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2020 – OTA – 187
Nonprecedential

OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18010714
W. HAVENS	)

OPINION

Representing the Parties:

For Appellant: W. Havens[1]

For Respondent: Christopher E. Haskins, Tax Counsel III[2]

For Office of Tax Appeals: Sheriene Anne Ridenour, Tax Counsel IV

S. HOSEY, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC) sections 19045 and 19324, W. Havens (appellant) appeals actions by respondent Franchise Tax Board (FTB) sustaining proposed assessments for tax years 1999 through 2002 and denying a refund claim for tax year 1999.

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

[1] Jose Nunez, accountant at Silicon Valley Accounting & Tax, represented appellant during the appeal. Edward I. Kaplan of Greene Radovsky Maloney Share & Hennigh LLP was also added as a representative to the appeal in May 2014 and assisted appellant through his protest with Franchise Tax Board.

[2] Alberto Rosas, who was previously counsel for Franchise Tax Board in this matter, is now working for the Office of Tax Appeals (OTA) as an administrative law judge. However, he was recused from this matter, has had no involvement in this appeal since joining OTA, and has not had any contact with other OTA employees regarding this appeal.

ISSUES[3]

1. Whether OTA has jurisdiction to consider appellant's claim for refund, and if so, whether appellant has demonstrated error in FTB's denial of his claim for refund.
2. Whether appellant has demonstrated that he is entitled to capitalize legal fees.
3. Whether appellant has shown that he is entitled to claim a bad debt deduction.
4. Whether appellant has demonstrated that he is entitled to abatement of the accuracy-related penalty.
5. Whether appellant has demonstrated that he is entitled to interest abatement.[4]
6. Whether OTA may consider the due process issues raised by appellant, and if so, whether FTB provided due process.

FACTUAL FINDINGS

General Background

1. Appellant, who works in the wireless communication industry, has formed, held an interest in, and/or been employed by various companies. As relevant for this appeal are the companies SunCom Mobile and Data, Inc. (SunCom), Highland Cellular, Inc. (HCI), SRS, LLC (SRS), and Net Radio Group Communications, Inc. (NRG).
2. In 1994, appellant formed SunCom, served as its president, and held a minority interest. In 1995, after the death of his father, appellant inherited shares of stock in HCI, which were combined with shares of stock in HCI that appellant already owned. Appellant maintained a minority interest in HCI.
3. In 1996, appellant hired the law firm Lukas, McGowan, Nace & Gutierrez (LMNG) to bring a shareholder derivative suit concerning his shares of stock in HCI, which came to a resolution in 1998 by settlement agreement. It appears that also in 1996, the Federal Communications Commission (FCC) denied a petition by SunCom that was integral to its

[3] FTB audited appellant's 1999, 2000, 2001, and 2002 tax years. FTB issued a Notice of Proposed Adjustment Carryover Amount (NPACA) for the 2000, 2001, and 2002 tax years, as well as a Notice of Action-Affirmation (NOAA) affirming the NPACA, which appellant appealed. During the briefing process, FTB conceded that the NPACA for the 2000, 2001, and 2002 tax years was untimely, and stated that it is withdrawing the NPACA, as well as the accompanying NOAA. Since there are no longer amounts at issue for the 2000, 2001, and 2002 tax years, this decision only addresses the issues relating to the 1999 tax year.

[4] As discussed below, FTB states that it will abate interest for the 1999 tax year from November 5, 2012, to May 3, 2013.

business plan and, as a result, appellant helped form SRS, which acquired all of SunCom's assets.

4. Thereafter, in 1998, appellant helped form NRG, and SRS contributed all of its assets to NRG in exchange for a minority interest. Also, in 1998, appellant terminated the services of LMNG, and in 1999, LMNG sued appellant and SunCom for payment for services rendered, to which appellant filed a counterclaim.

<u>1999 Tax Returns</u>

5. On April 15, 2003, appellant filed an untimely 1999 California income tax return (Form 540), reporting state wages of $33,000 and a federal adjusted gross income (AGI) of over $3 million. While appellant did not attach a federal tax return (Form 1040) to his return, appellant attached a California Schedule K-1 (568) and various federal schedules, including a federal Schedule C - Profit or Loss from Business, reporting bad debt expenses with respect to SunCom and SRS as well as a federal Schedule D - Capital Gains and Losses, reporting a basis of $468,587 in HCI shares and a sales price of $3,645,054, for a long-term capital gain of $3,176,467. Appellant did not report a total tax on his 1999 Form 540 and did not remit payment with the return.

6. On March 15, 2004, appellant filed a revised California Form 540 for 1999, which FTB treated as an amended return (first amended return), reporting state wages of $33,000 and federal AGI of approximately $2.7 million. Appellant also reported an amended long-term capital gain of $2,906,332 (i.e., $270,135 less than the $3,176,467 originally reported) for the sale of HCI shares. Appellant reported taxable income of $2,020,970, total tax of $186,258, and, after applying estimated tax payments of $180,000, tax due of $6,258, and a self-assessed underpayment of estimated tax penalty of $1,416. Appellant

did not calculate interest on the late payment of tax, nor provide an explanation with the return.[5] Appellant remitted a payment of $7,674 (i.e., $6,258 + $1,416) with the return.[6]

7. On December 8, 2004, appellant filed an amended California return for 1999 (Form 540X, second amended return), reporting state wages of $33,000 and federal AGI of $1,052,324.[7] Appellant also reported a second amended long term capital gain of $1,199,903 (i.e., $1,976,564 less than the $3,176,467 originally reported) for the sale of HCI shares. Appellant reported taxable income of $667,960, total tax of $60,428, and, after reporting total payments of $186,417, appellant claimed an overpayment of $125,989. Appellant attached to the return a statement indicating that the $1,706,429 reduction in reported federal AGI (i.e., from $2,758,753 to $1,052,324) was due to a "Reduction in capital gain from installment sale (Form 3805E)." Appellant also attached a declaration he signed under the penalty of perjury declaring that the reduction in reported federal AGI was due to an increase in basis in the HCI stock, and from moving $1,142,650 of the capital gain from the sale of the stock from the 1999 tax year to the 2002 tax year.

Audit

8. In May 2005, FTB opened an audit examination of appellant's 1999, 2000, 2001, and 2002 tax years. During the examination, appellant signed numerous waivers extending

[5] According to FTB's records, the interest on the self-assessed tax of $6,258 is a final liability and FTB has pursued collection action.

[6] FTB's Annual Notice dated November 28, 2012, states appellant paid $252,340.56 as of that date. FTB states that payments totaling $254,377.72 have been made with respect to the 1999 tax year consisting of: $159 (withholding effective April 15, 2000), $80,000 (June 10, 2003 payment), $100,000 (December 17, 2003 payment), $7,674 (August 3, 2004 payment), $20,000 (November 2, 2004 payment), $44,666.56 (December 7, 2004 payment), $1,873.27 (July 8, 2013 payment), and an adjustment of $4.89. FTB states that interest still remains outstanding on the first amended return for the 1999 tax year; according to their records, as of February 20, 2014, $3,358.68 remained due. The interest on the self-assessed tax is a final liability and FTB states it has pursued collection action with respect to that liability.

