OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 19064957
D. WHITE	)
	)
	)
	)
	)

OPINION

Representing the Parties:

For Appellant: D. White

For Respondent: Christopher T. Tuttle, Tax Counsel

A. ROSAS, Administrative Law Judge: Under California Revenue and Taxation Code section 19045, appellant D. White appeals respondent Franchise Tax Board's proposed assessments of $4,972 in additional tax for tax year 2013, $3,462 in additional tax for tax year 2014, $4,697 in additional tax for tax year 2015, and $2,026 in additional tax for tax year 2016, plus applicable interest for each tax year. Appellant waived the right to an oral hearing; therefore, we decide this matter based on the written record.

ISSUES

1. Did appellant establish error in the proposed assessments for tax years 2013 through 2016, based on the addition of Individual Retirement Account (IRA) distributions?
2. Did appellant establish error in the proposed assessment for tax year 2014, based on the addition of pension distributions?

FACTUAL FINDINGS

1. Appellant and his spouse[1] filed a timely 2013 California Resident Income Tax Return and used the married filing jointly (MFJ) filing status. Appellant reported a federal adjusted

[1] Although appellant and his spouse filed all four of the tax returns at issue, only appellant filed the appeal. For purposes of this opinion and the sake of simplicity, the opinion will refer to appellant only, although some of the facts and actions at issue may also apply to appellant's spouse.

gross income (AGI) of $200,753. On the Schedule CA (540) form for California Adjustments—Residents (hereinafter California Schedule), appellant reported that the federal taxable amounts from his federal tax return included $55,433.95 in IRA distributions. On the California Schedule, appellant subtracted the full amount of the IRA distributions from income for California purposes.

2. Appellant filed a timely 2014 California Resident Income Tax Return and used the MFJ filing status. Appellant reported a federal AGI of $174,159. On the California Schedule, appellant reported that the federal taxable amounts from his federal tax return included $52,500 in IRA distributions[2] and $6,400 in pension income.[3] On the California Schedule, appellant subtracted the full amount of the IRA and pension distributions from income for California purposes.

3. Appellant filed a timely 2015 California Resident Income Tax Return and used the MFJ filing status. Appellant reported a federal AGI of $192,926. On the California Schedule, appellant reported that the federal taxable amounts from his federal tax return included $75,000 in IRA distributions. On the California Schedule, appellant subtracted the full amount of the IRA distributions from income for California purposes.

4. Appellant filed a timely 2016 California Resident Income Tax Return and used the MFJ filing status. Appellant reported a federal AGI of $167,041. On the California Schedule, appellant reported that the federal taxable amounts from his federal tax return included $51,500 in IRA distributions.[4] On the California Schedule, appellant subtracted the full amount of the IRA distributions from income for California purposes.

5. During the tax years at issue, appellant was a California resident.

6. On February 20, 2018, respondent issued a Notice of Proposed Assessment (NPA) for each of the relevant tax years:

    - In the NPA for 2013, respondent added back $55,433 of IRA distributions, for additional tax of $4,972 plus interest.

[2] The evidence provided includes a Form 1099-R from Fidelity Investments issued to appellant in the sum of $52,500.

[3] The evidence provided includes a Form 1099-R from Bank of America, N.A. issued to appellant's spouse in the sum of $6,400.

[4] The evidence provided includes a Form 1099-R from Fidelity Investments issued to appellant's spouse in the sum of $51,500.

- In the NPA for 2014, respondent added back $52,500 of IRA distributions and $6,400 of pension income, for additional tax of $3,462 plus interest.
- In the NPA for 2015, respondent added back $75,000 of IRA distributions income, for additional tax of $4,697 plus interest.
- In the NPA for 2016, respondent added back $51,500 of IRA distributions, for additional tax of $2,026 plus interest.

7. Appellant protested the NPAs. Appellant claims (1) that respondent should not have issued refunds if the returns were not filed correctly, and (2) that payment of the tax liabilities at issue would be a financial hardship.
8. Respondent requested supporting documentation. Appellant did not provide any.
9. On May 9, 2019, respondent issued a Notice of Action for each tax year at issue, affirming the corresponding NPAs.
10. Appellant filed this timely appeal.

DISCUSSION

Issue 1: Did appellant establish error in the proposed assessments for tax years 2013 through 2016, based on the addition of IRA distributions?

Under certain factual situations, such as the one presented in this appeal, respondent's initial burden is to show why its assessment is reasonable and rational. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Myers* (2001-SBE-001) 2001 WL 37126924.) Thereafter, respondent's determination of an assessment is presumed correct, and appellant has the burden of proving it to be wrong. (*Todd v. McColgan, supra*; *Appeal of Myers, supra.*) Here, appellant's completion of each of the California Schedules, and the amounts that he reported on those schedules, indicated that he received IRA distributions. Additionally, respondent provided copies of a Form 1099-R (2014) from Fidelity Investments issued to appellant in the sum of $52,500, and a Form 1099-R (2016) from Fidelity Investments issued to appellant's spouse in the sum of $51,500. Based on these California Schedules and the Forms 1099-R from Fidelity Investments, respondent demonstrated why its assessments are reasonable and rational; and therefore, the assessment is presumed correct.

Because the assessment is presumed correct, we next look at whether appellant satisfied his burden of proving the assessments to be wrong. (*Todd v. McColgan*, *supra*; *Appeal of Myers*,

supra.) Here, as indicated on the California Schedules, appellant deducted the full amount of the IRA distributions from income for California purposes. As explained below, appellant has the burden of proof to demonstrate that he has a California basis in the IRA.

