

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:

R. STROM AND
H. NAM (STROM)

) OTA Case No. 19064965
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OPINION

Representing the Parties:

For Appellants:

R. Strom and H. Nam (Strom)

For Respondent:

Diane M. Deatherage, Specialist

A. LONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, R. Strom and H. Nam (Strom) (appellants) appeal an action by respondent Franchise Tax Board (FTB) proposing additional tax of \$3,278.00, and an accuracy-related penalty of \$655.60, plus interest, for the 2014 tax year.

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

ISSUES

1. Whether appellants have shown error in FTB's proposed assessment of additional tax, which is based on federal adjustments made by the Internal Revenue Service (IRS).
2. Whether FTB properly imposed the accuracy-related penalty.

FACTUAL FINDINGS

1. On September 3, 2015, appellants filed a joint 2014 income tax return (FTB Form 540).
2. Subsequently, FTB received information from the IRS, indicating that the IRS adjusted appellants' 2014 federal return by disallowing \$30,025 of the \$66,600 claimed alimony deduction and \$901 in claimed itemized deductions. The IRS additionally reduced appellants' itemized deductions by \$10,524 because the reported itemized deduction

- exceeded the adjusted gross income limitation for itemized deductions. The IRS assessed additional tax due of \$11,384.00 and imposed an accuracy-related penalty of \$2,276.80.
3. Based on the information provided by the IRS, FTB made corresponding adjustments to appellants' California taxable income and issued a Notice of Proposed Assessment (NPA). The NPA increased appellants' reported California taxable income by \$31,826, which consisted of an alimony deduction adjustment of \$30,025 and an itemized deduction limitation adjustment of \$1,801, for a total tax of \$53,746. The NPA proposed additional tax of \$3,278.00 and an accuracy-related penalty of \$655.60, plus interest, for a total of \$4,302.02. Appellants made the payment in full, which FTB is holding in suspense until the conclusion of this appeal.
 4. Appellants protested the NPA, stating that they correctly reported the alimony amount on the return.
 5. FTB responded by letter, stating that the information it received from the IRS did not show that the federal assessment was canceled or reduced, and California and federal law are the same for the issues involved. FTB informed appellants that if the IRS cancels or reduces its assessment, they should send FTB copies of the revised IRS report.
 6. After receiving no response from appellants, FTB issued a Notice of Action, affirming the NPA. This timely appeal followed.

DISCUSSION

Issue 1. Whether appellants have shown error in FTB's proposed assessment of additional tax, which is based on federal adjustments made by the IRS.

R&TC section 18622(a) provides that taxpayers shall either concede the accuracy of a federal determination or state wherein it is erroneous. It is well settled that a deficiency assessment based on a federal audit report is presumptively correct and that taxpayers bear the burden of proving that the determination is erroneous. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509, 514; *Appeal of Brockett* (86-SBE-109) 1986 WL 22731.) Unsupported assertions are insufficient to satisfy taxpayers' burden of proof. (*Appeal of Magidow* (82-SBE-274) 1982 WL 11930.)

Internal Revenue Code (IRC) section 71(b)(1) defines “alimony” as any payment in cash if the payment is received pursuant to a divorce decree or separation instrument.¹ IRC section 71(b)(2)(C) defines “divorce or separation instrument” to include “a decree requiring a spouse to make payments for the support or maintenance of the other spouse.” Voluntary alimony payments that are not made pursuant to a divorce decree or separation instrument are not deductible. (*Appeal of McAllister* (78-SBE-111) 1978 WL 3583.) Alimony is deductible from the payor spouse’s income. (IRC, § 215.)² However, deductions are a matter of legislative grace, and taxpayers bear the burden of proving entitlement to a deduction. (*New Colonial Ice Co., Inc. v. Helvering* (1934) 292 U.S. 435.)

Here, appellants provided copies of appellant-husband’s former spouse’s unsigned amended 2014 California and federal returns to show that his former spouse also reported alimony received of \$66,600. However, the returns do not indicate whether such payments were made pursuant to a divorce or separation agreement or whether such payments were voluntary. Appellants have not provided any additional evidence or argument demonstrating error in the proposed assessment of additional tax. Therefore, appellants have not met their burden of proving that FTB’s proposed assessment, which is based on federal adjustments, was erroneous.

