OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 19034534
K. FOSTER AND	)
S. FOSTER	)
	)
	)

OPINION

Representing the Parties:

For Appellants: K. Foster and S. Foster

For Respondent: Amrita Sethi, Graduate Legal Assistant

A. ROSAS, Administrative Law Judge: Under Revenue and Taxation Code (R&TC) section 19045, appellants K. H. Foster and S. A. Foster appeal respondent Franchise Tax Board's actions proposing assessments for tax years 2012 (additional tax of $17,125, accuracy-related penalty of $3,425, plus interest) and 2013 (additional tax of $3,204, plus interest). Appellants waived the right to an oral hearing; therefore, we decide this matter based on the written record.

ISSUES

1. Are the proposed assessments barred by the statute of limitations?
2. Did appellants establish error in respondent's proposed assessments for tax years 2012 and 2013, which are based on a final federal determination?
3. Whether the accuracy-related penalty for tax year 2012 should be abated.

FACTUAL FINDINGS

1. Appellants timely filed their 2012 California Resident Income Tax Return and reported total tax of $1,834. Appellants timely filed their 2013 California Resident Income Tax Return and reported total tax of $7,004.

2. The Internal Revenue Service (IRS) examined appellants' 2012 and 2013 federal tax returns. An IRS examiner signed an Income Tax Examination Changes form dated November 11, 2015, indicating that the IRS had proposed adjustments for tax years 2012 and 2013, plus penalties and interest.
3. On April 10, 2016, appellants sent respondent a letter informing respondent that the IRS had audited appellants' 2012 and 2013 tax returns, resulting in proposed adjustments.[1]
4. On July 11, 2016, the IRS made total final adjustments and assessed additional tax for 2012 and 2013, plus penalties and interest.
5. On July 12, 2016, the IRS informed respondent of these federal adjustments and assessments.
6. On September 27, 2017, respondent issued Notices of Proposed Assessment (NPAs) to appellants, which proposed assessments based on the federal changes. The 2012 NPA increased appellants' taxable income by $190,715 and proposed additional tax of $17,125 (i.e., total tax of $18,959, less original tax reported of $1,834) and an accuracy-related penalty of $3,425, plus interest. The 2013 NPA increased appellants' taxable income by $34,451 and proposed additional tax of $3,204, plus interest.
7. Appellants protested the NPAs. Because respondent believed that, during the protest, appellants did not provide any new information proving the proposed assessments were erroneous, on February 13, 2019, respondent issued Notices of Action for tax years 2012 and 2013 that affirmed the corresponding NPAs.
8. Appellants timely appealed.[2]

[1] Although respondent does not have a record of receiving the April 10, 2016 letter, appellants state that they sent the letter to respondent, and appellants submitted a copy of the letter to the Office of Tax Appeals (OTA) as part of appellants' exhibits. Because our conclusion is the same regardless of whether appellants sent the April 10, 2016 letter, we give appellants the benefit of the doubt and conclude that it is more likely than not to be correct that appellants sent the April 10, 2016 letter.

[2] Appellants seem to want to settle the amounts due for tax year 2013; they extended an offer and stated that they "do not have the means to pay the full amount." For OTA to reduce or eliminate appellants' tax liabilities or to consider their financial hardship as a mitigating factor would constitute a settlement or compromise of this case. However, OTA lacks the authority to settle or compromise a tax liability. An administrative agency's authority to act is of limited jurisdiction and it "has no powers except such as the law of its creation has given it." (*Ferdig v. State Personnel Board* (1969) 71 Cal.2d 96, 105, quoting *Conover v. Board of Equalization* (1941) 44 Cal.App.2d 283, 287.) As to the power to settle an appeal, that power is vested with respondent and the California Attorney General. (R&TC, § 19442.) As to the power to compromise a final tax liability, that power is vested solely with respondent. (R&TC, § 19443.) There is no statutory authority that similarly grants these powers to OTA.

DISCUSSION

Issue 1 – Are the proposed assessments barred by the statute of limitations?

Generally, respondent must issue a proposed assessment within four years of the original due date or the date the taxpayer filed his or her California return, whichever is later. (R&TC, §§ 19057, 19066.)

For tax year 2012, under the general four-year statute of limitations, respondent had until April 15, 2017, to issue a proposed assessment; thus, under R&TC section 19057, the 2012 NPA issued on September 27, 2017, was untimely. However, there are three exceptions to this four-year statute of limitations.[3] For purposes of this appeal, the relevant exception provides that: if there are adjustments to a taxpayer's federal account and either the taxpayer or the IRS notifies respondent *within six months* of the date the federal changes became final, respondent may issue an NPA within *two years* of the date of notification, or within the general four-year period, whichever expires later. (R&TC, § 19059(a).)

