

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:
RICKI G. CLAVIER

) OTA Case No. 18103919
)
) Date Issued: December 17, 2019
)
)
)

OPINION

Representing the Parties:

For Appellant: Ricki G. Clavier

For Respondent: Donna L. Webb, Staff Operation Specialist

For Office of Tax Appeals: Andrea Long, Tax Counsel

T. LEUNG, Administrative Law Judge: Pursuant to Revenue and Taxation Code section 19045,¹ Ricki G. Clavier (appellant) appeals an action by the Franchise Tax Board (respondent) proposing additional tax of \$3,962.00, an accuracy-related penalty of \$792.40, and applicable interest, for the 2014 taxable year.

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

ISSUES

1. Did appellant show error in the proposed assessment of additional tax, which is based on federal adjustments made by the Internal Revenue Service (IRS)?
2. Should the accuracy-related penalty be abated?

FACTUAL FINDINGS

1. Appellant’s 2014 federal income tax return was examined by the IRS.
2. Subsequently, respondent received information from the IRS, in the form of a CP2000 Data Sheet, indicating that the IRS made adjustments to appellant’s 2014 federal return

¹ Unless otherwise specified, all section references are to the Revenue and Taxation Code in effect for the 2014 taxable year.

by including unreported pension/annuity income of \$35,000 from Lincoln National Life Insurance Company, and cancellation of debt income (COD income) from Chase Bank in the amount of \$5,124 and from Barclay's Bank in the amount of \$2,424 (for a total of \$7,548) as evidenced by two Forms 1099-C. The federal adjustments resulted in additional federal income tax of \$11,067 and an accuracy-related penalty in the amount of \$2,213. The CP2000 Data Sheet indicates that appellant fully agreed with the federal adjustments.

3. Respondent issued a Notice of Proposed Assessment (NPA) based upon the federal adjustments. The NPA increased appellant's reported taxable income by \$42,548, which consisted of unreported pension income of \$35,000 and COD income of \$7,548. The NPA proposed additional tax of \$3,962.00, and imposed an accuracy-related penalty of \$792.40, plus interest. The NPA indicated that the proposed assessment was based on the federal audit report. The NPA stated that the accuracy-related penalty was calculated as "20 percent of the additional California tax on the same adjustments to which the [IRS] applied the federal accuracy related penalty."
4. Appellant protested the NPA, stating that the pension distribution was taken due to a pending job layoff. However, appellant conceded that the pension distribution was taxable. Appellant requested that respondent provide a more detailed account of the assessment because the NPA was very confusing.
5. Respondent acknowledged receiving appellant's protest letter and explained that no penalty for a premature distribution from a pension or annuity account was imposed, but additional tax on the unreported pension or annuity income and COD income was proposed. Respondent provided appellant with a copy of the federal CP2000 Data Sheet, which detailed the adjustments made to appellant's federal account. Respondent asserted that the information that it received from the IRS did not show that the federal assessment was canceled or reduced, and California and federal law is the same for the issues involved. Respondent informed appellant that if the IRS cancels or reduces its assessment, appellant should send respondent copies of the revised IRS report.
6. In reply, appellant claimed continued confusion about the CP2000 data sheet and the tax computation. Appellant also claimed to have entered into a debt relief program to keep his/her home after being laid off and unemployed for almost nine months and believed

there were exceptions and exclusions regarding COD income and distributions taken to make mortgage payments during unemployment. Appellant acknowledge owing taxes but wanted to “exhaust all potential options” in an attempt to reduce the amount owed to respondent.

7. Respondent issued a Notice of Action affirming the NPA. Respondent acknowledged appellant’s reply and explained that the IRS already determined that appellant did not meet the conditions to exclude either COD income or pension distributions for making mortgage payments during a period of unemployment.

DISCUSSION

Issue 1 – Did appellant show error in the proposed assessment of additional tax, which is based on federal adjustments made by the IRS.

The taxpayer shall either concede the accuracy of a federal determination or state wherein it is erroneous. (Rev. & Tax. Code, § 18622(a).) A federal determination is deemed final on the date on which the adjustment resulting from an IRS examination is assessed. (Rev. & Tax. Code, § 18622(a), (d); Int.Rev. Code, § 6203.) A federal determination is assessed when the liability is recorded in accordance with federal rules and regulations. (Treas. Reg. § 301.6203-1.) It is well settled that a deficiency assessment based on a federal audit report is presumptively correct and that the taxpayer bears the burden of proving that the determination is erroneous. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509, 514; *Appeal of Sheldon I. and Helen E. Brockett* (86-SBE-109) 1986 WL 22731.) Unsupported assertions are insufficient to satisfy the taxpayer’s burden of proof with respect to an assessment based on a federal action. (*Appeal of Aaron and Eloise Magidow* (82-SBE-274) 1982 WL 11930.) The taxpayer’s failure to produce evidence that is within the taxpayer’s control gives rise to a presumption that such evidence is unfavorable to his case. (*Appeal of Don A. Cookston* (83-SBE-048) 1983 WL 15434.)

Tax shall be imposed upon the entire taxable income of every resident of California. (Rev. & Tax. Code, § 17041(a).) “Gross income” includes “all income from whatever source derived” including annuities and pensions. (Rev. & Tax. Code, § 17071; Int.Rev. Code, § 61.) Except as otherwise provided, any amount paid or distributed out of an individual retirement plan shall be included in gross income by the payee or distributee, as the case may be, in the manner provided under Internal Revenue Code section 72. (Rev. & Tax. Code, § 17501;

Int.Rev. Code, § 408(d)(1).) Except as otherwise provided, gross income includes any amount received as an annuity under an annuity, endowment, or life insurance contract. (Int.Rev. Code, § 72(a)(1).)