[7] Appellant's 1999 federal Account Transcript reflects a federal AGI of $2,148,155.

the statute of limitations until October 15, 2010, for FTB to issue appellant a proposed deficiency assessment for each tax year at issue.[8]

9. On September 27, 2010, FTB sent appellant a letter denying the claim for refund of $125,989 for the 1999 tax year, as well as a Notice of Proposed Assessment (NPA) for the 1999 tax year that made the following adjustments: (1) increased K-1 interest income by $3,075; (2) increased basis of HCI stock by $21,078;[9] (3) disallowed an increase in basis of stock of $270,135 for claimed legal fees; (4) disallowed a deduction of $61,251 (i.e., $8,695 + $52,556) in claimed bad debt; and (5) disallowed $18,803 in claimed itemized deductions. The NPA increased appellant's 1999 taxable income by $332,186 (i.e., $3,075 - $21,078 + $270,135 + $61,251 + $18,803), from $2,020,970 to $2,353,156. The NPA proposed additional tax of $30,894.00, a late filing penalty of $2,723.50, an accuracy-related penalty of $6,178.80, and a post-amnesty penalty of $8,495.00, plus interest.

Protest

10. Appellant protested the 1999 NPA,[10] and a protest hearing was held on July 9, 2012.

11. On August 28, 2012, FTB issued a "Protest – Position Letter – Legal Fees" (protest position letter) for the 1999 tax year indicating that during the protest hearing, the parties agreed that the primary issue was the legal fees and, therefore, the protest hearing officer only reviewed the legal fees issue. According to the protest position letter, appellant claimed the following legal fees:

[8] For the 1999 tax year, appellant signed the following waivers: (1) a waiver signed on November 30, 2006, extending the statute of limitations until April 15, 2008; (2) a waiver signed on November 28, 2007, extending the statute of limitations until October 15, 2008; (3) a waiver signed on May 27, 2008, extending the statute of limitations until October 15, 2009; and (4) a waiver signed on February 26, 2009, extending the statute of limitations until October 15, 2010.

[9] This increased the originally reported basis of HCI from $468,587 to $489,665, which reduced the originally reported gain of $3,176,467 to $3,155,389.

[10] During protest, appellant indicated that he did not dispute the increased K-1 interest income, the disallowed itemized deductions, the increased basis in stock, and the late filing penalty. Since appellant has raised no substantive arguments on appeal for those adjustments and the late filing penalty, and we see no error in the adjustments and imposition of the penalty, we will not address them further.

Tax Year	Legal Matter	Amount Claimed
1996-1998	*Havens v. Attar*	$102,218[11]
1999	*Havens v. Attar*	$30[12]
1999	*LMNG v. Havens/SunCom*	$150,654
	TOTAL	$252,902
2000	SunCom bankruptcy	$188,712[13]
2001	*LMNG v. Havens/SunCom*	$71,629[14]
2002	*LMNG v. Havens/SunCom* [15]	$225,000
2002	*LMNG v. Havens/SunCom*	$1,318[16]
	TOTAL	$226,318

12. The protest position letter indicated that as to the claimed legal fees, the protest hearing officer concluded the following:

[11] As discussed below, this amount was allowed during protest.

[12] According to the protest position letter, this amount was allowed during audit.

[13] In the protest position letter, this amount is sometimes referred to as $188,812, which appears to be a typographical error and the correct amount is $188,712. According to the protest position letter, this amount was allowed during audit for the 2002 tax year, pursuant to IRC section 212. As discussed below, it appears that appellant contends that this amount should be capitalized and included in the basis of the HCI stock sale, which occurred in 1999.

[14] As discussed below, it appears that appellant contends that this amount should be capitalized and included in the basis of the HCI stock sale, which occurred in 1999.

[15] While the August 28, 2012 letter indicates *Havens v. Attar* in the summary table, this appears to be a typographical error.

[16] As discussed below, it appears that appellant contends that this amount should be capitalized and included in the basis of the HCI stock sale, which occurred in 1999.

Havens v. Attar[17] (1996-1998 expenses totaling $102,218): The legal fees of $102,218 are to be capitalized under Internal Revenue Code (IRC) section 263 and included in the basis of the stock sale, which occurred in 1999.[18]

LMNG v. Havens/SunCom[19] ($223,601[20] in expenses): The protest hearing officer concluded that the legal fees did not meet the requirements of IRC section 212, but rather were personal in nature, and, therefore, were not deductible.

SunCom bankruptcy ($188,712 in expenses): The protest hearing officer concluded that the legal fees were paid in connection with appellant's status as a shareholder and, therefore, an ordinary and necessary business expense for the production of income and thus deductible when paid under IRC section 212.

LMNG v. Havens/SunCom ($225,000 for tax year 2002): The protest hearing officer concluded that appellant received $225,000 pursuant to a settlement agreement, that the $225,000 is taxable income, and that appellant is entitled to deduct $225,000 in legal fees in tax year 2002 under IRC section 212.[21]

13. The protest position letter stated that the protest hearing officer recommended: (1) reducing the disallowed legal fees from $270,135 to $167,917, to account for $102,218 in legal fees that appellant paid in relation to the shareholder derivative suit; (2) increasing the late filing penalty by $2,480.75, from $2,723.50 to $5,204.25 to remedy prior calculation errors; (3) reducing the post-amnesty penalty to zero based on payments made within the amnesty period; and (4) sustaining the remainder of the auditor's actions.
14. On October 16, 2012, appellant's representative sent FTB a letter stating that pending the resolution of the $225,000 attributable to the lawsuit with LMNG for the 2002 tax year, appellant was willing to accept FTB's proposed treatment of the other legal expenses as

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[17] This pertains to the shareholder derivative suit.

[18] The August 28, 2012 protest position letter states the protest hearing officer's conclusion on this matter: "Since the legal fees were paid in connection with appellant's status as a shareholder; they are considered an ordinary and necessary business expense for the production of income and thus deductible when paid under IRC section 212." However, this appears to be a typographical error based on the analysis section of the August 28, 2012 letter, as well as FTB's opening brief, stating that the legal fees are to be capitalized under IRC section 263.

[19] This pertains to the lawsuit LMNG filed against appellant and SunCom for payment of services rendered, and the counterclaims appellant filed.

[20] This amount consists of $150,654 + $ 71,629 + $ 1,318.

[21] During the briefing process, FTB stated that while its position is that appellant is not entitled to deduct or capitalize these fees, FTB acknowledges that it is barred from increasing its assessment.

outlined in the August 28, 2012 protest letter and concede all other protested issues. On October 17, 2012, appellant sent a second supplemental protest letter.

