OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18103880
	)
GABRIEL C. GONZALEZ	)
	)
	)

OPINION

Representing the Parties:

For Appellant: Gabriel C. Gonzalez

For Respondent: Donna L. Webb, Staff Operation Specialist

A. ROSAS, Administrative Law Judge: Under Revenue and Taxation Code (R&TC) section 19045, appellant Gabriel C. Gonzalez appeals respondent Franchise Tax Board's action proposing an assessment of $5,117[1] in additional tax, plus interest, for the 2014 tax year. Appellant waived the right to an oral hearing and therefore we decide this matter based on the written record.

ISSUE

Did appellant establish error in respondent's proposed additional tax, which is based on federal adjustments?

FACTUAL FINDINGS

1. In 2013, the year prior to the tax year at issue, appellant filed a civil action against a former employer (Defendant), based on allegations that the Defendant was liable to appellant for lost wages.
2. In 2014, the parties reached a settlement agreement and agreed that the Defendant would pay appellant a total settlement payment of $70,000. Of this settlement payment, appellant was to receive a total of $30,582.85, with the Defendant paying the rest directly to appellant's counsel.

[1] In its Opening Brief, respondent agreed to reduce the proposed additional tax to $1,914, plus interest.

3. Specifically, the Defendant made the settlement payment of $70,000 in three installments, as follows:

   - First Installment Payment Totaling $50,000
     - $10,000 paid to appellant. Per the settlement agreement, Defendant was to report this $10,000 "on an IRS Form W-2 and the analogous state form."
     - $20,582.85 paid to appellant. Per the settlement agreement, Defendant was to report this amount "on an IRS Form 1099 and the analogous state form."
     - $19,417.15 paid directly to appellant's counsel.
   - Second Installment Payment Totaling $15,000
     - $15,000 paid directly to appellant's counsel.
   - Third Installment Payment Totaling $5,000
     - $5,000 paid directly to appellant's counsel.

4. For tax year 2014, the Defendant issued an IRS Form W-2 to appellant, reporting the $10,000 payment. In addition, the Defendant issued an IRS Form 1099 to appellant, reporting a payment of $55,000. The combined totals reported on IRS Form W-2 and IRS Form 1099 equaled the total sum of the first and second installment payments ($65,000),[2] although appellant only received $30,582.85.
5. Appellant filed a timely 2014 California return, reporting federal adjusted gross income of $85,265 and California wages of $83,013. These amounts included the $10,000 that the Defendant paid to appellant and reported on an IRS Form W-2. In the 2014 California return, appellant did not include either the additional $20,582.85 that the Defendant paid to appellant or the $55,000 that the Defendant reported on IRS Form 1099.
6. The Internal Revenue Service (IRS) audited appellant and, on March 7, 2016, adjusted appellant's 2014 federal return for interest income of $45 and "other income" of $55,000.
7. Two months later, on May 16, 2016, the IRS made additional adjustments to the 2014 federal return. In addition to the interest income of $45 and "other income" of $55,000, the IRS now allowed "Non-Gambling other miscellaneous deductions" of $34,417 (based on settlement payments that the Defendant paid directly to appellant's counsel).

[2] The third installment of $5,000, paid directly to appellant's counsel, is not at issue in this appeal.

8. Over a year later, respondent issued a Notice of Proposed Assessment (NPA) dated September 19, 2017, that applied the March 7, 2016 federal adjustments to appellant's California return, and respondent proposed an additional tax of $5,117, plus interest. The NPA did not include "Non-Gambling other miscellaneous deductions" of $34,417, which the IRS allowed in its May 16, 2016 adjustment.
9. Appellant protested the NPA, indicating that, as part of the settlement agreement, he only received $30,582.85, and arguing that the Defendant's issuance of an IRS Form 1099 for $55,000 was in error. In the protest letter, appellant pointed out that he only received two settlement payments—$10,000 and $20,582.85—and that the second amount of $20,582.85 had "been corrected with the IRS."
10. Respondent issued a Notice of Action (NOA) dated September 4, 2018, affirming the NPA.
11. Appellant timely appealed. In the appeal letter, appellant indicated that he "was unable to locate any of the documents received from the IRS."
12. In its Opening Brief, respondent indicated that, based on the IRS's revised adjustments on May 16, 2016, respondent will revise the NPA to allow the $34,417 deduction. Respondent stated it will reduce the NPA/NOA's proposed additional tax from $5,117 to $1,914, plus interest.

