**OFFICE OF TAX APPEALS**

**STATE OF CALIFORNIA**

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| In the Matter of the Appeal of: | ) OTA Case No. 18032549 |
| **PETER FLORIN** | ) Date Issued: March 29, 2019 |

## OPINION

Representing the Parties:

For Appellant: Peter Florin, Taxpayer

For Respondent: Bradley J. Coutinho, Tax Counsel

For Office of Tax Appeals: Neha Garner, Tax Counsel III

A. KWEE, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045 appellant appeals an action by respondent Franchise Tax Board (FTB) proposing $13,871 in additional tax, an accuracy-related penalty of $1,387.10, plus applicable interest, for the 2007 tax year.

This matter is being decided based on the written record because appellant waived the right to an oral hearing.

## ISSUES

1. Whether appellant established error in FTB's proposed assessment, which is based on a final federal determination.
2. Whether appellant established a basis for abatement of the accuracy-related penalty.
3. Whether appellant is entitled to interest abatement.

## FACTUAL FINDINGS

1. Appellant and his wife, Kristi Florin, timely filed a joint California Resident Income Tax Return for the 2007 tax year, reporting federal adjusted gross income (AGI) of $156,088,

less California adjustments of $2,529,[1] and a California tax liability of $7,057. After applying credits and tax withholdings, the couple reported an overpayment of $3,081, which FTB refunded on April 22, 2008.

2. Subsequently, the Internal Revenue Service (IRS) audited appellant's 2007 federal tax return (which was also a joint return) and determined that federal AGI was underreported by $149,159.

3. On December 24, 2012, the IRS assessed $46,279.00 in additional tax on the underreported income, plus an accuracy-related penalty of $4,627.90.

4. Neither appellant nor his wife reported the federal changes to FTB. The IRS notified FTB of the federal changes on July 30, 2014.

5. FTB issued a Notice of Proposed Assessment (NPA) for 2007 to Peter and Kristi Florin on March 29, 2016. The NPA was based on the federal changes and increased the taxable income as reported on the state tax return by $149,159. The NPA proposed additional tax of $13,871, an accuracy-related penalty of $1,387.10, plus applicable interest.

6. Appellant protested the NPA on or around May 27, 2016, requesting waiver of the accuracy-related penalty and interest on the basis that it took FTB too long to propose the additional tax.

7. On May 27, 2016, appellant paid a deposit in the amount of $13,871, for the proposed assessment of additional tax. The deposit stopped the accrual of additional interest on the proposed deficiency assessment, to the extent the liability was paid by deposit.

8. On October 12, 2017, FTB acknowledged receipt of appellant's protest letter.

9. On February 16, 2018, FTB issued a Notice of Action (NOA), denying appellant's protest. FTB attached a separate determination to the NOA, denying appellant's request for interest abatement.

10. On March 19, 2018, appellant paid a second deposit in the amount of $1,387.10 (for the accuracy-related penalty) and filed this timely appeal.[2]

[1] The California adjustment reported (which is used to establish California AGI) was for taxable refunds, credits or offsets of state taxes. This was the only California adjustment reported on the state tax return.

[2] Appellant's wife did not join in this appeal.

11. On appeal, FTB concedes that interest abatement is warranted for the period March 27, 2017, through October 12, 2017.

## DISCUSSION

Issue 1 - Whether appellant established error in FTB's proposed assessment, which is based on a final federal determination.

Gross income means all income from whatever source derived, unless specifically excluded. (R&TC, § 17071; Int.Rev. Code, § 61(a).) 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] If the IRS makes a change or correction to any item of gross income or deduction (federal change), the taxpayer must report the federal change to the FTB within six months after the date it becomes final. (R&TC, § 18622(a).) An NPA issued by FTB based on such a final federal change is presumed correct, and the taxpayer bears the burden of proving error. (*Appeal of S. Brockett and H. Brockett*, 86-SBE-109, June 18, 1986.)

Here, there is no evidence or allegation of error in the federal change. To the contrary, in his letter protesting FTB's proposed assessment, appellant admitted that: "After reviewing the notice I received . . . I realize that I owe the additional taxe[s] for the year 2007." Therefore, we have no basis to find that FTB's proposed assessment, which is based on the federal changes, is erroneous.

