OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18010970
M. DOHERTY	)
	)
	)
	)

OPINION

Representing the Parties:

For Appellant: M. Doherty

For Respondent: Eric A. Yadao, Tax Counsel III

J. LAMBERT, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, M. Doherty (appellant) appeals the actions of respondent Franchise Tax Board (FTB) denying appellant's claims for refund of $798 for the 2003 tax year and $3,073 for the 2004 tax year.[1]

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

ISSUES

1. Whether appellant has shown error in FTB's proposed assessments of additional tax, which are based on final federal determinations by the Internal Revenue Service (IRS).
2. Whether appellant is entitled to the abatement of interest.
3. Whether FTB's proposed assessments are barred by the equitable doctrine of laches.

[1] These amounts consist of proposed assessments of additional tax that appellant paid, and which are being held in suspense pending the conclusion of this appeal. FTB will reduce the 2004 proposed assessment of additional tax to $2,915. This would entitle appellant to a refund of $158 (i.e., $3,073 - $2,915), plus interest on that amount.

FACTUAL FINDINGS

1. Appellant filed timely California income tax returns for 2003 and 2004.
2. The IRS audited appellant's 2003 and 2004 federal tax returns. The audit adjustments are explained in federal Forms 4549 - Income Tax Explanation of Changes.
3. Appellant's federal Account Transcripts for 2003 and 2004 indicate a final federal determination date of April 20, 2009, which is the date additional tax was assessed.
4. Appellant filed a petition with the Tax Court of the United States. According to a letter dated October 10, 2008, appellant reached a settlement. On October 14, 2008, the IRS filed a Motion to Dismiss for Lack of Jurisdiction with the tax court on the ground that the tax court does not have jurisdiction to review the action because the IRS proposed to determine a tax deficiency when appellant paid the amount in full prior to the mailing of the notice of deficiency. In the motion, the IRS stated that it would only assess additional taxes and penalties that appellant agreed to, and that it would refund the overpayments. The tax court granted the motion on December 4, 2008.
5. The IRS reported these adjustments to FTB on April 17, 2013, in FEDSTAR IRS Data Sheets.
6. Based on the federal adjustments, FTB made similar adjustments to appellant's California taxable income in Notices of Proposed Assessment (NPAs) dated April 10, 2014.
7. The 2003 NPA increased appellant's taxable income by $69,535, and proposed to assess additional tax of $2,214, plus interest. The NPA made numerous adjustments, such as disallowing claimed bad debt deductions totaling $39,259 and claimed unreimbursed business expenses of $19,318.
8. After FTB determined that the IRS reduced its determination for the 2003 tax year, FTB notified appellant that it would similarly revise its 2003 NPA. On February 16, 2017, FTB issued a 2003 Notice of Action (NOA), which modified the NPA and increased appellant's taxable income by a revised amount of $52,044. The 2003 NOA proposed to assess a revised additional tax of $798, plus interest.[2]

[2] FTB states that it erred by disallowing itemized deductions of $10,718 instead of $18,756, and that the proposed assessment of additional tax for 2003 should have been $1,198. However, FTB states that it will not modify the 2003 NPA.

9. The 2004 NPA increased appellant's taxable income by $49,795, and proposed to assess additional tax of $3,073, plus interest. The NPA made adjustments based on the federal adjustments, which included the disallowance of a claimed bad debt deduction of $24,150. FTB affirmed the NPA in an NOA dated February 16, 2017.

10. Appellant protested the NPAs and paid the amounts due on June 5, 2014. FTB treated appellant's correspondence as claims for refund for 2003 and 2004, which it denied. This timely appeal followed.

DISCUSSION

Issue 1: Whether appellant has shown error in FTB's proposed assessments of additional tax, which are based on a final federal determination by the IRS.

A taxpayer shall either concede the accuracy of a federal determination or state wherein it is erroneous. (R&TC, § 18622(a).) A deficiency determination based on a federal audit is presumptively correct and a taxpayer bears the burden of proving that the determination is erroneous. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Brockett* (86-SBE-109) 1986 WL 22731.) Unsupported assertions are insufficient 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.)

Income tax deductions are a matter of legislative grace, and a taxpayer who claims a deduction has the burden of proving by competent evidence that he or she is entitled to that deduction. (*New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435; *Appeal of Walshe* (75-SBE-073) 1975 WL 3557.) In order to carry that burden, a taxpayer must point to an applicable statute and show by credible evidence that the transactions in question come within its terms. (*Appeal of Telles* (86-SBE-061) 1986 WL 22792.) A taxpayer's inability to produce records does not relieve the taxpayer of the burden of proof. (*Villarreal v. Commissioner,* T.C. Memo. 1998-420.) When a taxpayer's records have been lost or destroyed through circumstances beyond his or her control, he or she is entitled to substantiate the deductions by reconstructing the expenditures through other credible evidence. (*Inzano v. Commissioner*, T.C. Memo. 1998-282.)