15. FTB determined that appellant's claim for refund of $125,989 for the 1999 tax year was properly denied. In addition, FTB issued a Notice of Action (NOA) for the 1999 tax year on November 5, 2012, which contained typographical errors and, therefore, FTB issued a revised 1999 NOA on December 27, 2012.
16. The December 27, 2012 NOA revised the 1999 NPA, as follows: (1) reduced the disallowed legal fees by $102,218, from $270,135 to $167,917; (2) reduced the disallowed itemized deductions by $6,133, from $18,803 to $12,670; (3) increased the late filing penalty by $2,480.75, from $2,723.50 to $5,204.25; (4) decreased the accuracy-related penalty by $2,015.40, from $6,178.80 to $4,163.40; and (5) reduced the $8,495.00 post-amnesty penalty to zero. The December 27, 2012 NOA otherwise affirmed the 1999 NPA. The December 27, 2012 NOA increased appellant's 1999 taxable income by $223,835 (i.e., $3,075 - $21,078 + $167,917 + $61,251 + $12,670), from $2,020,970 to $2,244,805, proposed additional tax of $20,817.00, a late filing penalty of $5,204.25, and an accuracy-related penalty of $4,163.40, plus interest.
17. This timely appeal followed.

DISCUSSION

Issue 1 - Whether OTA has jurisdiction to consider appellant's claim for refund, and if so, whether appellant has demonstrated error in FTB's denial of his claim for refund.

A taxpayer is required to pay all of the taxes assessed or asserted before filing a claim for refund and before the claim for refund can be acted on administratively. This is commonly referred to as the "full payment rule." Article XIII, section 32, of the California Constitution provides:

> No legal or equitable process shall issue in any proceeding in any court against this State or any officer thereof to prevent or enjoin the collection of any tax. After payment of a tax claimed to be illegal, an action may be maintained to recover the tax paid, with interest, in such manner as may be provided by the Legislature.

R&TC section 19322 provides that every claim for refund shall be in writing, signed by the taxpayer (or the taxpayer's representative), and shall state the specific grounds upon which the claim is based.

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R&TC section 19322.1(a) provides that a claim for refund of tax that is otherwise valid under R&TC section 19322, but is made before the full payment of the disputed tax has been made, shall be a claim only for purposes of tolling the statute of limitations. This informal claim for refund will be perfected and deemed filed on the date when the full payment of the tax is made. (*Ibid*.) Perfected refund claims are claims for refund for amounts that have been paid in full. (FTB Notice 2003-5.)

California Code of Regulations, title 18, (Regulation) section 30103(a)(3) provides OTA with "jurisdiction to hear and decide an appeal that has been timely submitted" after FTB mails a notice which "denies any portion of a *perfected* claim for a refund of tax, penalties, fees, or interest." (Emphasis added.)

To perfect the refund claim with respect to amounts that are due and payable, i.e., billable, as in the present appeal, all amounts due, including tax, penalty, and interest, must be paid. R&TC section 19164(g) incorporates IRC section 6665(a)(2), which defines the term "tax" to include penalties, additions to tax, and additional amounts. R&TC section 19101(c)(1) provides that, except for references relating to deficiency assessments, any reference to any tax imposed by Part 10 or 11 of the Revenue and Taxation Code "shall be deemed also to refer to interest imposed by this article on that tax." FTB issued FTB Notice 2003-5 to "clarif[y] that all amounts due for the year, including tax, penalty and interest, must be paid to perfect an informal claim under RTC section 19322.1." (FTB Notice 2005-6.)[22]

Appellant self-assessed a tax liability of $6,258 on his first amended return for the 1999 tax year, which is a final liability. When appellant filed a claim for refund of $125,989 for the 1999 tax year, interest on the 1999 final liability remained, and appears to continue to remain, outstanding. As discussed above, other than for purposes of tolling the statute of limitations, a claim for refund may only be filed *after* the entire balance due has been paid, including tax, penalties, and interest. Since appellant had a 1999 outstanding liability when he filed his claim for refund, appellant did not file a perfected claim for a refund. Since appellant failed to file a *perfected* claim for refund, we lack jurisdiction to determine whether appellant has demonstrated error in FTB's denial of his claim for refund.

[22] R&TC section 19101 was added in 2001, after the tax year at issue. Regardless, appellant raises arguments against the penalties and interest on appeal, and therefore payment of those amounts are required before a claim for refund can be filed. (See *Shore v. U.S.* (Fed. Cir. 1993) 9 F.3d 1524, 1527–1528.)

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Issue 2 - Whether appellant has demonstrated that he is entitled to capitalize legal fees.

FTB's determination is presumed correct and a taxpayer has the burden of proving it to be wrong. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Myers* (2001-SBE-001) 2001 WL 37126924.) In the absence of credible, competent, and relevant evidence showing an error in FTB's determinations, FTB's determinations will be upheld. (*Appeal of Seltzer* (80-SBE-154) 1980 WL 5068.) Tax deductions and credits are a matter of legislative grace, meaning that taxpayers must show that they clearly meet all of the statutory requirements for any deduction or credit. (See *Appeal of Walshe* (75-SBE-073) 1975 WL 3557; *INDOPCO Inc. v. Commissioner* (1992) 503 U.S. 79, 84; *New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435; *MedChem Inc. v. Commissioner* (1st Cir. 2002) 295 F.3d 118, 123.)

IRC section 162(a) allows a deduction for the ordinary and necessary expenses paid or incurred during the tax year in carrying on any trade or business.[23] Deductible expenses include the ordinary and necessary expenditures directly connected with, or pertaining to, the taxpayer's trade or business. (Treas. Reg. § 1.162-1(a).)

IRC section 212 provides that, in the case of an individual, a deduction shall be allowed for all of the ordinary and necessary expenses paid or incurred in the taxable year for: 1) the production or collection of income; 2) the management, conservation, or maintenance of property held for the production of income; or 3) in connection with the determination, collection, or refund of any tax.[24] IRC section 67(a) and (b) limit deductions under IRC section 212 to the extent that the aggregate of such miscellaneous itemized deductions exceeds two percent of AGI.[25]

IRC section 263 provides that a taxpayer is not allowed to claim a deduction for expenses that are properly classified as capital expenditures, which are to be added to the basis of the capital asset.[26] While IRC section 263 does not specifically reference legal expenses, treasury regulations, by way of example, indicate that a capital expenditure includes "the cost of

[23] R&TC section 17201 conforms to IRC section 162.

[24] R&TC section 17201 conforms to IRC section 212.

[25] R&TC section 17076 conforms to IRC section 67.