Nevertheless, appellant disputes FTB's proposed assessment on the basis that he was merely following the advice of his Wells Fargo Insurance Broker when he made the investment that generated the income at issue. Appellant asserts it took the IRS five years to determine that the insurance fund he invested in was "not allowable," and it "took FTB 3 additional years to send me this notice." Therefore, appellant contends that if he had known the IRS was going to assess him taxes for this income, he never would have invested the money in this insurance fund. Appellant disputes the proposed assessment on the basis that he had no reason to know he would have to pay taxes to both the IRS and FTB. Although it may have taken FTB almost two years to issue the NPA after receiving notice of the federal change from the IRS on July 30, 2014, this

[3] Precedential decisions of the State Board of Equalization, designated by "SBE" in the citation, are available on that board's website at <http://www.boe.ca.gov/legal/legalopcont.htm#boeopinion>.

is within the applicable statute of limitations, which is four years from the date the IRS notified FTB of the federal changes. (R&TC, § 19060.) Considering that appellant admits that he owes the additional tax for 2007, and the lack of any evidence to show the federal change (or the NPA based thereon) was calculated incorrectly, we sustain the proposed assessment of additional tax.

Issue 2 - Whether appellant established a basis for abatement of the accuracy-related penalty.

The law 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); Int.Rev. Code, § 6662(b)(2).) For an individual taxpayer, 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. (Int.Rev. Code, § 6662(d)(1)(A).) Nevertheless, the accuracy-related penalty is reduced to the extent that any portion of the understatement is attributable to an item for which the taxpayer has substantial authority for the tax treatment of that item on the return.[4] (Int.Rev. Code, § 6662(d)(2)(B)(i).) The substantial authority standard is an objective standard involving an analysis of the law and application of the law to relevant facts. (Treas. Reg. § 1.6662-4(d)(2).) The taxpayer must have substantial authority, both under the facts and the law, to support the taxpayer's treatment of the item in dispute. (*Estate of Kluener v. Commissioner* (6th Cir. 1998) 154 F.3d 630, 638.)

The accuracy-related penalty does not apply to any portion of an underpayment if it is shown that there was reasonable cause for the underpayment and the taxpayer acted in good faith with respect to the underpayment. (Int.Rev. Code, § 6664(c)(1).) Such a determination is made on a case-by-case basis, taking into account all the pertinent facts and circumstances. (Treas. Reg. § 1.6664-4(b).) The relevant factors may include the taxpayer's efforts to assess the proper tax liability, including the taxpayer's reasonable and good faith reliance on the advice of a qualified tax professional. (Treas. Reg. § 1.6664-4(b); *Remy v. Commissioner*, T.C. Memo. 1997–72.)

[4] The penalty also will not apply to any portion of an understatement for which the taxpayer had a reasonable basis for the tax treatment of an item, provided that the taxpayer made an adequate disclosure of the relevant facts affecting the item's tax treatment on their return or on a statement attached to the return. (Int.Rev. Code, § 6662(d)(2)(B)(ii).) Appellant's 2007 federal tax return contains no such disclosure.

Appellant does not dispute the amount or calculation of the $1,387.10 accuracy-related penalty, which is based on appellant's substantial understatement of income tax.[5] Appellant instead contends that he was merely following the advice of his Wells Fargo Insurance Broker when he made the investment that generated the income at issue, and if he had known the IRS was going to assess him taxes on this income, he never would have invested his money in the insurance fund. Thus, we understand appellant's contention to be that he acted in good faith and had reasonable cause for his position.

In general, reliance on the advice of a professional tax advisor may demonstrate reasonable cause and good faith provided that the taxpayer did not know or have a reason to know that the information was incorrect. (Treas. Reg. § 1.6664-4(b).) Nevertheless, appellant provided us with no documentary evidence to corroborate what tax advice, if any, he received from his Wells Fargo Insurance Broker, or to show that his insurance broker was a professional tax adviser. Furthermore, the IRS imposed a substantial understatement accuracy-related penalty with respect to the same amount of understatement and this penalty was not abated by the IRS. California generally conforms to the IRS with respect to the accuracy-related penalty. (See R&TC, § 19164.) Therefore, appellant failed to establish that he acted in good faith and had reasonable cause for the position taken on his return and there is no basis for abating the penalty.

Issue 3 - Whether appellant is entitled to an abatement of interest.

