

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 19034387
SHARON BROWN AND AARON BROWN)
) Date Issued: December 18, 2019
)
)

OPINION

Representing the Parties:

For Appellant: Sharon Brown, Taxpayer

For Respondent: Angelina Yermolich, Legal Assistant

S. HOSEY, Administrative Law Judge: Pursuant to California Revenue and Taxation Code section 19045,¹ Sharon Brown and Aaron Brown (appellants) appeal an action by respondent Franchise Tax Board (FTB) proposing a 2.5 percent early distribution tax for the 2014 tax year.

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

ISSUE

Have appellants shown error in FTB’s proposed assessment of the 2.5 percent early distribution tax for the 2014 tax year?

FACTUAL FINDINGS

1. Appellants filed a timely 2014 California Resident Income Tax Return (Form 540). Appellants claimed an overpayment in the amount of \$5,886, which was refunded back to appellants on February 19, 2015.
2. FTB reviewed appellants’ tax return and determined that because appellants received an early distribution from a qualified retirement plan, they were subject to a 2.5 percent tax

¹ Unless otherwise indicated, all “section” references are to sections of the California Revenue & Taxation Code.

- on the taxable portion of the distribution. Appellants reported the 10 percent tax on their Form 1040 U.S. Individual Income Tax Return but did not report the 2.5 percent tax on their state return.
3. FTB issued a Notice of Proposed Assessment (NPA) adjusting the return to include the 2.5 percent additional tax on the early distribution. The NPA proposed additional tax of \$1,570, plus interest.²
 4. Appellants protested the NPA indicating that they used TurboTax software to enter their information and overpaid their taxes resulting in a refund. FTB responded by explaining that when a premature distribution is received, taxpayers are required to file Form 3805P, Additional Taxes on Qualified Plans and Other Tax-Favored Accounts, and report the additional 2.5 percent tax on their state tax return.
 5. FTB issued a Notice of Action affirming the NPA and appellants filed this timely appeal.

DISCUSSION

Section 17041 imposes a tax “upon the entire taxable income of every resident of this state.” Section 17071 incorporates Internal Revenue Code (IRC) section 61, which defines “gross income” as “all income from whatever source derived,” including pension income. IRC section 72(t)(2) generally imposes a 10 percent tax (in addition to the income tax otherwise imposed) on early distributions from qualified retirement plans that are includible in gross income. This 10 percent tax also is known as the federal early distribution tax or penalty. Section 17085(c)(1) adopts IRC section 72 for California income tax purposes, but reduces the rate of the early distribution tax from 10 percent to 2.5 percent.

Here, the amount of the early distribution tax in the proposed assessment is correct. Appellants have not met their burden to show any error in the proposed assessment. Indeed, they concede that they owe this tax, but claim there was a clerical error with TurboTax. Whether it was a clerical error or not, the imposition of the early distribution tax pursuant to section 17085(c)(1) is proper and we have no legal basis to overturn FTB’s assessment.

²The additional tax of \$1,570 is 2.5 percent times the distribution amount of \$62,805.85.

HOLDING

Appellants have not shown error in FTB’s proposed assessment of the 2.5 percent early distribution tax for the 2014 tax year.

DISPOSITION

FTB’s action is sustained.

DocuSigned by:
Sara A. Hosey
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Sara A. Hosey
Administrative Law Judge

We concur:

DocuSigned by:
Jeffrey I. Margolis
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Jeffrey I. Margolis
Administrative Law Judge

DocuSigned by:
Elliott Scott Ewing
2D8DE82F8B65E4A8...
Elliott Scott Ewing
Administrative Law Judge