[26] R&TC section 17201 conforms to IRC section 263.

defending or perfecting title to property." (See former Treas. Reg. § 1.263(a)-2(c), which was in effect until 2012.)[27]

Legal expenses that are neither capitalizable nor deductible, are nondeductible personal expenses. The tax treatment of legal expenses paid in connection with litigation depends on the nature of the matter for which the expenses were incurred, which is determined by applying the "origin of the claim" test. (*U.S. v. Gilmore* (1963) 372 U.S. 39 (*Gilmore*).) As stated by the court in *Gilmore*: "[T]he characterization, as 'business' or 'personal,' of the litigation costs of resisting a claim depends on whether or not the claim arises in connection with the taxpayer's profit-seeking activities. It does not depend on the consequences that might result to a taxpayer's income-producing property from a failure to defeat the claim."

> "[T]he origin and character of the claim with respect to which an expense was incurred, rather than its potential consequences upon the fortunes of the taxpayer, is the controlling basic test of whether the expense was 'business' or 'personal' and hence whether it is deductible or not . . . ."

(*Gilmore,* pp. 48 - 49.)

Under the "origin of the claim" test, the substance of the underlying claim or transaction out of which the expenditure arose is what governs whether the expenditure is a deductible expense, a capital expenditure, or a nondeductible personal expense, regardless of the motive and intent of the payer, or the consequences that may result from failure to defeat the claim. The "origin of the claim" test applies regardless of whether it is the plaintiff or the defendant who seeks the deduction. (See *Dugrenier, Inc. v. Commissioner* (1972) 58 T.C. 931, 938.)

The "origin of the claim" test is not a mechanical search for what occurred first in the chain of events leading to the litigation, but is instead based on all the facts and circumstances of the litigation. (*Estate of Kincaid v. Commissioner* (1986) T.C. Memo. 1986-543.) The inquiry is directed to the determination of the "kind of transaction" from which the litigation arose. Consideration is given to "the issues involved, the nature and objectives of the litigation, the

[27] TD 9636 amended Treasury Regulation sections 1.162-3, 1.162-4, 1.162-11, 1.165-2, 1.167(a)-4, 1.167(a)-7, 1.167(a)-8, 1.168(i)-7, 1.263(a)-1, 1.263(a)-2, 1.263(a)-3, 1.263(a)-6, 1.263A-1, and 1.1016-3 (collectively referred to as the Capitalization Regulations). The Capitalization Regulations, which are effective for tax years beginning on or after January 1, 2014, replaced the rehabilitation doctrine. Taxpayers have the option of applying the Temporary Regulations for tax years beginning on or after January 1, 2012. (1-4 Federal Taxes Affecting Real Estate §§ 4.03(1)(a)(i)-(ii) (2015), fns. 215.1, 218.1, 218.2.) These amendments do not apply to this appeal because the tax year at issue is 1999.

defenses asserted, the purpose for which the claimed deductions were expended, the background of the litigation, and all facts pertinent to the controversy." (*Ibid.*)

Appellant contends that legal fees totaling $223,601[28] for *LMNG v. Havens/SunCom* and legal fees of $188,712 for *SunCom bankruptcy* should be capitalized and included in the basis of the HCI stock sale.[29] We will address each case separately.

LMNG v. Havens/SunCom ($223,601 in expenses)

Appellant asserts that the *LMNG v. Havens/SunCom* case was a direct result from the *Havens v. Attar* case, in that LMNG filed suit alleging that it was due a portion of the buyout HCI paid appellant for his shares. Appellant contends that he refused to pay the fees since he believed LMNG's fees for the *Havens v. Attar* case were greatly overstated, and that his decision to withhold payment does not convert a business cost into a personal cost. Appellant contends that the *LMNG v. Havens/SunCom* attorney fees are directly connected to, and intertwined with, the *Havens v. Attar* case, and since the attorney fees are essentially a continuation of the same action, treatment of these legal fees must be consistent with the legal fees paid in relation to *Havens v. Attar*. Appellant contends that before appellant received the proceeds from the HCI buyout, LMNG filed a complaint alleging a claim to a portion of the proceeds, and that appellant then filed a counterclaim against LMNG. Appellant asserts that this lawsuit "arose solely out of the first one" and that appellant sued LMNG in his "business and trade, as a continuation of the first lawsuit and to protect the income (capital gains) [appellant] got in relation to the first lawsuit." Appellant contends that the fact that a personal decision was made to dispute payment of the fees does not alter the underlying nature and origin of the claim of the action, the trail of which leads straight back to the sale of appellant's HCI stock.

As discussed above, the "origin of the claim" test is not a mechanical search for what occurred first in the chain of events leading to the litigation, but is instead based on all the facts and circumstances of the litigation. (*Estate of Kincaid v. Commissioner*, *supra*.) The inquiry is

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[28] This amount consists of $150,654 (paid in 1999) + $ 71,629 (paid in 2000) + $ 1,318 (paid in 2002).

[29] We note that in support of his contention, appellant refers to IRS Private Letter Ruling (PLR) 201045005 (November 12, 2010). According to PLR 201045005, a taxpayer requested a ruling whether it was entitled to a deduction under IRC section 162(a) for payments it made on behalf of its employee regarding restitution and legal expenses attributable to the employee's lawsuit and settlement. We find that PLR 201045005 is factually distinguishable from this appeal, and, therefore, does not substantiate appellant's contention. Furthermore, a PLR may not be used or cited as precedent unless the Secretary of the Treasury establishes regulations to that effect. (IRC, § 6110(k)(3).)

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directed to the determination of the "kind of transaction" from which the litigation arose. We have reviewed the various court documents provided regarding the *LMNG v. Havens/SunCom* case. While the *Havens v. Attar* case may have been the first in the chain of events leading to the *LMNG v. Havens/SunCom* case, LMNG's claims were based on a contract dispute and to compel payment for services rendered, and appellant's claims were based on the quality of legal services LMNG performed. The "origin of the claim" test requires that the facts of the particular controversy for which the expenditure arose is what governs, as opposed to what occurred first in the chain of events leading to the litigation. The origin of the *LMNG v. Havens/SunCom* case is a breach of contract dispute, as opposed to the protection or disposition of a capital asset.

Appellant has not established that the legal fees from the *LMNG v. Havens/SunCom* should be capitalized and included in the basis of the HCI stock sale. In addition, appellant has not demonstrated that the legal fees meet the requirements to be deductible under IRC section 212. We find that the legal fees from the *LMNG v. Havens/SunCom* case were personal in nature, and, therefore, are neither capitalizable nor deductible, but rather are nondeductible personal expenses.

SunCom bankruptcy ($188,712 in expenses)

Appellant asserts that this bankruptcy action would not have occurred but for the existence of the *Havens v. Attar* litigation and the resulting *SunCom v. LMNG* litigation. Therefore, appellant contends, the fees related to the bankruptcy should also be capitalized. Appellant asserts that LMNG performed services for SunCom during the period of 1993 through 1995, and that appellant agreed, both on behalf of SunCom and himself, to pay for the services. Appellant contends that the SunCom bankruptcy was filed in response to claims in the *LMNG v. Havens/SunCom* lawsuit, "as LMNG responded in the bankruptcy based solely on its claims in the lawsuit." Appellant asserts that under federal bankruptcy law, when an entity files bankruptcy, it acts as an automatic stay as to any court case that was pending against the entity, regardless if the case involves parties other than the entity filing for bankruptcy. Appellant contends that with regard to the *LMNG v. Havens/SunCom* lawsuit, the automatic stay of litigation allowed appellant benefits including additional time to seek representation and experts for his counterclaim and, therefore, payment of expenses related to the SunCom bankruptcy "was directly linked to, and in fact achieved for [appellant's] benefits in" the *LMNG v. Havens/SunCom* lawsuit.