If any amount of tax is not paid by the due date, interest is required to be imposed from the due date until the date the taxes are paid. (R&TC, § 19101(a).) Interest generally accrues as provided above on any unpaid accuracy-related penalty. (R&TC, § 19101(c)(2)(B).) Imposition of interest is mandatory and there is no reasonable cause exception to imposition of interest. (*Appeal of Yvonne M. Goodwin*, 97-SBE-003, Mar. 19, 1997; *Appeal of Amy M. Yamachi*, 77-SBE-095, June 28, 1977.) FTB may abate interest related to a proposed deficiency to the extent the interest is attributable in whole or in part to: (1) an unreasonable error or delay (2) by an officer or employee of FTB (3) in performing a ministerial or managerial act (4) which occurred

[5] The total tax required to be reported was $20,982. The additional tax amount was $13,871, resulting in a 66.1 percent understatement. This is substantial because it exceeds the greater of $5,000 or 10 percent of the tax required to be shown on the return. (Int.Rev. Code, § 6662(d)(1)(A).) FTB only imposed the 20-percent accuracy-related penalty on half of the $13,871 understatement (that, or the IRS imposed the 20-percent accuracy-related penalty at a rate of 10-percent). The record does not reflect on what basis the IRS reduced the accuracy-related penalty. Nevertheless, FTB followed the IRS's determination and reduced the state's accuracy-related penalty consistent with the IRS reduction.

after FTB contacted the taxpayer in writing regarding the proposed assessment, provided that no significant aspect of that error or delay is attributable to the taxpayer. (R&TC, § 19104(a)(1), (b)(1); *Appeal of Michael and Sonia Kishner*, 99-SBE-007, Sept. 29, 1999.) OTA has jurisdiction to determine whether a failure by FTB to abate interest was an abuse of discretion, and may abate interest in such cases. (R&TC, §§ 20(b), 19104(b)(2)(B).) In other contexts, the courts have found that a state agency has abused its discretion where its finding is unsupported by the evidence. (*McDonald's Systems of California, Inc. v. Board of Permit Appeals* (1975) 44 Cal.App.3d 525, 548.) A state board or agency also has abused its discretion where its finding is contrary to uncontradicted evidence (*Naughton v. Retirement Board of San Francisco* (1941) 43 Cal.App.2d 254, 260), or is otherwise arbitrary or capricious. (*McDonough v. Goodcell* (1939) 13 Cal.2d 741, 748-749.) Correspondingly, there is no abuse of discretion where the finding has a "sufficient factual basis." (*McDonough v. Goodcell, supra*, at p. 749.)

The California Revenue and Taxation Code does not define what is meant by an "unreasonable error or delay," or "a ministerial or managerial act." (R&TC, § 19104(a)(1).) Nevertheless, section 19104(a)(1), California's interest abatement provision for unreasonable error or delay, applies the same standard and uses substantially identical language as IRC section 6404(e), which is the comparable federal statute authorizing interest abatement for unreasonable error or delay. Therefore, it is appropriate to look to federal authority for guidance. (*Douglas v. State* (1948) 48 Cal.App.2d 835, 838; *Appeal of Michael and Sophia Kishner, supra*.)

Congress intended that interest abatement be limited to circumstances where the failure to abate interest would be widely perceived as grossly unfair. (*Franklin v. Commissioner* (2008) T.C. Memo. 2008-13 [citing H. Rept. 99–426, at p. 844 (1985), 1986–3 C.B. (Vol. 2) 1, 844; S. Rept. 99–313, at p. 208 (1986), 1986–3 C.B. (Vol. 3) 1, 208].) The mere passage of time does not establish an unreasonable error or delay. (*Ibrahim v. Commissioner* (2011) T.C. Memo. 2011-215.) Further, to show that the interest accrual is attributable to the tax agency, the taxpayer must show that the tax liability would have been paid earlier but for the error or delay. (*Hull v. Commissioner* (2014) T.C. Memo. 2014-36; *Paneque v. Commissioner*, T.C. Memo. 2013–48.)

