

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:
KENT KAUFMAN

) OTA Case No. 18032450
)
) Date Issued: August 22, 2019
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)
)

OPINION

Representing the Parties:

For Appellant: Kent Kaufman

For Respondent: Rachel Abston, Senior Legal Analyst

For Office of Tax Appeals: Philip Wahlquist, Graduate Student Assistant

N. ROBINSON, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, Kent Kaufman (appellant) ¹ appeals an action by the Franchise Tax Board (FTB) proposing \$1,555 of additional tax and applicable interest, for the 2013 tax year.

Appellant waived his right to an oral hearing and therefore the matter is being decided based on the written record.

ISSUE

Has appellant established error in FTB’s proposed assessment, which is based on a federal determination?

FACTUAL FINDINGS

1. Appellant timely filed a joint 2013 California Resident Income Tax Return (Form 540). On the return, appellant reported federal adjusted gross income (AGI) of \$175,430 less the standard deduction of \$7,812 for taxable income of \$167,618 and tax of \$10,713. After subtracting exemption credits of \$864, appellant reported a total tax liability of

¹ Appellant filed a joint return with his wife, Linda Alter-Kaufman. The appeal letter contained only appellant’s signature. Therefore “appellant” in this appeal will refer only to Mr. Kaufman.

\$9,849. After applying a withholding credit of \$1,306 and claimed estimated tax payments of \$250, appellant reported tax due of \$8,293 and submitted payment of that amount with his return.

2. FTB received information from the Internal Revenue Service (IRS) that showed increases were made to appellant's taxable income in the amount of \$4,468 (due to unreported income of \$3,199² from a distribution from a qualifying retirement plan, \$7 from dividend income, and \$1,262 from capital gain dividend income).
3. The IRS determined that \$3,199 of the increase in taxable income was from an early distribution from a qualifying retirement plan, which was subject to the 10 percent early distribution tax on his federal return.
4. Appellant's 2013 federal Wage and Income Transcript indicates that Charles Schwab issued appellant two Form 1099-R documents ("Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.") showing that appellant received two early distributions from qualified retirement plans totaling \$48,070³ (\$3,200 + \$44,870).
5. Upon a review of appellant's California tax return, FTB determined that appellant failed to apply California's 2.5 percent early distribution tax to the early retirement distribution previously reported on his California return.
6. FTB issued a Notice of Proposed Assessment (NPA) on January 24, 2017, increasing appellant's taxable income by \$4,468 from \$167,618 to \$172,086 and imposing the early distribution tax. The proposed assessment of \$1,555 included \$1,139 for the early distribution tax⁴ and \$416 of additional tax due to the increase in gross income from taxable dividends and capital gains tax on dividends in addition to applicable interest.
7. Appellant timely protested the NPA asserting that although the addition of \$4,468 to taxable income was correct, FTB's assessment of \$1,555 in additional tax was erroneous. Appellant asserted that the early distribution tax was only applicable to the \$3,200 added

² Due to rounding, this amount appears on appellant's Wage and Income Transcript as \$3,200.

³ Due to rounding, this amount appears on appellant's Form 1040 as \$48,071.

⁴ The early distribution tax was applied to distributions of \$45,570, which is the total amount of early distributions (i.e., \$48,070) minus an excepted rollover amount of \$2,500.

to appellant's federal AGI from unreported qualified retirement plan distributions, not the total amount of retirement plan distributions.

8. On October 9, 2017, FTB issued a Notice of Action affirming the NPA. This timely appeal followed.

DISCUSSION

R&TC section 18622(a) provides that a taxpayer shall either concede the accuracy of a federal determination or state wherein it is erroneous. It is well settled that a deficiency assessment based on a federal audit report is correct and that a taxpayer bears the burden of proving that the determination is erroneous. (*Appeal of Sheldon I. and Helen E. Brockett* (86-SBE-109) 1986 WL 22731.) In the absence of credible, competent, and relevant evidence showing that FTB's determination is incorrect, it must be upheld. (*Appeal of Oscar D. and Agatha E. Seltzer* (80-SBE-154) 1980 WL 5068.)

R&TC section 17041 imposes a tax "upon the entire taxable income of every resident of this state." R&TC section 17071 incorporates Internal Revenue Code (IRC) section 61 and generally provides that gross income means all income from whatever source derived, including retirement income from annuities and pensions. Additionally, R&TC section 17501 incorporates IRC section 408(d) to include in gross income any distribution from a qualified retirement plan.

Premature distributions from qualified retirement plans are governed by IRC section 72. IRC section 72(t)(1) provides that if a taxpayer receives a premature distribution from a qualified retirement plan, an additional tax levy of 10 percent of the distribution amount is imposed, unless the taxpayer meets a stated exception. R&TC section 17085 incorporates, but also modifies, IRC section 72 to reduce the amount of tax owed on a premature distribution from 10 percent of the amount includible in gross income to 2.5 percent of that amount for California purposes.

On appellant's Form 1040, appellant originally reported \$48,071 in qualified retirement plan distributions and claimed two separate distributions of \$2,500 and \$3,200 were properly rolled over, thereby excluding a total of \$5,700 (\$2,500 + \$3,200) from appellant's taxable income. Thus, appellant reported taxable qualified retirement plan distributions totaling \$42,371

and included this amount in federal AGI. Appellant paid 10 percent in early distribution tax on this amount and reported this tax on Form 1040.⁵

The IRS provided FTB with an audit report that showed increases were made to appellant's 2013 federal tax return for unreported dividend income of \$7, unreported capital gain dividend income of \$1,262, and unreported qualified retirement plan income of \$3,200. The federal audit determined that the \$3,200 appellant believed was properly rolled over, was in fact not properly rolled over and thus includable in gross income and subject to tax. The IRS increased appellant's federal AGI by \$4,468.

Appellant agrees the additional \$4,468 of gross income is taxable for California purposes, but asserts that the early distribution tax should not be applied to the total of the qualified retirement plan distributions of \$45,571. Appellant contends he need only pay the 2.5 percent early distribution tax on the \$3,200 of additional qualified retirement plan distributions added to appellant's taxable income per the federal adjustments, which he calculated to be \$79.98, plus applicable interest.

However, because appellant did not previously apply a 2.5 percent early distribution tax on the \$42,371 originally reported on the Form 540, appellant is responsible for a 2.5 percent early distribution tax on the total revised amount of qualified retirement plan distributions of \$45,571, not just the increased income amount of \$3,200.

As such, appellant has failed to establish error in FTB's proposed assessment or the federal determination on which it is based.

⁵ On the 2013 Form 1040, appellant made a typographical error and calculated a 10 percent early distribution tax of \$4,612 on reported IRA distributions of \$42,371. The proper amount of the federal early distribution tax on the reported amount should have been \$4,237 ($\$42,371 \times 10\%$).

HOLDING

Appellant has not shown error in FTB's proposed assessment of additional tax, which is based on a federal determination.

DISPOSITION

FTB's action in assessing additional tax is sustained in full.

DocuSigned by:

Neil Robinson

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Neil Robinson

Administrative Law Judge

We concur:

DocuSigned by:

John O Johnson

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John O. Johnson

Administrative Law Judge

DocuSigned by:

Amanda Vassigh

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Amanda Vassigh

Administrative Law Judge