As discussed above, this amount was allowed during audit for the 2002 tax year. Specifically, the protest hearing officer concluded that the legal fees were paid in connection with appellant's status as a shareholder of SunCom and, therefore, an ordinary and necessary business expense for the production of income, and thus deductible under IRC section 212. While the 2002 tax year is no longer at issue, it appears that appellant contends that this amount should be capitalized and included in the basis of the HCI stock sale, which occurred in 1999.

According to appellant, the SunCom bankruptcy petition was a strategic litigation decision he made in order receive an automatic stay in the *LMNG v. Havens/SunCom* lawsuit and, therefore, payment of expenses related to the SunCom bankruptcy is directly linked to the *LMNG v. Havens/SunCom* lawsuit. We find appellant's argument that the SunCom bankruptcy legal fees should be capitalized and included in the basis of the HCI stock sale to be untenable. We find that the SunCom bankruptcy legal fees are not related to any capital transaction, let alone the protection or disposition of appellant's HCI shares. In addition, we find that appellant has not demonstrated the legal fees appellant incurred when SunCom filed a lawsuit against LMNG (*SunCom v. LMNG*) should be capitalized and included in the basis of the HCI stock sale.

As such, we find that appellant has failed to establish that the $188,712 in legal expenses for the SunCom bankruptcy and *SunCom v. LMNG* should be capitalized and included in the basis of the 1999 HCI stock sale, as opposed to being allowed as a deduction, pursuant to IRC section 212, for the 2002 tax year.

<u>Issue 3 - Whether appellant has shown that he is entitled to claim a bad debt deduction</u>.

Tax deductions and credits are a matter of legislative grace, meaning that taxpayers must show that they clearly meet all of the statutory requirements for any deduction or credit. (See *Appeal of Walshe*, *supra*; *INDOPCO Inc. v. Commissioner*, *supra*; *New Colonial Ice Co. v. Helvering*, *supra*; *MedChem Inc. v. Commissioner*, *supra*.) Taxpayers claiming deductions and credits must keep sufficient records to substantiate the claimed deduction or credit. (*Sparkman v. Commissioner* (9th Cir. 2007) 509 F.3d 1149, 1159.) Unsubstantiated assertions are insufficient to satisfy the burden of proof. (*Appeal of Telle*s (86-SBE-061) 1986 WL 22792.) The fact that it may be difficult, if not impossible, for the taxpayer to substantiate any claimed deduction does not relieve the taxpayer of this burden. (*Burnet v. Houston* (1931) 283 U.S. 223; *Appeal of Lew* (73-SBE-053) 1973 WL 2786.) A taxpayer's failure to introduce evidence that is within his control gives rise to the presumption that the evidence, if provided, would be unfavorable to the

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party's position. (*Appeal of Cookston* (83-SBE-048) 1983 WL 15434.) There is a presumption of correctness as to FTB's denial of deductions and the burden is on the taxpayer to show by competent evidence that it is entitled to any deductions claimed. (*New Colonial Ice Co. v. Helvering*, *supra*; *Appeal of Walshe*, *supra*; *Appeal of Janke* (80-SBE-059) 1980 WL 4988; *Todd v. McColgan*, *supra*.)

IRC section 166, to which California conforms pursuant to R&TC section 17201, allows a deduction for a business or nonbusiness debt that becomes worthless within the taxable year. (IRC, § 166(a) & (d).) A taxpayer claiming a bad debt loss deduction has the burden of proof to establish a deductible bad debt loss. (See, e.g., *Appeal of Credo Developers, Inc.* (84-SBE-028) 1984 WL 16108.) To be deductible under IRC section 166, a loss must be attributable to a bona fide debt. (*Adelson v. U.S.* (Fed. Cir. 1984) 737 F.2d 1569, 1571.) Treasury Regulation section 1.166-1(c) defines a bona fide debt as "a debt which arises from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money." (See also *Calumet Industries, Inc. v. Commissioner* (1990) 95 T.C. 257, 284.)

No deduction may be allowed for a particular year if the debt became worthless before or after that year. (*Appeal of Kune* (84-SBE-106) 1984 WL 16186.) The time when something became worthless must be fixed by an identifiable event or events that furnish a reasonable basis for a taxpayer to abandon any hope of future recovery. (*Appeal of Southwestern Development Company* (85-SBE-104) 1985 WL 15875.) The subjective good faith opinion of the taxpayer, by itself, is insufficient to show worthlessness. (*Newman v. Commissioner*, T.C. Memo. 1982-61; *Fox v. Commissioner* (1968) 50 T.C. 813.) FTB's findings are presumptively correct, and appellant has the burden of showing that FTB's findings are erroneous. (*Appeal of Brockett* (86-SBE-109) 1986 WL 22731.)

Appellant attached to his original 1999 California income tax return a federal Schedule C - Profit or Loss from Business, reporting bad debt expenses of $52,556 and $8,695 with respect to SunCom and SRS, respectively. Appellant asserts that while he did not own a controlling interest in SunCom and SRS, he made the advances to ensure the viability of the companies, since without the advances he would not have had gainful employment. Appellant asserts that the purported loans were for the purpose of appellant's trade and business ("to establish and manage legal entities holding and developing FCC licenses for new forms of wireless") and, therefore, appellant properly attributed the amounts as business bad debts. Appellant contends

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that the loans were not investments but, instead, were made in order to secure and improve appellant's position in the companies. Appellant asserts that he helped form SunCom in 1994, that he was a minority shareholder, and that between 1994 and 1996 he loaned SunCom $52,556. Appellant asserts that the success of SunCom was dependent upon its acquiring certain FCC licenses. Appellant contends that when SunCom's petition to acquire the licenses was denied, it was "clear that its business venture would not be successful and its future prospects and ability to repay [appellant] the loans were minimal, at best." Appellant asserts that thereafter, in 1997, SunCom contributed its assets to SRS in an exchange for a minority interest. Appellant asserts that he loaned SRS $8,695 to fund its operations during 1997 and 1998, and that subsequently, SRS contributed its assets to NRG for a non-controlling interest. Appellant asserts that NRG was insolvent by early 2000, and that SunCom filed for bankruptcy in February of 2000. Appellant asserts that as a result of the asset transfer from SunCom to SRS to NRG, and with NRG failing, there was no question that SunCom and SRS had both become virtually worthless and would never be able to repay appellant.

