assessments. Because the protest provisions are not applicable to the amnesty penalty, there is no FTB action on a protest for us to review under R&TC section 19045. Thus, we do not have any authority under R&TC section 19045 to review FTB’s imposition of the amnesty penalty.

The second potential basis for our jurisdiction to review the imposition of the amnesty provision is provided through section 19324, which gives us jurisdiction to review FTB’s denial of refund claims. However, subdivision (e) of section 19777.5 severely limits the ability of taxpayers to file a refund claim with respect to the imposition of the amnesty penalty by providing that “[n]otwithstanding Chapter 6 [which commences with section 19301 and includes section 19324], a taxpayer may not file a claim for refund or credit for any amounts paid in connection with [the amnesty penalty,] except as provided in paragraph 2.” Paragraph 2 states that a taxpayer may file a claim for refund for any amounts paid to satisfy the amnesty penalty “on the grounds that the amount of the penalty was not properly computed by the Franchise Tax Board.” Thus, a taxpayer may not file a claim for refund of the amnesty penalty unless the refund claim asserts that FTB failed to “properly compute” the amount of the penalty. As a result, there is no valid claim for a refund of the amnesty penalty for us to review under the authority provided by section 19324 unless the refund claim contends that FTB failed to properly compute the amount of the penalty.

Here, appellants have not paid the post-amnesty penalty; nor have they have they filed a refund claim asserting that the penalty was not properly computed. Furthermore, as appellants have not filed a refund claim, there is no FTB action on a refund claim for us to review. Accordingly, there is no statutory basis for us to review appellants’ contention that the amnesty penalties should be removed.

3. Whether appellants’ OIC with the IRS entitles appellants to a reduction in FTB’s proposed assessments.

There is no authority to support appellants’ argument that FTB must adjust its assessments based on the acceptance of appellants’ federal OIC. Appellants’ federal OIC was a settlement based on doubt as to the ability of the IRS to collect on the amounts due. The federal

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OIC did not modify or adjust appellants' taxable income or otherwise change the federal determination for the years at issue. As a result, the federal OIC does not provide a basis to adjust FTB's proposed assessments.

When this appeal is completed and the deficiencies at issue become final, appellants may seek to participate in FTB's OIC program.[11] Section 19443 only provides FTB with authority to compromise "final" tax liabilities. Appellants' tax liabilities are not final, because the liabilities are the subject of this appeal.[12] Moreover, neither Section 19443 nor any other provision provides us with authority to compel FTB to accept an OIC or determine the terms of an OIC. Under section 19443, the power to compromise income tax liabilities is vested solely with FTB.

For the foregoing reasons, there is no basis for us to modify FTB's proposed assessments based on the federal OIC or compel FTB to accept a similar OIC.

4. Whether OTA may consider the due process issues raised by appellants, and, if so, whether FTB provided due process.

Appellants argued that FTB failed to conduct an audit or provide a protest hearing. On this basis, appellants argued that they did not receive due process.

We note that the California Constitution prohibits an administrative agency, such as OTA, from refusing to enforce a statute on the basis of it being unconstitutional, unless an appellate court has made a determination that such statute is unconstitutional. (Cal. Const., art. III, § 3.5.) Our predecessor, the BOE, had a well-established policy of abstaining from deciding constitutional issues. (See, e.g., *Appeal of Aimor Corp.*, 83-SBE-221, Oct. 26, 1983; *Appeal of Vortox Manufacturing Co.*, 30-SBE-017, Aug. 4, 1930.) This policy was based upon the absence of any specific statutory authority that would allow FTB to obtain judicial review in such cases and upon the belief that judicial review should be available for questions of constitutional importance. (See *Appeal of Aimor Corp.*, *supra*; *Appeal of Vortox Manufacturing Co.*, *supra*.) We see no reason to depart from this established policy.[13]

[11] During the appeal, FTB provided appellants with information about how to request an OIC.

[12] If no petition for rehearing is filed, our determination in this appeal will become final thirty days following the date of this opinion. (R&TC, § 19048.)

[13] Moreover, "due process is satisfied with respect to tax matters so long as an opportunity is given to question the validity of a tax at some stage of the proceedings." (*Appeal of Bailey*, 92-SBE-001, Feb. 20, 1992.) Here, appellants had the opportunity to, and did, protest FTB's proposed assessment. Also, during protest, FTB specifically requested that, if appellants disagreed with its proposed assessment, appellants provide evidence to

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Appellants argue that FTB's proposed assessments were invalid or premature because FTB allegedly failed to provide adequate due process prior to the issuance of the notices. However, in *Clapp v. Commissioner* (9th Cir. 1989) 875 F.2d 1396, the Ninth Circuit explained that "[o]nly where the notice of deficiency reveals on its face that the Commissioner failed to make a determination is the Commissioner required to prove that he did in fact make a determination." The Ninth Circuit further stated that, in assessing the validity of the notice, it would not consider internal IRS memoranda and would not "depart from the rule that we should not 'look behind a deficiency notice to question the Commissioner's motives and procedures leading to a determination.' " (*Clapp, supra,* 875 F.2d 1396, 1401 [quoting *Scar v. Commissioner* (9th Cir. 1987) 814 F.2d 1363,1368].) Here, FTB made a reasonable determination based on a federal determination. As noted previously, this determination is presumed to be correct. (*Appeal of Magidow, supra*.) We will not look behind FTB's notices to question FTB's procedures leading to its determination.

Like our predecessor, the BOE, our only power is to determine the correct amount of tax. (See *Appeals of Dauberger, et al.,* 82-SBE-082, Mar. 31, 1982.) "We have no power to remedy any other real or imagined wrongs that taxpayers believe they may have suffered at the hands of the Franchise Tax Board." (*Ibid.*)

To the extent that appellants made other arguments that we have not addressed in this opinion, we have considered such arguments and found them to be without merit.

HOLDINGS

1. Appellants have not shown error in FTB's proposed assessments of additional tax. However, as agreed by FTB, the accuracy-related penalty for 1993 is removed. Furthermore, as appellants were contesting the federal deficiencies for 1994 and 1995 in the Tax Court as of February 1, 2005, we find that FTB erred in proposing the accuracy-related penalties for 1994 and 1995 based on 40 percent of the underpayments, and we reduce those penalties to 20 percent of the underpayments.
2. OTA has no jurisdiction to review the post-amnesty penalties because appellants have not satisfied the jurisdictional prerequisites for us to review the penalties.

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support their position. Thus, FTB provided an opportunity for appellants to contest its determination. Furthermore, appellants had multiple opportunities to provide evidence during this appeal, and received an oral hearing at which they offered testimony and argument. Accordingly, appellants had multiple opportunities to question the validity of FTB's deficiencies.

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3. Appellants' OIC with the IRS does not entitle appellants to a reduction in FTB's proposed assessments.

4. OTA is not authorized to consider the due process issues raised by appellants.

DISPOSITION

FTB's actions are sustained with the modifications that the accuracy-related penalty for 1993 is removed and the accuracy-related penalties for 1994 and 1995 are reduced to 20 percent of the underpayments for those years.

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Grant S. Thompson
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Grant S. Thompson
Administrative Law Judge

We concur:

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Douglas Bramhall
Administrative Law Judge

DocuSigned by:
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Linda C. Cheng
Administrative Law Judge