Unreasonable error or delay due to a ministerial or managerial act may be eligible for interest abatement, whereas error or delay due to general administrative decisions are not eligible

for interest abatement. (R&TC, § 19104; Int.Rev. Code, § 6404(e).) Treasury Regulation section 301.6404-2(b) defines these terms as follows:

> (1) Managerial act means an administrative act that occurs during the processing of a taxpayer's case involving the temporary or permanent loss of records or the exercise of judgment or discretion relating to management of personnel. A decision concerning the proper application of federal tax law (or other federal or state law) is not a managerial act. Further, a general administrative decision, such as the IRS's decision on how to organize the processing of tax returns or its delay in implementing an improved computer system, is not a managerial act for which interest can be abated under paragraph (a) of this section.
>
> (2) Ministerial act means a procedural or mechanical act that does not involve the exercise of judgment or discretion, and that occurs during the processing of a taxpayer's case after all prerequisites to the act, such as conferences and review by supervisors, have taken place. A decision concerning the proper application of federal tax law (or other federal or state law) is not a ministerial act.

(Treas. Reg. § 301.6404-2(b)(1), (b)(2).) For example, a delay in the issuance of a notice of deficiency, after it was approved for mailing by the IRS, is due to a ministerial act because the act of mailing the notice involves no exercise of discretion or judgment. (Treas. Reg. § 301.6404-2(c) example (2).) Similarly, delay by an IRS attorney in signing and filing with the Tax Court a stipulated decision that already had been approved by both parties, results from a ministerial act, because signing and filing the document involved no exercise of discretion or judgment. (*Goettee v. Commissioner* (2003) T.C. Memo. 2003-43.)

Appellant contends it took almost 10 years after the close of the 2007 tax year before FTB contacted him regarding the liability, and requests interest abatement due to this delay. Interest abatement for unreasonable error or delay is limited by statute to that interest which accrues after FTB first contacted the taxpayer in writing regarding the proposed assessment. (R&TC, § 19104(a)(1), (b)(1).) FTB first contacted appellant in writing when it issued the NPA on March 29, 2016. The NPA proposes to assess $5,524.61 for interest accruing through March 29, 2016. Under these facts, there is no statutory authority to abate the interest accruing through March 29, 2016, the date FTB issued the NPA.

Appellant also contends there was an unreasonable delay because it took FTB almost two

years to resolve his protest.[6] Appellant submitted his protest on May 27, 2016, and FTB did not acknowledge his protest until October 12, 2017, almost 17 months later. FTB issued an NOA denying the protest on February 16, 2018, four months after acknowledgment. It is not clear from the record how much interest accrued during the protest period; however, the proposed tax amount of $13,871 did not accrue interest during the protest period because appellant paid a deposit for the tax on the same day he filed the protest.

FTB concedes that there was an unreasonable delay in acknowledging the protest, and that this delay resulted from a managerial or ministerial act. On this basis, FTB conceded six and a half months of interest abatement, for the period from March 27, 2017 (ten months after appellant filed the protest), through October 12, 2017 (the date FTB acknowledged the protest). In support, FTB contends in its opening brief that during this timeframe protests were "typically acknowledged within ten months." FTB provided no other evidence or clarifying statements on standard turnaround timeframes for acknowledging an appeal. This statement is ambiguous because it is unclear from this statement whether just under 10 months would be a standard response time, a slow response time, or an extremely slow response time. FTB contends that interest abatement is statutorily inapplicable after the date FTB acknowledged appellant's protest (i.e., after October 12, 2017), because FTB reviewed and worked on the protest during this time period. FTB further contends that reviewing and working on a protest does not constitute "either a ministerial act or a managerial act [citation], so there's no basis in the law to abate interest during that time period." Based on FTB's position that interest abatement is inapplicable for periods that it worked on the protest, FTB implicitly acknowledges that it did not work on the protest prior to October 12, 2017.

We find that the act of mailing a letter informing a taxpayer that a protest has been received is a ministerial act that involves no exercise of discretion or judgment. Appellant paid a deposit for the penalty on March 19, 2018, approximately one-month after receiving FTB's determination on his protest, and previously paid the tax on the date he filed the protest with FTB. Nothing was requested or expected from appellant during the protest period. These facts indicate that no significant aspect of the delay during the protest period was due to appellant. Therefore, we agree with FTB that the admitted 17-month delay in mailing out a letter informing

[6] In his appeal letter, appellant requests interest abatement through February 16, 2018, the date FTB denied his protest.

a taxpayer that their protest had been accepted, in absence of some sort of evidence or explanation for the reason for such delay, is unreasonable.