Appellant contends that SunCom filing for bankruptcy in February 2000 does not establish that SunCom was able to repay the loan prior to the filing. Appellant asserts that following SunCom's filing for bankruptcy, appellant loaned it $38,220 (which appellant claimed as a bad debt deduction on his 2002 return) to help pay for legal expenses, which indicates SunCom's financial inability to repay debt owed. Appellant contends that the amounts he advanced were loans, and always treated as such by the parties. Appellant contends that since it was clear by December 31, 1999, that the loans to SunCom would not be repaid, and the $8,695 he loaned to SRS became worthless by the end of 1999, he claimed a bad debt deduction for both loans on his 1999 return.

Appellant has not met his burden of proof to establish a deductible bad debt loss. While appellant provided copies of a Quicken Account report stating that funds were loaned, appellant has provided no documentation evidencing that the money was transferred. More importantly, even if appellant substantiated that he advanced funds to either company, appellant has provided no source documentation, such as a promissory note between appellant and either company, evidencing a bona fide debt existed between himself and SunCom, nor between himself and SRS. Appellant claims he was a victim of burglary in early 2000, when NRG managers removed from NRG's office (which appellant indicates was located in his residence), books, records, and

computers. Appellant asserts that since NRG "was made of a 'roll-up' of the assets of many small companies," NRG's books and records, which the managers removed, included the books and records of SunCom and SRS. Since appellant has provided no source documentation substantiating his contention that a bona fide debt existed between himself and either company, and a showing that a loss is attributable to bona fide debt is necessary to claim a bad debt deduction under IRC section 166, we do not find it necessary to discuss whether the alleged bad debt was a business or nonbusiness debt, nor the year the alleged debt became worthless.

Issue 4 - Whether appellant has demonstrated that he is entitled to abatement of the accuracy-related penalty.

R&TC section 19164, which incorporates the provisions of IRC section 6662, provides for an accuracy-related penalty of 20 percent of the applicable underpayment. The penalty applies to the portion of the underpayment attributable to (1) negligence or to a disregard of rules and regulations or (2) any substantial understatement of income tax. (IRC, § 6662(b).) The IRC defines "negligence" to include "any failure to make a reasonable attempt to comply" with the provisions of the IRC. (IRC, § 6662(c).) The term "disregard" is defined to include any "careless, reckless, or intentional disregard." (*Ibid*.) IRC section 6662 provides that a substantial understatement of tax exists if the amount of the understatement exceeds the greater of 10 percent of the tax required to be shown on the return or $5,000. (IRC, § 6662(d)(1).) The term "understatement" means the excess of the amount required to be shown on the return for the taxable year over the amount of the tax imposed which is shown on the return, reduced by any rebate. (IRC, § 6662(d)(2).)

There are three exceptions to the imposition of the accuracy-related penalty. The taxpayer bears the burden of proving any defenses to the imposition of the accuracy-related penalty. (*Recovery Group, Inc. v. Commissioner*, T.C. Memo. 2010-76.) Under the first exception, the accuracy-related penalty shall be reduced by the portion of the understatement attributable to a tax treatment of any item if there is substantial authority for such treatment. (IRC, § 6662(d)(2)(B).) Under the second exception, the accuracy-related penalty shall 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 are adequately disclosed and there is a reasonable basis for the tax treatment of such item. (IRC, § 6662(d)(2)(B).) The exception for adequate disclosure, however, will not apply if the taxpayer failed to keep adequate books or records or

the taxpayer failed to substantiate items on the return. (Treas. Reg. § 1.6662-3(c)(1).) Under the third exception, the accuracy-related penalty will not be imposed to the extent that a taxpayer shows a portion of the underpayment was due to reasonable cause and that it acted in good faith with respect to such portion of the underpayment. (IRC, § 6664(c)(1); Treas. Reg. §§ 1.6664-1(b)(2) & 1.6664-4.)

A determination of whether taxpayers acted with reasonable cause and in good faith is made on a case-by-case basis and depends on the pertinent facts and circumstances, including their efforts to assess the proper tax liability, their knowledge and experience, and the extent to which they relied on the advice of a tax professional.[30] Generally, the most important factor is the extent of taxpayers' efforts to assess their proper tax liability. The reliance on the advice of a professional tax advisor does not necessarily demonstrate reasonable cause and good faith. However, the reliance on professional advice constitutes reasonable cause and good faith if, under all of the circumstances, such reliance was reasonable and the taxpayer acted in good faith. (Treas. Reg. § 1.6664-4(b)(1).)

With respect to an underpayment attributable to the reliance by the taxpayer on professional advice, the advice must not be based on unreasonable factual or legal assumptions (including assumptions regarding future events) and must not unreasonably rely on the representations, statements, findings, or agreements of the taxpayer or any other person. (Treas. Reg. § 1.6664-4(c)(ii).) For example, the advice must not be based on a representation or assumption which the taxpayer knows or has reason to know is unlikely to be true, such as an inaccurate representation or assumption regarding the taxpayer's purpose for entering into a transaction or for structuring a transaction in a particular manner. (*Ibid.*) A taxpayer claiming reliance on a professional must show that (1) the tax preparer was a competent professional who had sufficient expertise to justify reliance; (2) the tax preparer was supplied with necessary and accurate information; and (3) the taxpayer actually relied in good faith on the advice. (*Neufeld v. Commissioner*, T.C. Memo. 2008-79, citing *Neonatology Assocs., P.A. v. Commissioner* (2000) 115 T.C. 43, 99.)

[30] "Advice" is any communication, including the opinion of a professional tax advisor, setting forth the analysis or conclusion of a person, other than the taxpayers, provided to (or for the benefit of) the taxpayers and on which the taxpayers rely, directly or indirectly, and does not have to be in any particular form. (Treas. Reg. § 1.6664-4(c)(2).)

Appellant contends that he made every effort to properly compute his tax liability for the 1999 tax year. Appellant asserts that he sought the advice of professional counsel, as well as accountants, to discuss the proper tax treatment for the amounts at issue, and that all the relevant surrounding facts and circumstances related to each issue were made known to the advisors, whose advice appellant relied on when he claimed his deductions. Appellant contends that while specific disclosure of the various transactions was not made on the original 1999 tax return, appellant had substantial authority for his claimed tax treatment for the items and showed good faith and reasonable cause in preparing his 1999 tax return.

While appellant contends that he relied in good faith on advice from professionals, appellant only offers his statement without providing supporting documentation. Without further information, it is unclear what steps appellant took to ascertain his tax liability. Appellant has not shown that the advice was from competent professionals who had sufficient expertise to justify reliance. Also, appellant has not demonstrated that the professionals were supplied with necessary and accurate information and appellant relied in good faith on the advice. Appellant has failed to show either substantial authority to justify the understatement or adequate disclosure of the understatement specifying a reasonable basis. Furthermore, appellant has not established that there is substantial authority or a reasonable basis for the treatment of his taxes as reported on his return. Appellant has failed to produce credible and competent evidence to show that FTB improperly imposed the accuracy-related penalty or that any of the three exceptions to the imposition of the accuracy-related penalty are applicable here. Accordingly, appellant has not met his burden of establishing any basis for an abatement of the accuracy-related penalty.