“[I]ncome from discharge of indebtedness” (also known as cancellation of debt or “COD”) is gross income. (Rev. & Tax. Code, § 17071; Int.Rev. Code, § 61(a)(12).) The rationale for including discharge of indebtedness in gross income is, to the extent a taxpayer has been released from indebtedness, the taxpayer has realized additional income because the cancellation of indebtedness effects a freeing of assets previously offset by the liability. (*Jelle v. Commissioner* (2001) 116 T.C. 63, 67, citing *United States v. Kirby Lumber Co.* (1931) 284 U.S. 1, 3.) COD income is generally recognized in the year the debt is canceled. (*Bui v. Commissioner*, T.C. Memo. 2019-54.)

Gross income does not include any amount that would otherwise be included in the gross income of a taxpayer if the discharge of indebtedness occurs while the taxpayer is insolvent. (Int.Rev. Code, § 108(a)(1)(B).)² “Insolvent” means the excess of liabilities over the fair market value of assets, and the amount by which the taxpayer is insolvent is determined on the basis of the taxpayer's assets and liabilities immediately before the discharge. (Int.Rev. Code, § 108(d)(3).) Exclusions from income must be narrowly construed. (*Polone v. Commissioner* (9th Cir. 2007) 505 F.3d 966, 969, citing *Commissioner v. Schleier* (1995) 515 U.S. 323, 328.)

Here, appellant does not dispute that the IRS and respondent made proper adjustments to the 2014 federal and California returns. However, appellant argues that the law allows for an exclusion for COD income if the taxpayer is insolvent. (See Int.Rev. Code, § 108(a)(1)(B).) However, appellant does not qualify for the insolvency exclusion. Appellant did not show that the two discharges of debts occurred during a period of insolvency in 2014. According to the Forms 1099-C, appellant's debts from Chase Bank and Barclay's Bank were canceled on December 20, 2014, and March 18, 2014, respectively. The debt consolidation documentation and 2018 lay-off letter is not helpful in determining whether appellant was insolvent in 2014. Without any 2014 documentation (such as foreclosure documents, credit card bills, evidence of assets/liabilities), the discharge of indebtedness is properly included in appellant's gross income. Accordingly, appellant failed to show error in the proposed assessment of tax.

² California conforms to Internal Revenue Code section 108 pursuant to section 17131.

With respect to appellant's assertions regarding financial hardship, Office of Tax Appeals (OTA) has no authority to settle or compromise an income tax appeal. OTA's jurisdiction is limited to determining the correct amount of appellant's California personal income tax liability. (*Appeals of Fred R. Dauberger, et. al.* (82-SBE-082) 1982 WL 11759.)³

Issue 2 – Whether the accuracy-related penalty should be abated.

With regard to the accuracy-related penalty, section 19164 generally incorporates the provisions of Internal Revenue Code section 6662 and imposes an accuracy-related penalty of 20 percent of the applicable underpayment. As relevant here, the penalty applies to any portion of an underpayment attributable to negligence or disregard of rules and regulations, or any "substantial understatement of income tax." (Int.Rev. Code, § 6662(b)(1) & (2).) For an individual, there is a "substantial understatement of income tax" when the amount of the understatement for a taxable year exceeds the greater of ten percent of the tax required to be shown on the return, or \$5,000. (Int.Rev. Code, § 6662(d)(1).)

The accuracy-related penalty may be reduced or abated in some circumstances. It will be reduced by the portion of the understatement attributable to the tax treatment of any item if there is substantial authority for such treatment. (Int.Rev. Code, § 6662(d)(2)(B).) The penalty also will be reduced by the portion of the understatement attributable to a tax treatment of any item if the relevant facts affecting the item's tax treatment were adequately disclosed and there was a reasonable basis for the tax treatment of such item. (Int.Rev. Code, § 6662(d)(2)(B).) Also, the penalty will not be imposed to the extent that the taxpayer can show the underpayment was due to reasonable cause and that he or she acted in good faith. (Int.Rev. Code, § 6664(c)(1); Treas. Reg. §§ 1.6664-1(b)(2) & 1.6664-4.) Here, appellant's understatement of California income tax does not constitute a substantial understatement of California income tax because it is less than \$5,000. Accordingly, the accuracy-related penalty is only applicable for California purposes if there is another basis for its imposition, such as negligence.⁴

³ After the decision in this appeal becomes final, appellant may wish to contact respondent to determine eligibility for its Offer in Compromise program or whether an installment payment agreement is appropriate.

⁴ While the accuracy-related penalty may be imposed on various bases, such as an overstatement of pension liabilities, the only basis for the accuracy-related penalty that appears potentially relevant here is negligence.


Respondent admitted in its opening brief that the sole basis for its determination of an accuracy-related penalty is the fact that IRS imposed an accuracy-related penalty at the federal level. However, as explained above, the federal accuracy-related penalty may have been imposed because the federal tax deficiency constituted a substantial understatement of tax, and not on account of negligence. Respondent has not proven that the federal penalty was based on negligence, nor has it independently raised affirmative allegations of negligence on the part of appellant. Accordingly, we find that the accuracy-related penalty must be abated.

HOLDINGS

1. Appellant did not establish error in the proposed assessment which was imposed pursuant to section 18622.
2. Appellant is not liable for the section 19164 accuracy-related penalty.

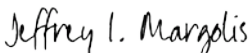
DISPOSITION

Respondent’s tax deficiency determination for 2014 is sustained, but its imposition of the accuracy-related penalty is reversed.


DocuSigned by:


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 Tommy Leung
 Administrative Law Judge

We concur:

DocuSigned by:


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 Jeffrey I. Margolis
 Administrative Law Judge

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 Andrew J. Kwee
 Administrative Law Judge