

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:
RAFAEL CABRERA AND
MONICA CABRERA

) OTA Case No. 18032404
)
) Date Issued: September 9, 2019
)
)
)

OPINION

Representing the Parties:

For Appellants: Rafael and Monica Cabrera

For Respondent: Anne Mazur, Specialist

For Office of Tax Appeals: Andrew Jacobson, Tax Counsel III

N. DANG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, Rafael Cabrera and Monica Cabrera (appellants) appeal an action by respondent Franchise Tax Board (FTB) denying their protest of a proposed assessment for additional tax of \$9,143.00, an accuracy-related penalty of \$1,828.60, and interest, for the 2012 tax year.¹

Appellants waived their right to an oral hearing, and therefore, we decide the matter based on the written record.

ISSUE

Whether appellants must recognize \$98,012 of cancellation of indebtedness income for the 2012 tax year.

FACTUAL FINDINGS

1. For the 2012 tax year, appellants received \$193,912.55 of principal loan forgiveness from Bank of America. Prior to receiving loan forgiveness, appellants’ principal balance was \$610,912. Of this amount, \$512,900 was debt incurred in the acquisition or improvement

¹ Appellants do not provide any evidence or specific arguments related to the accuracy-related penalty. Therefore, it will not be discussed.

of appellants' principal residence. The remaining \$98,012 was used by appellants to purchase cars and furniture and to pay mortgage interest.

2. Appellants excluded from their reported income for the 2012 tax year, the full \$193,912.55 of principal loan forgiveness.
3. Subsequently, the Internal Revenue Service (IRS) audited appellants' 2012 federal income tax return, and determined that appellants must recognize \$98,012 of cancellation of indebtedness income.
4. The IRS shared the results of its audit with FTB. To the extent California conforms to federal law, FTB made corresponding adjustments to appellants' 2012 California income tax return based on the IRS audit, and issued a Notice of Proposed Assessment (NPA) to appellants proposing additional tax of \$9,143.00, an accuracy-related penalty of \$1,828.60, plus applicable interest.
5. Appellants protested the NPA, disputing only the inclusion of \$98,012 of cancellation of indebtedness income. In response, FTB issued a Notice of Action affirming the NPA. This timely appeal followed.

DISCUSSION

R&TC section 18622 requires taxpayers to concede the accuracy of the federal changes or state wherein the adjustments are erroneous. It is well settled that a deficiency assessment based upon a federal adjustment to income, as here, is presumptively correct, and that a taxpayer bears the burden of proving that the determination is erroneous. (*Appeal of Brockett* (86-SBE 109) 1986 WL 22731.)

Appellants assert that because they received \$193,912.55 of principal loan forgiveness and were no longer personally liable for repayment of that debt, that entire amount is excludable from income.

Appellants' contention, however, is misplaced. California incorporates by reference Internal Revenue Code (IRC) section 61, which defines gross income. (R&TC, § 17071.) IRC section 61(a)(12), as in effect during 2012, expressly provides that gross income includes "[i]ncome from discharge of indebtedness." (Emphasis added.) "The rationale for such inclusion is that to the extent a taxpayer is released from indebtedness, he or she realizes an accession to income due to the freeing of assets previously offset by the liability. (*Jelle v. Commissioner* (2001) 116 T.C. 63, 67.)

IRC section 108(a)(1)(E)² provides an exclusion to this rule for debts secured by a qualified residence of the taxpayer. However, this exclusion applies only to debt which is incurred for the purposes of acquiring, constructing, or substantially improving that residence. (Int.Rev. Code, §§ 108(h)(2), 163(h)(3)(B).) The \$98,012 appellants borrowed against their home to purchase cars and furniture and to pay mortgage interest does not fall within the aforementioned exclusion, and thus, it must be included in gross income.

HOLDING

Appellants must recognize \$98,012 of cancellation of indebtedness income for the 2012 tax year.

DISPOSITION

FTB’s action is sustained.

DocuSigned by:
Nguyen Dang
4D465973FB44469...
Nguyen Dang
Administrative Law Judge

We concur:

DocuSigned by:
Josh Lambert
B90E40A720E3440...
Josh Lambert
Administrative Law Judge

DocuSigned by:
Andrew J. Kwee
3CAD462FB4884CB
Andrew J. Kwee
Administrative Law Judge

² California conforms to IRC section 108. (See R&TC, § 17131.)