Issue 5 - Whether appellant has demonstrated that he is entitled to interest abatement.

The assessment of interest on a tax deficiency is mandatory. (R&TC, § 19101(a); *Appeal of Yamachi* (77-SBE-095) 1977 WL 3905.) Interest is not a penalty but is simply compensation for a taxpayer's use of money. (*Appeal of Jaegle* (76-SBE-070) 1976 WL 4086.) There is no reasonable cause exception to the imposition of interest. (*Ibid.*) FTB's determination not to abate interest is presumed correct, and the burden is on the taxpayer to prove error. (*Appeal of Myers, supra*.) Our jurisdiction in an interest abatement case is limited by statute to a review of FTB's determination for an abuse of discretion. (R&TC, § 19104(b)(2)(B).) To show an abuse of discretion, a taxpayer must establish that, in refusing to abate interest, FTB exercised its

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discretion arbitrarily, capriciously, or without sound basis in fact or law. (*Woodral v. Commissioner* (1999) 112 T.C. 19, 23.) Because the interest abatement provisions were not intended to be routinely used to avoid the payment of interest, interest should be abated only "where failure to abate interest would be widely perceived as grossly unfair." (*Lee v. Commissioner* (1999) 113 T.C. 145, 149.)

To obtain interest abatement, an appellant must qualify under one of the following three statutes: R&TC sections 21012, 19112, or 19104. R&TC section 21012 is not applicable here because there has been no reliance on any written advice requested of FTB. Under R&TC section 19112, interest may be waived for any period for which FTB determines that an individual or fiduciary demonstrates an inability to pay that interest solely because of extreme financial hardship caused by a significant disability or other catastrophic circumstances. However, this statute does not provide any authority for OTA to review FTB's determination to abate interest for extreme financial hardship. (*Appeal of Moy*, 2019-OTA-057P).

Under R&TC section 19104, FTB may abate all or a part of any interest on a deficiency to the extent that interest is attributable in whole or in part to any unreasonable error or delay committed by FTB in the performance of a ministerial or managerial act. (R&TC, § 19104(a)(1).) An error or delay can only be considered when no significant aspect of the error or delay is attributable to appellant and after FTB contacted appellant in writing with respect to the deficiency or payment. (R&TC, § 19104(b)(1); *Appeal of Teichert* (99-SBE-006) 1999 WL 1080256.) There is no reasonable cause exception to the imposition of interest. (*Appeal of Jaegle, supra.)* The mere passage of time does not establish error or delay in performing a ministerial or managerial act. (*Howell v. Commissioner*, T.C. Memo. 2007-204; *Larkin v. Commissioner*, T.C. Memo. 2010-73.)

In *Appeal of Kishner* (99-SBE-007) 1999 WL 1080250, the Board of Equalization (BOE) adopted the language from Treasury Regulation section 301.6404-2(b)(2), defining a "ministerial act" as:

> [A] procedural or mechanical act that does not involve the exercise of judgment or discretion, and that occurs during the processing of a taxpayer's case after all prerequisites to the act, such as conferences and review by supervisors, have taken place. A decision concerning the proper application of federal tax law (or other federal or state law) is not a ministerial act.

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When a California statute is substantially identical to a federal statute (such as with the interest abatement statute in this case),[31] OTA may consider federal law interpreting the federal statute as highly persuasive. (*Appeal of Kishner*, *supra*.) Treasury Regulation section 301.6404-2(b)(1) defines a "managerial act" as:

> [A]n administrative act that occurs during the processing of a taxpayer's case involving the temporary or permanent loss of records or the exercise of judgment or discretion relating to management of personnel. A decision concerning the proper application of federal tax law (or other federal or state law) is not a managerial act.

A decision concerning the proper application of federal tax law, or other federal or state laws, to the facts and circumstances surrounding a taxpayer's tax liability is not a ministerial or managerial act. (Treas. Reg. § 301.6404-2(b); *Bucaro v. Commissioner*, T.C. Memo. 2009-247.) Workload constraints are not a basis for an abatement or refund of interest. (*Leffert v. Commissioner*, T.C. Memo. 2001-23; *Strang v. Commissioner*, T.C. Memo. 2001-104.)

Appellant argues that interest should be abated on any amount that was assessed in error.[32] Appellant also contends that there were unreasonable delays during the audit due to FTB's lack of understanding of the special nature of appellant's business and related investments, and the unusual litigation involved.

Appellant's contentions do not constitute ministerial or managerial acts that would authorize FTB to abate interest. The mere passage of time, as well the actions of FTB employees in applying tax law to appellant's facts and circumstances, are not a ministerial or managerial act that could provide a basis for interest abatement. (*Denny's Auto Sales v. Commissioner*, T.C. Memo. 2002-266.)

FTB states that it will abate interest for the 1999 tax year from November 5, 2012, to May 3, 2013, due to a typographical error on the 1999 NPA and FTB's delay in issuing the

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[31] R&TC section 19104(a) and (b)(2)(B) are substantially identical to IRC section 6404 (e) and (h).

[32] Interest that accrues on assessed amounts which are later withdrawn by FTB is automatically abated.

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NPACA for the 2000 through 2002 tax years.[33] FTB explains that the errors constitute ministerial acts that do not involve the exercise of judgment or discretion. Appellant, however, has not established that he is entitled to additional interest abatement.

Issue 6 - Whether OTA may consider the due process issues raised by appellant, and if so, whether FTB provided due process.

Appellant argues that FTB notices are confusing, and while his accountant contacted FTB regarding differences between the notices, and eventually received advice, appellant is still unclear as to the differences and he was not properly informed of the tax determinations. Appellant asserts that the NOA does not show all of the tax payments and credits, and that FTB has not shown appellant a clear accounting.[34] Appellant contends that FTB did not respect the power of attorney appellant granted his accountant, which caused delay and prejudice. Appellant asserts that the "large and ongoing errors of the FTB, and improper procedure and confusion . . . violate due process and property rights under the California and US Constitutions," and that a remedy includes correction of the errors, relief from interest and penalties, and for the actual costs appellant incurred in the audit, protest, and appeal, pursuant to R&TC sections 21001 through 21028 (Taxpayers' Bill of Rights).

