

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:
JEFFREY G. SANDOVAL

) OTA Case No. 18043037
)
) Date Issued: July 8, 2019
)
)
)

OPINION

Representing the Parties:

For Appellant: Jeffrey G. Sandoval

For Respondent: David Gemmingen, Tax Counsel IV

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

J. JOHNSON, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, appellant Jeffrey G. Sandoval appeals an action by respondent Franchise Tax Board in denying appellant’s protest of a proposed assessment of additional tax of \$9,618, plus interest, for the 2013 tax year.

Appellant requested an oral hearing in this matter, but on the day of the hearing waived his right to an oral hearing, and therefore this matter is decided based on the written record.

ISSUES

1. Whether appellant has shown that respondent improperly disallowed his claimed loss deduction of \$92,880 for the 2013 tax year.
2. Whether appellant has established his entitlement to a California passive activity loss adjustment of \$11,098 for the 2013 tax year.

FACTUAL FINDINGS

1. Appellant was a 50 percent shareholder in Goodwood Cabinets, Inc. (Goodwood), an S corporation.
2. Appellant filed a 2013 California income tax return. On his return, appellant deducted \$103,399 of losses and other adjustments from his taxable income as reflected on his

- Schedule CA. The \$103,399 deduction included \$92,880 in claimed losses from the disposition of property and \$11,098 in passive activity losses.¹
3. Respondent subsequently audited appellant's return and requested that appellant explain why he was reporting the S corporation's expenses and items on his Schedule CA. Respondent explained to appellant that "Schedule CA is used only to report adjustments to federal adjusted gross income when that income is taxed differently for state and federal purposes. The difference in taxation must arise from differences between state and federal tax law, not from the source of income." Respondent then requested that appellant provide: (1) a detailed explanation along with supporting documentation and law(s) which allows for the subtraction of \$103,399; and (2) if the subtraction is due to a pass-through entity such as a partnership, corporation, estate, trust, etc., to provide a copy of the Schedule K-1 filed at the federal and state level that substantiates the adjustment.
 4. Appellant failed to respond to respondent's request to explain and provide supporting documentation substantiating the deduction of \$103,399.
 5. On September 20, 2017, respondent issued a Notice of Proposed Assessment (NPA) to appellant disallowing the \$103,399 deduction from income.
 6. Appellant protested the NPA, stating only that "[i]nformation requested in order to mitigate your assessment of taxes due on return is attached." With his protest, appellant provided a copy of Goodwood's 2013 federal income tax return and its Form 1120S with its associated schedules, including Schedules K-1 and shareholder reports.
 7. Respondent replied by letter, indicating that it received appellant's protest and attached documents but that the information provided did not substantiate the \$103,399 deduction on appellant's Schedule CA. Respondent stated that it was disallowing appellant's deduction and that if appellant disagreed with its determination, he should provide a detailed explanation of the deduction and supporting documentation.
 8. Appellant failed to respond and respondent issued a Notice of Action on March 13, 2018, affirming the NPA. This timely appeal followed.

¹ The loss amounts of \$92,880 and \$11,098 equal a total of \$103,978. Appellant's return also reported adjustments totaling \$579, based on state adjustments to reported federal deductions under Internal Revenue Code section 179 and ordinary business losses, reducing the total claimed deduction to \$103,399 (i.e., \$103,978 - \$579). These adjustments are not at issue on appeal.

DISCUSSION

Issue 1: Whether appellant has shown that respondent improperly disallowed his claimed loss deduction of \$92,880 for the 2013 tax year.

It is well established that deductions from gross income are a matter of legislative grace, respondent's denials of deductions are presumed correct, and the burden is on the taxpayer to show by competent evidence that he is entitled to deductions claimed. (*Appeal of Walshe* (75-SBE-073) 1975 WL 3557; *New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435.) To carry his burden of proof, a taxpayer must point to an applicable statute and show by credible evidence that the deductions he claims come within its terms. (*Appeal of Telles* (86-SBE-061) 1982 WL 11930.) A taxpayer's unsupported assertions are insufficient to carry this burden of proof. (*Appeal of Magidow* (82-SBE-274) 1982 WL 11930.) In the absence of credible, competent, and relevant evidence showing error in respondent's determinations, such assessments must be upheld. (*Appeal of Seltzer* (80-SBE-154) 1980 WL 5068.) A taxpayer's failure to produce evidence that is within his control gives rise to a presumption that such evidence is unfavorable to his case. (*Appeal of Cookston* (83-SBE-048) 1983 WL 15434.)