DISCUSSION

When the IRS makes changes to a taxpayer's income, the taxpayer must report those changes to respondent. (R&TC, § 18622.) A taxpayer must either concede the accuracy of federal changes to a taxpayer's income or state where the changes are erroneous. (R&TC, § 18622(a).) Under well-settled law, there is a presumption of correctness when respondent bases its deficiency assessment on a federal adjustment to income, and a taxpayer bears the burden of proving respondent's determination is erroneous. (*Appeal of Brockett* (86-SBE-109) 1986 WL 22731; *Appeal of Lew* (78-SBE-073) 1978 WL 3876; *Appeal of Webb* (75-SBE-061) 1975 WL 3545.) The applicable burden of proof is by a preponderance of the evidence. (*Appeal of Estate of Gillespie*, 2018-OTA-052P; Cal. Code Regs., tit. 18, § 30219(c).)

At the outset, based on all the facts, it is clear that respondent's 2017 NPA and 2018 NOA were erroneous. The NPA and NOA were based on the IRS's March 7, 2016 adjustments; however, the IRS had revised these adjustments two months later, on May 16, 2016, to allow a

$34,417 deduction, based on settlement payments that the Defendant paid directly to appellant's counsel.

Respondent stated, in its Opening Brief, that its 2018 NOA affirmed the 2017 NPA because "[t]he information received from the IRS did not show that the IRS had cancelled or reduced its assessment." However, the IRS did in fact reduce its assessment; on May 16, 2016—one year before the 2017 NPA and two years before the 2018 NOA—the IRS allowed a $34,417 deduction. It is not clear why respondent was unaware of the IRS's reduction to its federal assessment.

But it is clear that appellant did not inform respondent of these federal changes to his income. As stated above, when the IRS makes changes to a taxpayer's income, the taxpayer must report those changes to respondent. Here, on May 16, 2016, the IRS made a favorable change to appellant's income, allowing a $34,417 deduction for settlement payments that the Defendant paid directly to appellant's counsel, which offset the $55,000 reported to appellant on IRS Form 1099. However, appellant did not report this favorable change to respondent. Moreover, in his protest, appellant was correct to point out that he only received two settlement payments—$10,000 and $20,582.85—and that the second amount of $20,582.85 had "been corrected with the IRS." Yet, this general and vague statement was not enough to help his case at protest. Taxpayers bear the burden of proving respondent's determination is erroneous, and appellant should have supported his claim with documents received from the IRS, especially the IRS's May 16, 2016 notice, which indicated the IRS had reduced its assessment by allowing a $34,417 deduction. Unfortunately, appellant could not support his case earlier in the process because, as indicated in the appeal letter, appellant "was unable to locate any of the documents received from the IRS."

In its Opening Brief, respondent indicated that it will reduce its proposed assessment to allow the $34,417 deduction. Because respondent is reducing the $55,000 reported on IRS Form 1099 by this $34,417 deduction, respondent is taxing appellant only on the balance of $20,583. Therefore, based on the totality of the evidence, appellant is paying taxes on two settlement amount payments. First, he already paid taxes on the $10,000 settlement payment reported on IRS Form W-2, which appellant reported on his original return. Second, based on the revisions respondent is now making to the NPA and NOA, appellant is asked to pay taxes on the additional settlement payment of $20,583.

Therefore, we want to point out for appellant's benefit that respondent is not taxing appellant on the full $55,000 reported on IRS Form 1099. Appellant's total tax liability for the settlement is based only on the two settlement payments that he received (i.e., the $10,000 and the $20,582.85 amounts). Accordingly, respondent stated it will reduce the NPA and NOA's proposed additional tax from $5,117 to $1,914, plus interest. As to this reduced deficiency amount, which is based on the revised federal adjustment, appellant has not shown the existence of other errors.

HOLDING

Appellant did not establish error on respondent's part in proposing an additional tax of $1,914, based on a revised federal adjustment.

DISPOSITION

Respondent agreed to reduce the proposed additional tax from $5,117 to $1,914, plus interest. We sustain respondent's action, subject to this reduction to the proposed additional tax.

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Alberto T. Rosas
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Alberto T. Rosas
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
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Elliott Scott Ewing
Administrative Law Judge

Date Issued: 2/6/2020