We note that the California Constitution prohibits an administrative agency, such as OTA, from refusing to enforce a statute on the basis of it being unconstitutional, unless an appellate court has made a determination that such statute is unconstitutional. (Cal. Const., art. III, § 3.5.) Our predecessor, the BOE, had a well-established policy of abstaining from deciding

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[33] FTB states that the corrected 1999 NOA was issued on December 27, 2012, and the NOAA for 2000 through 2002 was issued on May 3, 2013, and asserts that had the 1999 NOA not contained typographical errors, and if the 2000 through 2002 tax years were originally considered timely protested, the NOAs would have been issued on November 5, 2012. As stated above, the 2000 through 2002 tax years are no longer at issue due to the NPACA for those tax years being untimely. The interest abatement period conceded by FTB includes errors for tax years 2000 through 2002, and, therefore, is longer than the interest abatement period would be for just tax year 1999 (i.e., the corrected 1999 NOA was issued on December 27, 2012). We see no reason to shorten the interest abatement period conceded by FTB for the tax year at issue, since it is in appellant's favor.

[34] Specifically, appellant contends that FTB did not properly apply his payments of $252,340.56 to his 1999 account. Appellant contends that the December 27, 2012 NOA only incorporated payments made of $186,258. It appears that appellant is referring to the 1999 NOA line item titled "Less Original or Revised total tax" of $186,258. As discussed above, appellant reported on his "first amended return" for the 1999 tax year total tax of $186,258. According to FTB, credits totaling $254,377.72 were applied towards appellant's 1999 tax year, as follows: (1) $159.00 ((i.e., $2,109 - $1,950) 1999 withholding, effective April 15, 2000; (2) $80,000.00 (June 10, 2003); (3) $100,000.00 (December 17, 2003); (4) $7,674.00 (August 3, 2004); (5) $20,000.00 (November 2, 2004); (6) $44,666.56 (December 7, 2004); (7) $1,873.27 (July 8, 2013); and (8) $4.89 (adjustment). Not all account credits are reflected on an NOA.

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constitutional issues. (See, e.g., *Appeal of Aimor Corp*. (83-SBE-221) 1983 WL 15592; *Appeal of Vortox Manufacturing Co*. (30-SBE-017) 1930 WL 890.) This policy was based upon the absence of any specific statutory authority that would allow FTB to obtain judicial review in such cases and upon the belief that judicial review should be available for questions of constitutional importance. (See *Appeal of Aimor Corp*., *supra*; *Appeal of Vortox Manufacturing Co*., *supra*.) We see no reason to depart from this established policy.[35]

In *Clapp v. Commissioner* (9th Cir. 1989) 875 F.2d 1396, 1402, the Ninth Circuit explained that "[o]nly where the notice of deficiency reveals on its face that the Commissioner failed to make a determination is the Commissioner required to prove that he did in fact make a determination." The Ninth Circuit further stated that, in assessing the validity of the notice, it would not consider internal IRS memoranda and would not "depart from the rule that we should not 'look behind a deficiency notice to question the Commissioner's motives and procedures leading to a determination.'" (*Clapp*, *supra*, 875 F.2d 1396, 1401, quoting *Scar v. Commissioner* (9th Cir. 1987) 814 F.2d 1363,1368.) Here, FTB made a reasonable determination based on an audit examination. As noted previously, this determination is presumed to be correct. (*Appeal of Magidow*, *supra*.) We will not look behind FTB's notices to question FTB's procedures leading to its determination.

Like our predecessor, the BOE, our only power is to determine the correct amount of tax. (See *Appeals of Dauberger, et al.* (82-SBE-082) 1982 WL 11759.) "We have no power to remedy any other real or imagined wrongs that taxpayers believe they may have suffered at the hands of the Franchise Tax Board." (*Ibid.*)

Furthermore, in *Appeals of Bailey, supra*, the BOE stated:

> [D]ue process is satisfied with respect to tax matters so long as an opportunity is given to question the validity of a tax at some stage of the proceedings. It has long been held that more summary proceedings are permitted in the field of taxation because taxes are the lifeblood of government and their prompt collection is critical.

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[35] Moreover, "due process is satisfied with respect to tax matters so long as an opportunity is given to question the validity of a tax at some stage of the proceedings." (*Appeals of Bailey* (92-SBE-001) 1992 WL 100118.) Here, appellant had the opportunity to, and did, protest FTB's proposed assessment. Also, during protest, FTB specifically requested that, if appellant disagreed with its proposed assessment, appellant provide evidence to support his position. Thus, FTB provided an opportunity for appellant to contest its determination. Furthermore, appellant had multiple opportunities to provide evidence during this appeal. Accordingly, appellant had multiple opportunities to question the validity of FTB's determination.

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Here, appellant has been provided an opportunity to question the assessment during this appeal. We decline to further consider constitutional arguments.[36]

Financial Hardship

With respect to appellant's contention that he is experiencing financial difficulties, OTA's jurisdiction is limited to determining the correct amount of appellant's California personal income tax liability. (*Appeals of Dauberger, et. al.*, *supra*.) OTA does not have the authority to adjust a taxpayer's tax liability based on a taxpayer's inability to pay. (*Appeal of Luebbert* (71-SBE-028) 1971 WL 2708.) Once the decision in this appeal becomes final, appellant may contact FTB to determine whether he is eligible to participate in the Offer in Compromise program or whether he can enter into an installment payment agreement with FTB.

[36] See Regulation section 30104(d) stating OTA does not have jurisdiction to consider whether an appellant is entitled to a remedy for FTB's actual or alleged violation of any substantive or procedural right, unless the violation affects the adequacy of a notice, the validity of an action from which a timely appeal was made, or the amount at issue in the appeal.

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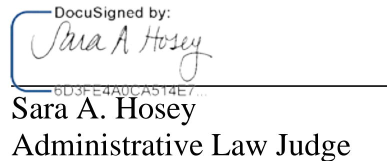
HOLDINGS

1. OTA does not have jurisdiction to consider whether appellant has demonstrated error in FTB's denial of his claim for refund.
2. Appellant has not demonstrated that he is entitled to capitalize legal fees.
3. Appellant has not shown that he is entitled to claim a bad debt deduction.
4. Appellant has not demonstrated that he is entitled to abatement of the accuracy-related penalty.
5. Appellant has not demonstrated that he is entitled to additional interest abatement.
6. OTA is not authorized to consider the due process issues raised by appellant.

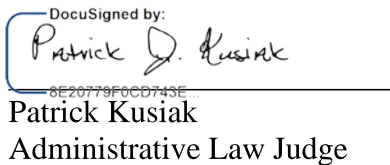
DISPOSITION

FTB's action is modified, in accordance with FTB's concession on appeal, to remove the carryover adjustments for the 2000, 2001, and 2002 tax years, and to abate interest that accrued from November 5, 2012, to May 3, 2013, for the 1999 tax year. Otherwise, FTB's action is sustained.

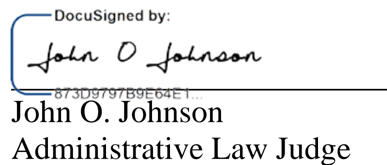


Sara A. Hosey
Administrative Law Judge

We concur:



Patrick Kusiak
Administrative Law Judge



John O. Johnson
Administrative Law Judge

Date issued: 5/21/2020