Issue 2. Whether FTB properly imposed the accuracy-related penalty.

IRC section 6662, incorporated by R&TC section 19164, provides for an accuracy-related penalty of 20 percent of the applicable underpayment. IRC section 6662(b) provides, in relevant part, that the penalty applies to the portion of the underpayment attributable to any substantial understatement of income tax. A substantial understatement of tax exists if the understated amount exceeds the greater of 10 percent of the tax required to be shown on the return or \$5,000. (IRC, § 6662(d)(1).)³ An “understatement” is defined as the excess of the amount of tax required to be shown on the return for the tax year over the amount of the tax imposed which is shown on the return, reduced by any rebate. (IRC, § 6662(d)(2).)

¹ California conformed to IRC section 71 pursuant to R&TC section 17081.

² California conformed to IRC section 215 pursuant to R&TC section 17201.

³ The “amount of the tax required to be shown on the return” has the same meaning as “the amount of income tax imposed” as defined in Treasury Regulation section 1.6664-2(b). (Treas. Reg. § 1.6662-4(b)(3).) Treasury Regulation section 1.6664-2(b) essentially provides that this is the amount of tax imposed on the taxpayer, determined without regard to, among other items, credits relating to tax withheld on wages and payments of tax or estimated tax by the taxpayer.

Here, the proposed assessment provides a revised total tax of \$53,746, while appellants reported tax of \$50,468. Therefore, the understatement of \$3,278.00 (i.e., \$53,746.00 - \$50,468.00) does not exceed \$5,374.60, which is the greater of 10 percent of the tax required to be shown on the return (10 percent of \$53,746.00) or \$5,000.00. Accordingly, the accuracy-related penalty cannot be imposed based on a substantial understatement of tax, unless there is another basis for its imposition, such as negligence.

IRC section 6662(b) provides, in relevant part, that the penalty applies to the portion of the underpayment attributable to negligence or disregard of rules and regulations. “Negligence” is defined to include “any failure to make a reasonable attempt to comply” with the provisions of the code. (IRC, § 6662(c).) “Disregard” is defined to include “careless, reckless, or intentional disregard.” (*Ibid.*)

FTB states that it imposed an accuracy-related penalty based on the IRS’s imposition of the same penalty. FTB argues that a “California penalty is presumptively correct if based on a federal penalty” and cites to *Appeal of Beadling* (77-SBE-021) 1977 WL 3831 and *Appeal of Gire* (69-SBE-029) 1969 WL 1806 in its Law Summary Federal Adjustments or Changes for this proposition. However, neither opinion involves an imposition of a penalty based on a federal determination. These opinions merely state that FTB’s own determinations of tax and penalties are presumptively correct. (*Appeal of Beadling, supra*; *Appeal of Gire, supra*.)⁴

Here, the record does not indicate the basis for the IRS’s imposition of the accuracy-related penalty. The IRS may have imposed the accuracy-related penalty because the federal tax deficiency constituted a substantial understatement of tax. However, for California purposes, there was no substantial understatement of tax. Alternatively, the IRS may have imposed the penalty based on a finding of negligence, but FTB has not pointed to any evidence to support such a conjecture. Therefore, FTB’s presumption that the penalty was properly imposed based on the federal determination simply cannot apply. FTB also has not independently raised allegations of negligence by appellants. Accordingly, having failed to establish a proper basis for imposing the penalty, the accuracy-related penalty must be abated.

⁴ We note that FTB has the initial burden to show that its assessment is reasonable and rational before this presumption applies. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509, 514; *Appeal of Myers* (2001-SBE-001) 2001 WL 37126924.)


HOLDINGS

1. Appellants have not established error in FTB's proposed assessment of additional tax.
2. FTB improperly imposed the accuracy-related penalty.

DISPOSITION

FTB's imposition of the accuracy-related penalty is reversed. FTB's action is otherwise sustained.

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Andrea L.H. Long

Administrative Law Judge

We concur:

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Sheriene Anne Ridenour
Administrative Law Judge

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Sara A. Hosey
Administrative Law Judge

Date Issued: 2/25/2020