

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:
SHANNON BALDWIN AND
RYAN BALDWIN

) OTA Case No. 18063270
)
) Date Issued: October 9, 2019
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)
)

OPINION

Representing the Parties:

For Appellants: Shannon and Ryan Baldwin

For Respondent: David Muradyan, Tax Counsel III

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

E. S. EWING, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, Shannon and Ryan Baldwin (appellants) appeal an action by respondent Franchise Tax Board (FTB) proposing additional tax, penalties and interest for the 2012, 2013 and 2014 tax years.

Appellants waived their right to an oral hearing; therefore, the matter is being decided based on the written record.

ISSUES

1. Whether appellants have shown error in FTB’s proposed assessments, which are based on final federal determinations provided by the Internal Revenue Service (IRS) for the 2012, 2013, and 2014 tax years.
2. Whether appellants have established reasonable cause for the abatement of the accuracy-related penalties for the 2013 and 2014 tax years.
3. Whether appellants have established reasonable cause for the abatement of the late-filing penalty for the 2014 tax year.

FACTUAL FINDINGS

2012 Tax Year

1. Appellants timely filed a joint 2012 California resident tax return (Form 540), reporting California adjusted gross income (AGI) of -\$28,366, and a standard deduction of \$7,682. After accounting for withholding credits, appellants claimed a refund of \$2,933 which FTB refunded.
2. Subsequently, the IRS audited appellants' 2012 federal tax return and made multiple adjustments. Appellants failed to inform FTB of the federal audit results.
3. On March 7, 2016, FTB received information regarding the adjustments in the form of a Fedstar IRS Data Sheet. Based on this information, FTB issued a Notice of Proposed Assessment (NPA) for the 2012 tax year on July 17, 2017. The NPA incorporated the federal adjustments to the extent applicable under California law and determined appellants had additional gross receipts of \$200,860, disallowed the net operating loss (NOL) carryforward of \$103,739, and allowed additional costs of goods sold of \$138,595, additional other expenses of \$29,485, and a deduction of \$1,383 for one-half of appellants' self-employment tax. After these adjustments, appellants' taxable income increased by \$135,136. Based on the revised taxable income, the NPA proposed additional tax of \$4,215, plus applicable interest.

2013 Tax Year

4. Appellants timely filed a joint 2013 California resident tax return on August 1, 2014, reporting California AGI of -\$5,704 and a standard deduction of \$7,812. After accounting for withholding credits, appellants claimed a refund due of \$2,285, which FTB refunded.
5. Subsequently, the IRS audited appellants' 2013 federal tax return and made multiple adjustments and imposed an accuracy-related penalty. Appellants failed to inform FTB of the federal audit results.
6. On March 7, 2016, FTB received information regarding the adjustments in the form of a Fedstar IRS Data Sheet. Based on this information, FTB issued an NPA for the 2013 tax year on July 17, 2017. The NPA incorporated the federal adjustments to the extent applicable under state law and imputed additional gross receipts of \$305,541, and

allowed additional costs of goods sold of \$121,366, additional other expenses of \$46,752, and a deduction of \$8,890 for one-half of appellants' self-employment tax. After these adjustments, appellants' taxable income increased by \$128,533.

7. Based on the revised taxable income, the NPA proposed additional tax of \$5,610 and an accuracy-related penalty of \$1,122, plus applicable interest.

2014 Tax Year

8. Appellants filed a joint 2014 California resident tax return on July 11, 2016, over a year late. Appellants reported California AGI of \$41,422 and a standard deduction of \$7,984. After accounting for exemption credits and withholding credits, appellants claimed a refund due of \$1,746, which FTB refunded.
9. Subsequently, the IRS audited appellants' 2014 federal tax return and made multiple adjustments and imposed an accuracy-related penalty. Appellants failed to inform FTB of the federal audit results.
10. On March 7, 2016, FTB received information regarding the adjustments in the form of a Fedstar IRS Data Sheet. Based on this information, FTB issued an NPA for the 2014 tax year on July 17, 2017. The NPA incorporated the federal adjustments to the extent applicable under California law and determined appellants had additional gross receipts of \$241,815, disallowed the NOL carryforward of \$41,752, and allowed additional costs of goods sold of \$75,356, additional other expenses of \$76,700, and a deduction of \$6,342 for one-half of appellants' self-employment tax. After these adjustments, appellants' taxable income increased by \$125,169. Based on the revised taxable income, the NPA proposed additional tax of \$9,255, an accuracy-related penalty of \$1,851, and a late-filing penalty of \$1,877.25 plus applicable interest.
11. Appellants protested FTB's NPAs for the 2012, 2013, and 2014 tax years stating that they had a store and an online business selling children's products, but they had to close the store in late 2013 due to poor performance. Appellants noted that while they were being audited, the separation of business between out-of-state online sales and store sales, plus their significant donation of goods of leftover inventory, were not taken into consideration. Appellants further noted that in 2014 they started a new business that was online and had a presence in California. Appellants stated they have always paid their

taxes and believed that their taxable income, as revised by the IRS and FTB, was incorrect.

12. FTB replied to appellants' protest, stating that information recently received from the IRS did not indicate that the IRS had reduced or cancelled its adjustments to appellants' returns, nor did it indicate that the IRS was in the process of reconsidering its adjustments. FTB asked that appellants provide further information to establish that appellants' federal assessments were not yet final or were in the process of IRS reconsideration. Otherwise, FTB would affirm the NPAs.
13. Appellants responded, stating that they were currently on a payment plan with the IRS for the 2013 and 2014 tax years, but that they needed additional time as they would not be in California for an extended period until July 1, 2018.
14. On March 23, 2018, FTB issued Notices of Action (NOAs) for the 2012, 2013, and 2014 tax years, affirming the NPAs for those years in total because the information appellants provided did not establish that FTB's assessments were incorrect. This timely appeal followed.