The basic tax characteristics of a traditional IRA are (1) deductible contributions, (2) the accrual of tax-free earnings (except with respect to Internal Revenue Code (IRC) section 511 unrelated business income), and (3) the inclusion of distributions in gross income. (See IRC, §§ 219(a), 408(a), (d)(1), (e); see also *Taproot Admin. Servs., Inc. v. Commissioner* (2009) 133 T.C. 202, 206.) Generally, any amount paid or distributed out of an IRA is to be included in gross income when received, as provided under IRC section 72. (IRC, § 408(d)(1); see also *Repetto v. Commissioner*, T.C. Memo. 2012-168. With some exceptions, California generally conforms to the federal treatment of IRA distributions. (R&TC, § 17507.)[5] Distributions from an IRA are only taxable, however, to the extent that they exceed the taxpayer's basis in the IRA. (IRC, § 72(b).) A taxpayer has a zero basis in an IRA, unless the taxpayer has made nondeductible contributions to the IRA. (IRC, § 408(d)(1).) Owners of traditional IRAs who make nondeductible contributions receive basis in their IRAs and are taxed under IRC section 72. For this purpose, all IRA accounts are treated as a single IRA account. (IRC, § 408(d)(2).)

Appellant does not dispute receiving IRA distributions in 2013, 2014, 2015, and 2016. Appellant argues that respondent should not have issued refunds if the returns were not filed correctly, and that respondent should not attempt to collect at this late stage. Although appellant disagrees that he owes the proposed additional taxes, appellant produced no evidence showing that he or his spouse had made nondeductible contributions to the IRAs or showing that he or his spouse otherwise had a basis in the IRAs. Instead, in addition to his general and unsupported disagreement, appellant argues (1) that respondent should not have issued refunds if the returns were not filed correctly, and on protest argued (2) that payment of the tax liabilities at issue would be a financial hardship.

First, it is irrelevant that, despite appellant's erroneous deductions of his IRA distributions, respondent issued refunds to which appellant was not entitled. What is relevant is

[5] For example, a taxpayer's California basis in an IRA may differ from the federal basis because, prior to 1987, California's limit on the deductibility of IRA contributions was lower than that allowed under the IRC. When a California resident made the maximum federal contribution, the difference between the federal and California limits is included in the California basis. (R&TC, § 17507(b)(1).)

that respondent issued the NPAs on February 20, 2018—within four years of the dates appellant filed the four California returns. (R&TC, § 19057.) Thus, the NPAs were timely.

Second, the Office of Tax Appeals (OTA) cannot consider the argument that appellant may not be able to pay his tax liabilities if OTA were to sustain respondent's actions. For us to reduce or eliminate appellant's tax liabilities or to consider his 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.

Moreover, although R&TC section 19112 allows relief from interest in limited circumstances based on a showing of extreme financial hardship, OTA does not have jurisdiction to review respondent's interest abatement determination under this statute. (*Appeal of Moy*, 2019-OTA-057P.)

Therefore, because appellant failed to show the existence of nondeductible contributions to the IRAs or that the basis in the IRAs was an amount greater than zero, appellant failed to show error in the proposed assessments for tax years 2013 through 2016.

Issue 2: Did appellant establish error in the proposed assessment for tax year 2014, based on the addition of pension distributions?

In general, gross income includes all income from whatever source derived, including income from pensions and annuities. (IRC, §§ 61(a)(9), (11), 72(a).) Distributions from qualified pension plans are taxable by California if a taxpayer was a California resident at the time when the pension income was distributed to the taxpayer. (IRC, § 402(a), incorporated in R&TC, § 17501; see also *Daks v. Franchise Tax Board* (1999) 73 Cal.App.4th 31 [holding that the pension income distributed to a taxpayer while the taxpayer resided in California was income taxable by the State of California].) Here, appellant filed California resident income tax returns for tax years 2013 through 2016, and it is undisputed that he was a California resident during this relevant period.

However, if a taxpayer made after-tax contributions to a pension or annuity, the taxpayer can exclude part of their pension or annuity distributions from income; more specifically, under IRC sections 72 and 402, the taxpayers can exclude a fraction of each benefit payment from income; that fraction (the "exclusion ratio") is based on the amount of premiums or other after-tax contributions made by the individual. (IRC, §§ 72(b), 402(c).) The exclusion ratio enables taxpayers to recover their own after-tax contributions tax free and to pay tax only on the remaining portion of benefits which represents income.

The evidence shows that Bank of America, N.A. issued a Form 1099-R (2014) to appellant's spouse in the sum of $6,400. The evidence also shows that appellant reported that the federal taxable amounts from his federal tax return included $6,400 in pension income, but appellant then subtracted the full amount of the pension from income for California purposes. Thus, as with the IRA distributions, respondent had a reasonable and rational basis to assess additional tax based on the pension income.

Appellant failed to show that his spouse had made any after-tax contributions to her pension or that he or his spouse had a basis in the pension that allowed them to exclude part of their pension or annuity distributions from income. Appellant's only arguments, as discussed above, are both irrelevant. Therefore, because appellant failed to show the existence of after-tax contributions to the pension or that the basis in the pension was an amount greater than zero, appellant failed to show error in the proposed assessment for tax year 2014.

HOLDINGS

1. Appellant failed to show error in the proposed assessments for tax years 2013 through 2016, based on the addition of IRA distributions to California income.
2. Appellant failed to show error in the proposed assessment for tax year 2014, based on the addition of pension distributions to California income.

DISPOSITION

We sustain respondent's actions.

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Alberto T. Rosas
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Alberto T. Rosas
Administrative Law Judge

We concur:

DocuSigned by:
F8E81582726F448...
Richard Tay
Administrative Law Judge

DocuSigned by:
John O Johnson
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John O. Johnson
Administrative Law Judge

Date Issued: 5/15/2020