Appellant argues that the IRS admitted there was no liability and reversed its assessment. However, FTB's adjustments are consistent with the federal adjustments indicated on the FEDSTAR IRS Data Sheets and Forms 4549 - Income Tax Explanation of Changes. Appellant's

2003 and 2004 federal Account Transcripts also indicate that additional tax was assessed on April 20, 2009, as a result of the IRS examination.[3] Therefore, appellant has not shown that the IRS assessment was reversed.

Despite final IRS assessments, appellant nonetheless contends that she is entitled to, for instance, claimed bad debt deductions and unreimbursed business expense deductions that were disallowed by the IRS.[4] Internal Revenue Code (IRC) section 166, to which California conforms under R&TC section 17201, allows a deduction for a business or nonbusiness debt that becomes worthless within the taxable year. Only a bona fide debt qualifies for purposes of the bad debt deduction. (Treas. Reg. § 1.166-1(c).) A "bona fide debt" is defined 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." (*Ibid*.) Transactions between family members are subject to special scrutiny to determine whether a purported loan was actually a gift. (*Caligiuri v. Commissioner* (8th Cir.1977) 549 F.2d 1155, 1157.)

Appellant argues she is entitled to a bad debt deduction for legal services provided to her father, Mr. Doherty. Invoices provided indicate approximately $78,000 charged for legal services. Appellant asserts that the debt became worthless because Mr. Doherty filed for bankruptcy, in which she filed claims as a creditor totaling $591,293.97. However, insolvency by itself does not establish worthlessness. (*Buchanan v. United States* (7th Cir. 1996) 87 F.3d 197, 200.) Here, on September 30, 2001, appellant and her father entered into a retainer agreement for services to be provided by appellant. The agreement states that the payment may be made with a promissory note. Several days later, on October 2, 2001, a promissory note was executed in which Mr. Doherty promised to pay appellant $100,000 with interest, in monthly installments of $100. The note was secured by a "lot or parcel of land." Ten days later, appellant filed a lien against the land. On March 11, 2002, Mr. Doherty filed a warranty deed conveying the "lot or parcel of land" to appellant.

Appellant argues that the property is valueless and that it was transferred to her in order make her a party to a lawsuit with regard to the land. According to the property's assessment

[3] FTB states that it will reduce the 2004 proposed assessment of tax to $2,915.

[4] The federal Form 886-A, Explanation of Items, states: "Since you did not establish that the amount shown was (a) a bad debt, and (b) your bad debt loss, we have disallowed it. Since you did not establish that the business expense shown in your tax return was paid or incurred during the taxable year and that the expense was ordinary and necessary to your business, we have disallowed the amount shown."

record, the land is not valueless, but had a total assessed value of $95,000 as of 2017 (land value of $83,200 and improvement value of $11,800). In addition, appellant has not presented evidence to otherwise establish that the land was not payment for her services (since it was used to secure payment for the promissory note), or that she is otherwise entitled to a bad debt deduction for legal services. As noted below, appellant provides voluminous documentation, but provides no guidance clearly linking the documentation to FTB's adjustments that would enable us to determine whether she is entitled to the claimed deductions. Based on the foregoing, appellant has not met her burden to establish that she is entitled to a bad debt deduction for legal services.

Appellant also contends she is entitled to a bad debt deduction for nursing services provided to Mr. Doherty. However, documentation in the record indicates that Mr. Doherty was placed in a residential care facility in October 2001, and that he was still there in 2003. Therefore, appellant has not established that she provided nursing services, as it appears that Mr. Doherty resided at a residential care facility. Therefore, appellant has not met her burden to establish that she is entitled to a debt deduction for such services.

Lastly, with regard to her disallowed deductions, appellant asserts that most of her records have been destroyed. However, as noted above, a taxpayer's inability to produce records does not relieve the taxpayer of the burden of proof. (*Villarreal v. Commissioner, supra*.) There must be an evidentiary basis to allow such a deduction and, in certain circumstances, such as for travel expenses, the taxpayer must meet heightened substantiation requirements to be allowed an unreimbursed business expense deduction under IRC section 162, such as by providing adequate records or sufficient corroborating evidence. (See IRC, § 274(d).)

Appellant provides voluminous documentation of over 1,000 pages, including hundreds of pages of exhibits, much of which are unrelated to the adjustments, and provides us with no clear and straightforward guidance so that we may link the documentation to FTB's adjustments. Appellant also provides hundreds of pages of briefing and argument that are also, to a great extent, unrelated to the adjustments. We need not undertake the task of sorting through voluminous and unorganized documentation in an attempt to find adequate substantiation for claimed deductions. (See *Hale v. Commissioner*, T.C. Memo. 2010-229 ["petitioner offers us what amounts in effect to a shoebox full of papers"]; *Patterson v. Commissioner*, T.C. Memo. 1979-362 [disapproving the "shoebox method" of recordkeeping].)

Therefore, appellant has not met her burden to provide sufficient evidence to show she is entitled to the disallowed deductions, including, for instance, moving expenses or unreimbursed business expenses. Otherwise, we have considered all of appellant's evidence and arguments and to the extent not discussed herein, we find she has not shown error in FTB's proposed assessments.

Issue 2: Whether appellant is entitled to the abatement of interest.