Appellant argues that he has been "following his adjusted basis for the properties sold in 2013." Appellant also states that these properties "were sold in the corporation, 'Goodwood Cabinets, Inc' thus the taxpayer received a K-1 showing the flow through of the gain." However, appellant fails to provide documentation, such as sales and purchase contracts, or other materials that would identify what property was sold and its cost basis, as well as depreciation and adjusted basis schedules. Furthermore, he fails to specify how and under what tax authority Goodwood's adjusted basis in the sold property would be different for California than federal tax purposes. The question of a taxpayer's basis is an issue of fact.² (*Vaira v. Commissioner* (3d Cir. 1971) 444 F.2d 770, 774; *Appeal of Giesea* (86-SBE-016) 1986 WL 22687.) "The fact that basis may be difficult to establish does not relieve a taxpayer from his burden." (*Coloman v. Commissioner* (9th Cir. 1976) 540 F.2d 427, 430 [citing *O'Neill v. Commissioner* (9th Cir. 1959) 271 F.2d 44].) Here, appellant has not only failed to establish the basis of the property sold, he has not even identified what property was sold.

² California generally conforms to the Internal Revenue Code with regards to determining the gain from the sale of property as the excess of the amount realized over the adjusted basis. (See R&TC, section 18031; Int.Rev. Code, section 1001, et seq.)

Appellant also refers to unknown people who “did not have sufficient basis to take proper year losses, thus they had to recognize gain” However, appellant fails to explain who had to recognize gain and their relationship to appellant and his income tax liability. Appellant then states that he has enclosed basis worksheets that have been tracking the basis of the disposed properties to support the adjustment. However, he failed to provide proof of the purchase price of the disposed properties, identify what properties he is referring to, or provide evidence substantiating the figures he references. Therefore, appellant has provided inadequate evidence to satisfy his burden of proof.

Taxpayers are required to keep permanent books and records sufficient to establish matters reported in a return. (Int.Rev. Code, § 6001; Treas. Reg. § 1.6001-1; *Cracchiola v. Commissioner* (9th Cir. 1981) 643 F.2d 1383, 1385.) Treasury Regulations section 1.6001-1(a) provides that taxpayers “shall keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits, or other matters” Moreover, “the books or records . . . shall be kept at all times available . . . and shall be retained so long as the contents thereof may become material in the administration of any internal revenue law.” (Treas. Reg. § 1.6001-1(e).)

Appellant has only submitted 2013 tax return documents to support his position, despite respondent’s request to provide the books of account, records, purchase orders, depreciation schedules, and other documentation to support the amounts disclosed on Goodwood’s tax returns. Appellant also fails to provide legal support for his claimed California basis discrepancies from the federal basis. Therefore, appellant has failed to satisfy his burden of proof to substantiate his deduction.

Issue 2: Whether appellant has established his entitlement to a California passive activity loss adjustment of \$11,098.

Internal Revenue Code (IRC) 469(a) disallows passive activity losses and is incorporated into California law pursuant to R&TC section 17561. IRC section 469(d)(1) provides that the term “passive activity loss” means the amount (if any) by which the aggregate losses from all passive activities for the taxable year exceed the aggregate income from all passive activities for such year. IRC section 469(c)(1) generally defines a “passive activity” as any activity which involves the conduct of any trade or business and in which the taxpayer does not materially participate.

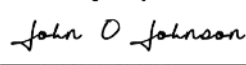
On appeal, appellant refers to one or more unexplained transactions that generated suspended passive activity loss. Appellant has failed to provide evidence or explain what transactions he is referring to and fails to satisfy his burden of proof as to his entitlement to deduct these losses from his taxable income. As noted above, income tax deductions are a matter of legislative grace, and a taxpayer who claims a deduction has the burden of proving by competent evidence that he or she is entitled to that deduction. (See *New Colonial Ice Co. v. Helvering, supra; Appeal of Myers* (2001-SBE-001) 2019 WL 1187160.) Appellant has not provided any evidence showing error with respondent’s assessment and we find no such evidence in the appeal record.

HOLDINGS

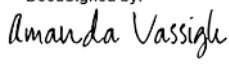
1. Appellant has failed to show that respondent improperly disallowed his claimed loss deduction of \$92,880 for the 2013 tax year.
2. Appellant has failed to establish his entitlement to a California passive activity loss adjustment of \$11,098.


DISPOSITION

Respondent’s action is sustained in full.

DocuSigned by:

873D8797B9E64E1...
John O. Johnson
Administrative Law Judge

We concur:

DocuSigned by:

7B17E956B7C14AC...
Amanda Vassigh
Administrative Law Judge

DocuSigned by:

2281E8D466014D1...
Alberto T. Rosas
Administrative Law Judge