

**OFFICE OF TAX APPEALS**  
**STATE OF CALIFORNIA**

In the Matter of the Appeal of: ) OTA Case No. 18042859  
PATRICIA A. HEROLD )  
AND STUART M. HEROLD ) Date Issued: November 13, 2019  
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\_\_\_\_\_)

**OPINION**

Representing the Parties:

For Appellants: Patricia A. Herold and Stuart M. Herold

For Respondent: Donna L. Webb, Staff Operation Specialist

For Office of Tax Appeals: Tom Hudson, Tax Counsel III

N. ROBINSON, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, Patricia A. Herold and Stuart M. Herold (appellants) appeal from the action of the Franchise Tax Board (FTB) in proposing to assess \$205<sup>1</sup> in tax, plus applicable interest, for the 2014 tax year.

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

**ISSUE**

Have appellants shown error in the proposed assessment of \$205 for 2014 based on information received from the Internal Revenue Service (IRS)?

**FACTUAL FINDINGS**

1. Appellants filed a timely 2014 California income tax return (Form 540).
2. FTB received information from the Internal Revenue Service (IRS) showing that appellants’ federal return had been adjusted for unreported pension or retirement annuity

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<sup>1</sup> FTB recalculated the premature distribution tax from \$103 to \$44.08. Thus, the proposed assessment is \$205 rather than the initially proposed amount of \$264.

- income of \$1,763 from Fidelity Investments and unreported forgiveness of debt income of \$7,626 from JP Morgan Chase Bank.
3. FTB issued an April 12, 2017 Notice of Proposed Assessment (NPA) to appellants, based on the IRS adjustments. The NPA applied California taxes to the unreported pension income and the forgiveness of debt income, allowed a non-refundable renter's credit of \$120, assessed a premature distribution tax of \$103 on the unreported pension income, and proposed additional tax of \$264, plus interest. In its opening brief, FTB recalculated appellants' liability to \$205 plus interest.<sup>2</sup>
  4. Appellants timely protested the NPA, contending that they "never owned the vehicle" on which the debt was forgiven and that, "[i]t was financed and voluntarily repossessed due to mechanical issues." Appellants stated that they never received a statement for the \$1,763 distribution that they received from an annuity.<sup>3</sup> Appellants thought that the annuity distribution was not taxable.
  5. Rejecting appellants' arguments on protest, FTB issued a January 22, 2018 Notice of Action affirming the NPA.
  6. This timely appeal followed.

### DISCUSSION

When the IRS determines that adjustments on a taxpayer's federal return are necessary R&TC section 18622 requires the taxpayer to report the adjustments to FTB and either concede the accuracy of the federal determination or state wherein it is erroneous. The taxpayer bears the burden of proving a federal adjustment is erroneous. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Brockett* (86-SBE-109) 1986 WL 22731.) 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.) Appellants must meet

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<sup>2</sup> FTB recalculated the early distribution tax from the proposed \$103 to \$44 ( $\$1,763 \times 2.5\% = \$44.08$ ). The new revised liability is \$205 and is \$59 less than the \$264 proposed initially.

<sup>3</sup> In their May 2, 2017 protest letter, appellants describe this investment as a "taxable annuity." For purposes of this analysis, we shall refer to this investment as an annuity.

their burden of proof by a preponderance of the evidence.<sup>4</sup> (Cal. Code. Regs., tit. 18, § 30705, subd. (c).)

### Income from Pensions and Annuities

R&TC section 17041, states that California income tax is imposed on the entire taxable income of California residents. California R&TC section 17071 incorporates Internal Revenue Code (IRC) section 61 into California law. IRC section 61 defines income that includes annuities. IRC section 72 generally imposes a 10 percent penalty on early distributions that take place before the taxpayer has attained the age of 59 and one-half. This provision is incorporated into California law by R&TC section 17085, but the penalty for California purposes is specified as 2.5 percent. Utilizing this formula FTB has recalculated the penalty on the unreported annuity income.