On April 10, 2016, appellants sent respondent a letter informing respondent that the IRS had audited appellants' 2012 and 2013 tax returns, which resulted in proposed adjustments. However, these federal changes had not yet become final. The federal changes became final three months later, on July 11, 2016. The next day, July 12, 2016, the IRS informed respondent of these final federal changes. Regardless of whether the April 10, 2016, or July 12, 2016 date is used as the starting point to start the two-year period under R&TC section 19059(a), the 2012 NPA was timely because it was issued in 2017.

For tax year 2013, for the same reasons discussed above, the 2013 NPA was timely under R&TC section 19059(a). Furthermore, the 2013 NPA was also timely under the general four-year statute of limitations because respondent had until April 15, 2018, to issue an NPA. Thus, under R&TC section 19057, the 2013 NPA issued in 2017 was timely.

[3] The California Supreme Court, when discussing R&TC section 19057's predecessor, indicated it "is a general statute of limitations and it expressly provides for exceptions to the general rule. Either of two exceptions applies when federal changes are made to a taxpayer's gross income or deductions . . . ." (*Ordlock v. Franchise Tax Bd.* (2006) 38 Cal.4th 897, 911.) The California Supreme Court pointed out that "[i]n the event of such IRS intervention, section 19059 or section 19060 provides an alternative period during which the [Franchise Tax Board] may notify the taxpayer of a deficiency assessment, the duration of which depends upon when or *whether* the taxpayer reports to the [Franchise Tax Board] the final results of the federal authorities' examination of the taxpayer's return." (*Id.* at p. 902.)

Issue 2 – Did appellants establish error in respondent's proposed assessments for tax years 2012 and 2013, which are based on a final federal determination?

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 final federal determination, 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. (Cal. Code Regs., tit. 18, § 30219(c)*; Appeal of Estate of Gillespie*, 2018-OTA-052P.)

Appellants did not submit any evidence that shows or tends to show error in either respondent's assessment or the final federal determination on which they are based. Additionally, appellants provided no evidence indicating whether the IRS had canceled or reduced their final assessments. Therefore, appellants did not prove that respondent's proposed assessments, based on a final federal determination, are erroneous.

Issue 3 – Whether the accuracy-related penalty for tax year 2012 should be abated.

Internal Revenue Code (IRC) section 6662(b) provides, in part, that an accuracy-related penalty applies to the portion of the underpayment attributable to any substantial understatement of income tax. For individual taxpayers, a substantial understatement of tax exists if the amount of the understatement exceeds the greater of ten percent of the tax required to be shown on the return or $5,000. (IRC, § 6662(d)(1).) IRC section 6662, incorporated by R&TC section 19164, provides for an accuracy-related penalty of 20-percent of the applicable underpayment.

For tax year 2012, respondent proposed total tax of $18,959, less the original tax reported of $1,834. Thus, the amount of the understatement (i.e., $17,125) exceeds the greater of ten percent of the tax required to be shown on the return or $5,000, and respondent imposed a penalty of $3,425.

Taxpayers bear the burden of proving any defenses to the imposition of the accuracy-related penalty. (*Recovery Group, Inc. v. Commissioner*, T.C. Memo. 2010-76.) Taxpayers may reduce or eliminate their liability if they successfully demonstrate one of three exceptions:

(1) they had substantial authority for their treatment of any item giving rise to the understatement; (2) the relevant facts affecting the item's tax treatment are adequately disclosed and there is or was a reasonable basis for the tax treatment of such item; or (3) the underpayment was due to reasonable cause and the taxpayers acted in good faith with respect to such portion of the underpayment. (IRC, §§ 6662(d)(2)(B) & 6664(c)(1).) But appellants did not provide any argument or evidence establishing the existence of any of these exceptions. Therefore, appellants have failed to establish that respondent improperly imposed the accuracy-related penalty or that the penalty should be abated.

HOLDINGS

1. The 2012 and 2013 NPAs were timely under R&TC section 19059, and the 2013 NPA was also timely under R&TC section 19057. Thus, the proposed assessments are not barred by the statute of limitations.
2. Appellants did not establish error in respondent's proposed assessments for tax years 2012 or 2013, which are based on a final federal determination.
3. Appellants did not show that respondent improperly imposed an accuracy-related penalty for tax year 2012 or that the penalty should be abated.

DISPOSITION

We sustain respondent's action in full.

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Alberto T. Rosas
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Alberto T. Rosas
Administrative Law Judge

We concur:

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Tommy Leung
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Tommy Leung
Administrative Law Judge

DocuSigned by:
Daniel Cho
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Daniel K. Cho
Administrative Law Judge

Date Issued: 4/9/2020