In this case, FTB drew the line for reasonableness at 10 months and we find that this decision was arbitrary and not supported by the available evidence. It appears that FTB's position is that a 10-month period of delay resulting from a managerial or ministerial act, during which time FTB failed to acknowledge or work on appellant's protest, and in absence of evidence or even allegation of workload limitations, does not constitute an unreasonable error or delay. Nevertheless, having admitted to an unreasonable delay, FTB was in the best position to establish a standard turnaround timeframe. Instead, FTB provided an ambiguous, at best, contention as justification. Therefore, we find the decision to grant relief for only 7 out of 17 months due to an admitted error or delay by FTB to be arbitrary because it does not appear to be based on a recognizable standard, and is unsupported by the available evidence. We find that FTB's failure to grant additional interest abatement under the facts of this case was an abuse of discretion for the period July 27, 2016, through October 12, 2017, and we grant interest abatement for this period.[7]

During the remaining period, October 12, 2017, through February 16, 2018, FTB was working on appellant's appeal. The act of reviewing and considering a taxpayer's position and the proper application of the law to the case is not a managerial or ministerial act, and we cannot grant interest abatement on such a basis. (Treas. Reg. § 301.6404-2(b)(1), (b)(2).) Furthermore, appellant offers no evidence that FTB exercised any discretion in appellant's case, such as by selecting appellant's protest for different or separate treatment outside of the general process, during this period. Finally, we do not find the four months it took to complete the protest to be unreasonable or grossly unfair. Therefore, interest abatement is inapplicable for the period after FTB acknowledged the protest.

## HOLDING

1. Appellant failed to establish error in FTB's proposed assessment.
2. Appellant failed to establish a basis for abatement of the accuracy-related penalty.

[7] We acknowledge that the existence of some delay is not automatically an unreasonable delay. Nevertheless, in absence of further evidence, we decline to establish a standard turnaround timeframe to acknowledge an appeal for purposes of interest abatement.

3. Appellant established a basis for interest abatement for the period July 27, 2016, through October 12, 2017, but not for any other period.

## DISPOSITION

For the foregoing reasons, FTB's action is modified, and we grant interest abatement for the period from July 27, 2016, through October 12, 2017. Otherwise, FTB's action is sustained.

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Andrew J. Kwee
Administrative Law Judge

I concur:

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Douglas Bramhall
Administrative Law Judge

## DISSENT

T. LEUNG, Administrative Law Judge: I agree with the majority opinion except with respect to its conclusion regarding the California Revenue and Taxation Code section 19104 interest abatement issue. In an interest abatement case, jurisdiction is limited to a review of FTB's determination for an abuse of discretion. (R&TC, § 19104(b)(2)(B).) To show an abuse of discretion, an appellant must establish that in refusing to abate interest, FTB "exercised this discretion arbitrarily, capriciously, or without sound basis in fact or law." (*Woodral v. Commissioner* (1999) 112 T.C. 19, 23.) Interest abatement provisions are not intended to be routinely used to avoid the payment of interest. Thus, interest abatement should be ordered only " 'where failure to abate interest would be widely perceived as grossly unfair.' " (*Lee v. Commissioner* (1999) 113 T.C. 145, 149, quoting from H. Rept. 99–426, at p. 844 (1985), 1986–3 C.B. (Vol. 2) 1, 844; S. Rept. 99–313, at p. 208 (1986), 1986–3 C.B. (Vol. 3) 1, 208].)

Here, respondent exercised its discretion under section 19104 to abate interest for the period from March 27, 2017 (ten months after receiving appellant's protest) to October 12, 2017, because protests were "typically acknowledged" after 10 months during that period. Although many will contend that 10 months is unreasonable, "reasonableness" is not the standard of review under Section 19104. Because respondent made its interest abatement determination using a 10-month acknowledgement average, it cannot be said that its decision was arbitrary, capricious, or without sound basis. Whether the appropriate amount of time to acknowledge a protest is greater or lesser than 10 months is an issue that should be left to another forum after gathering and considering all relevant data.

Furthermore, under *Hull v. Commissioner*, T.C. Memo. 2014-36, appellant needs to show that respondent's delay prevented him from paying his tax liability earlier. Here, appellant made a $13,871 tax deposit when he filed his protest, and then made a $1,387.10 payment for the penalty after receiving the NOA. Appellant did not explain why the $1,387.10 was submitted later, and the record does not show that the delay in sending out the acknowledgement letter caused him to do so.

Therefore, I vote to sustain respondent's action in full.

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Tommy Leung
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Tommy Leung
Administrative Law Judge