Appellants state that they were unaware that their annuity income of \$1,763 from Fidelity Investments was taxable and they did not receive a statement. The 2014 Wage and Income Transcript from the IRS corroborates FTB's position that appellants received \$1,763 from Fidelity Investments. Appellants have proffered no arguments or evidence to demonstrate that they did not receive annuity income in 2014.

Appellants have failed to show that the proposed assessment based on a federal determination is erroneous and therefore, FTB's proposed assessment of a penalty and interest on unreported annuity income must be sustained.

### Forgiveness of Debt Income

Generally, the definition of income in IRC section 61 includes income from discharge of indebtedness. As noted above, this federal definition of income is incorporated into California law by R&TC section 17071. Therefore, a discharge of indebtedness must be included in California income unless the taxpayer qualifies for an exception. "The underlying rationale for such inclusion is that to the extent a taxpayer is released from indebtedness, he or she realizes . . . income due to the freeing of assets previously offset by the liability." (*Jelle v. Commissioner* (2001) 116 T.C. 63, 67.) The taxpayer bears the burden of establishing entitlement to any

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<sup>4</sup> A preponderance of evidence means that the taxpayer must establish by documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (*Concrete Pipe and Products of California, Inc. v. Construction Laborers Pension Trust for Southern California* (1993) 508 U.S. 602, 622.)

deductions from gross income. (*Appeal of Janke* (80-SBE-059) 1980 WL 4988; *Appeal of Walshe* (75-SBE-073) 1975 WL 3557.)

The 2014 Wage and Income Transcript from the IRS and the copy of the Form 1099-C from JP Morgan Chase Bank confirm that appellants received cancellation of debt income of \$7,626. Appellants argued at protest that they never owned the vehicle and that it was voluntarily repossessed due to mechanical issues. Appellants do not contend that they did not borrow money from JP Morgan Chase Bank and thus were not responsible for the repayment of the debt. Whether appellants possessed the vehicle or if it had been subject to voluntary repossession before the loan was forgiven by the lending institution, appellants were obligated to repay the loan. Thus, appellants realized income when J.P. Morgan Chase Bank elected to forgive the loan balance in 2014.

IRC section 108, adopted in part by California, is one of the exceptions to the inclusion of debt cancellation in gross income. IRC section 108(a)(1) provides, in part, that gross income does not include any amount derived from a discharge of indebtedness if the debt was discharged in bankruptcy or, at the time the debt was forgiven, the taxpayer was insolvent. Appellants argue that they were insolvent in 2014 when the debt of \$7,626 was forgiven by JP Morgan Chase Bank, but they have not submitted any evidence proving they were bankrupt or insolvent at the time this debt was forgiven. Thus, we have insufficient information to conclude that the discharge of indebtedness was a nontaxable event.

Appellants further argue that they have submitted Form 982 (Reduction of Tax Attributes Due to Discharge of Indebtedness) to the IRS claiming insolvency so that they may avoid tax on income from the discharge of loan debt. In their appeal, appellants state that if the IRS determines they were insolvent in 2014 when the discharge of debt occurred, then California would similarly abate the tax. The June 27, 2018 IRS Federal Wage and Income Transcript does not include any mention of appellants' Form 982 request. Without proof that the IRS granted relief, we have no basis to conclude that the IRS's calculation of income for 2014 is not final.

Without further documentation or explanation, we cannot apply the IRC section 108(a)(1) exception to sustain appellants' appeal.

HOLDING

Appellants have not shown any error in the proposed assessment for 2014.

DISPOSITION

FTB's proposed assessment shall be modified to reduce the additional tax for early distribution of pension or retirement annuity from \$103 to \$44, as conceded by FTB on appeal, but in all other respects is sustained.

DocuSigned by:

*Neil Robinson*

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Neil Robinson

Administrative Law Judge

We concur:

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*Michael F. Geary*

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Michael F. Geary

Administrative Law Judge

DocuSigned by:

*John O. Johnson*

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John O. Johnson

Administrative Law Judge