DISCUSSION

Issue 1 - Whether appellants have shown error in FTB's proposed assessments, which are based on final federal changes.

R&TC section 18622 provides that a taxpayer shall either concede the accuracy of a federal determination or state why it is erroneous. It is well settled that an FTB determination based on a federal audit report is presumptively correct and that the taxpayer bears the burden of proving that the determination is erroneous. (*Appeal of Brockett* (86-SBE-109) 1986 WL 22731; *Todd v. McColgan* (1949) 89 Cal.App.2d 509.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof with respect to a determination based on a federal action. (*Appeal of Magidow* (82-SBE-274) 1982 WL 11930.) In the absence of credible, uncontradicted, competent, and relevant evidence showing that FTB's determination is incorrect, it must be upheld. (*Appeal of Seltzer* (80-SBE-154) 1980 WL 5068.) A taxpayer's failure to produce evidence that is within his or her control gives rise to a presumption that such evidence is unfavorable to his or her case. (*Appeal of Cookston* (83-SBE-048) 1983 WL 15434.)

Appellants have provided no evidence to show that the federal adjustments, or FTB's proposed assessment based thereon, are incorrect. The FTB provided federal account transcripts for each year at issue confirming the amounts reported in the IRS audit reports as final federal adjustments.

Appellants provide a worksheet from the 2014 tax year which they argue shows the volume of out-of-state transactions which they do not collect taxes on. However, it appears that appellants may be confusing their state liability for *sales* taxes collected on the goods sold in their business with their personal income tax liabilities on the income they earned from their business. Because they are California residents, appellants are taxed on all their income, not just on the income earned from California sales. Accordingly, appellants have not satisfied their burden in showing error in FTB's proposed assessment for the 2012, 2013, and 2014 tax years.

Issue 2 - Whether appellants have established reasonable cause for the abatement of the accuracy-related penalties for the 2013 and 2014 tax years.

R&TC section 19164, which incorporates the provisions of the Internal Revenue Code (IRC) section 6662, provides for an accuracy-related penalty of 20 percent of any portion of an underpayment of tax required to be shown on a return. As relevant here, the penalty applies to the portion of the underpayment attributable to: (1) negligence or disregard of rules and regulations; or (2) any substantial understatement of income tax. (IRC, § 6662(b).) For individual taxpayers, there is a "substantial understatement of income tax" when the amount of the understatement for a taxable year exceeds the greater of 10 percent of the tax required to be shown on the return, or \$5,000. (IRC, § 6662(d)(1).) In this instance, appellants' underpayment of tax for 2013 was \$5,601, a substantial understatement under IRC section 6662(d)(1). Appellants' underpayment of tax for 2014 was \$9,255, also a substantial understatement under IRC section 6662(d)(1). Thus, FTB correctly imposed accuracy-related penalties of 20 percent of the applicable underpayments, in the amounts of \$1,122 for the 2013 tax year and \$1,851 for the 2014 tax year, consistent with the IRS determination.

An accuracy-related penalty shall not be imposed to the extent the taxpayer can show that the understatements were attributable to reasonable cause and good faith. (R&TC, § 19164(d); IRC, § 6664(c)(1); Cal. Code Regs., tit. 18, § 19164(a).) Appellants have not provided any argument or evidence of reasonable cause to abate the penalty, which was properly imposed under R&TC section 19164. Accordingly, the accuracy-related penalty must be upheld.

Issue 3 - Whether appellants have established reasonable cause for the abatement of the late-filing penalty for the 2014 tax year.

R&TC section 19131 provides that FTB shall impose a late-filing penalty when a taxpayer fails to file a tax return on or before its due date, computed at 5 percent of the tax due, after allowing for timely payments, for every month that the return is late, up to a maximum of 25 percent. The penalty shall be imposed unless the taxpayer establishes that the late filing was due to reasonable cause and not willful neglect. (R&TC, § 19131.) The burden is on the taxpayer to establish reasonable cause for the untimely filing. (*Appeal of Scott* (82-SBE-249) 1982 WL 11906.) For these purposes, reasonable cause exists if it can be shown that the taxpayer acted as an ordinarily intelligent and prudent businessperson would have acted under similar circumstances. (*Appeal of Tons* (79-SBE-027) 1979 WL 4068; *Appeal of Cummings* (60-SBE-040) 1960 WL 1418.) A taxpayer must show that the failure to file the return occurred despite the exercise of ordinary business care and prudence. (*Appeal of Bieneman* (82-SBE-148) 1982 WL 11825; *Appeal of Tons, supra.*)


Appellants' 2014 return was filed on July 11, 2016, over a year past the original due date of April 15, 2015. Therefore, FTB correctly calculated the late-filing penalty at 25 percent of the tax due, or \$1,877.25 (i.e., \$7,509 x .25). Appellants have provided no evidence of reasonable cause to abate the penalty. Therefore, the late-filing penalty must be upheld.

HOLDINGS

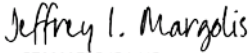
1. Appellants have failed to show error in FTB’s proposed assessments of tax that were based on final federal determinations.
2. Appellants have failed to establish reasonable cause for abatement of the accuracy-related penalties for the 2013 and 2014 tax years.
3. Appellants have failed to establish reasonable cause for abatement of the late-filing penalty for the 2014 tax year.

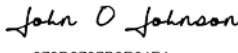
DISPOSITION

For the foregoing reasons, FTB’s action is sustained.

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Elliott Scott Ewing
Administrative Law Judge

We concur:

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Jeffrey I. Margolis
Administrative Law Judge

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John O. Johnson
Administrative Law Judge