Imposing interest on a tax deficiency is mandatory. (R&TC, § 19101(a).) Interest is not a penalty but is compensation for the taxpayer's use of money after it should have been paid to the state. (*Appeal of Yamachi* (77-SBE-095) 1977 WL 3905.) There is no reasonable cause exception to the imposition of interest. (*Appeal of Goodwin* (97-SBE-003) 1997 WL 258474.)

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 by FTB in the performance of a ministerial or managerial act.[5] (R&TC, § 19104(a)(1).) "Ministerial act means 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." (Treas. Reg. § 301.6404-2(b)(2).) In contrast, managerial act means, in part, "an 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." (Treas. Reg. § 301.6404-2(b)(1).) Neither act involves a decision concerning the proper application of federal tax law (or other federal or state law). (Treas. Reg. § 301.6404-2(b)(1), (b)(2).) An error or delay can only be considered when no significant aspect of the error or delay is attributable to a taxpayer and after FTB contacted the taxpayer in writing with respect to the deficiency or payment. (R&TC, § 19104(b)(1); *Appeal of Teichert* (99-SBE-006) 1999 WL 1080256.)

Appellant argues that interest should be abated because FTB caused an undue delay in waiting 13 to 14 years before this appeal could be filed. However, interest cannot be abated before FTB's first written contact as to the deficiencies, which was the NPA dated

[5] R&TC section 19104(a)(1) applies the same standard and uses substantially identical language as IRC section 6404(e), which is the comparable federal statute authorizing interest abatement for unreasonable error or delay. Therefore, it is appropriate to look to federal authority for guidance. (*Douglas v. State of California* (1948) 48 Cal.App.2d 835, 838; *Appeal of Kishner* (99-SBE-007) 1999 WL 1080250.)

April 10, 2014. Furthermore, appellant paid the amounts due on June 5, 2014, and no interest accrued since her payment. Accordingly, interest may only be potentially abated between April 10, 2014, and June 5, 2014. Appellant, however, has not shown there was any unreasonable error or delay by FTB during that period. Additionally, FTB was not aware of the federal changes until the IRS reported the changes to FTB on April 17, 2013. FTB timely issued the NPAs within the statute of limitations on April 10, 2014, which is within four years from the date the IRS notified FTB of the federal changes. (R&TC, § 19060(b).) Appellant did not notify FTB of the federal changes within six months of the date of the final federal determination, as required by R&TC section 18622(a). Therefore, any alleged error or delay is attributable to appellant. Accordingly, appellant is not entitled to the abatement of interest.

Issue 3: Whether FTB's proposed assessments are barred by the equitable doctrine of laches.

Appellant contends that FTB's actions should be barred pursuant to the doctrine of laches, due to FTB's delay in issuing the NPAs. The equitable defense of laches may apply in situations where there is a showing of an unreasonable delay in the exercise of rights, and injury which resulted because of the delay. (*Appeals of Renshaw* (86-SBE-191) 1986 WL 22873.) Whether any delay was unreasonable is a question of fact. (*Ibid*.) The application of the doctrine is based upon the fact that material changes of condition may have taken place during the period of neglect. (*Ibid*.) Moreover, the defense of laches depends not only upon an unreasonable delay in asserting a right, but also upon an injury to the taxpayer occasioned by that delay, since a mere lapse of time, without prejudice to the taxpayer therefrom, is in itself insufficient to constitute laches in equity. (*Ibid*.)

As noted above, there was no delay by FTB in issuing the NPAs, pursuant to the statute of limitations. Therefore, there has been no showing that there was an unreasonable delay. (*Dial v. Commissioner* (9th Cir.1992) 968 F.2d 898, 904 [no unreasonable delay where no violation of statute of limitations].) Additionally, laches is not applicable where the record indicates that the primary cause for delay was the processing of the related federal matter and a taxpayer's failure to advise FTB with respect to the results of the federal proceedings. (*Appeal of Frey* (80-SBE-056) 1980 WL 4985.) Similarly, the doctrine of unclean hands is a defense to an equitable action based on the maxim that " 'he who comes into equity must come with clean hands.' " (*Camp v. Jeffer, Mangels, Butler & Marmaro* (1995) 35 Cal.App.4th 620, 638.) Here, as stated

above, any alleged delay was the result of appellant's failure to timely notify FTB of the federal changes. Therefore, the defense of laches does not apply here.

HOLDINGS

1. Appellant has not shown error in FTB's proposed assessments of additional tax, which are based on final federal determinations by the IRS.
2. Appellant is not entitled to the abatement of interest.
3. FTB's proposed assessments are not barred by the equitable doctrine of laches.

DISPOSITION

FTB's actions are modified as conceded to reduce the 2004 proposed assessment of additional tax to $2,915. As a result, appellant is entitled to a refund of $158 (i.e., $3,073 - $2,915), plus interest on that amount. FTB's actions are otherwise sustained.

DocuSigned by:
Josh Lambert
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Josh Lambert
Administrative Law Judge

We concur:

DocuSigned by:
Andrea LH Long
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Andrea L.H. Long
Administrative Law Judge

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Date Issued: 6/3/2020