

**OFFICE OF TAX APPEALS**  
**STATE OF CALIFORNIA**

In the Matter of the Appeal of:  
**R. SETSER<sup>1</sup>**

) OTA Case No. 18093696  
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**OPINION**

Representing the Parties:

For Appellant: Tim Krusey, Enrolled Agent

For Respondent: Nathan H. Hall, Tax Counsel III

For Office of Tax Appeals: Michele Brown, Tax Counsel IV

A. VASSIGH, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19047, R. Setser (appellant) appeals an action by the Franchise Tax Board (FTB) proposing \$115,936.00 of additional tax, an accuracy-related penalty of \$23,187.20, and applicable interest, for the 2008 tax year, and \$846.00 of additional tax, and applicable interest, for the 2009 tax year.

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

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<sup>1</sup> Although appellant filed joint tax returns with his wife for 2008 and 2009, he is the sole appellant in this matter.

### ISSUES

1. Whether appellant has demonstrated error in the proposed assessments for 2008 and 2009, which are based on federal determinations.
2. Whether appellant has demonstrated that the accuracy-related penalty imposed on tax year 2008 should be abated.

### FACTUAL FINDINGS

1. Appellant filed a timely joint 2008 California tax return, reporting adjusted gross income (AGI) of \$213,958, with California additions of \$154,625, less itemized deductions of \$139,290, resulting in taxable income of \$229,293 and tax of \$16,716. After exemption credits and other taxes and credit recapture, the total tax was \$16,400. FTB accepted and processed the return as filed.
2. Appellant filed a timely joint 2009 California tax return, reporting AGI of \$16,680, with no California additions, less itemized deductions of \$101,753, resulting in taxable income of \$0 and a tax liability of \$250.<sup>2</sup> FTB accepted and processed the return as filed.
3. The Internal Revenue Service (IRS) subsequently provided information to FTB indicating that the IRS audited appellant. The IRS disallowed, among other items, \$1,107,506 in Schedule C1 – Other Expenses, relating to an expense claimed by appellant in 2008 for "Net Equity Advisors Expen" in the amount of \$1,107,506. The IRS also made adjustments to appellant's 2009 federal tax return for Individual Retirement Account (IRA) Distributions, Wages, Other Income, Schedule C - Other Expenses, and Itemized Deductions totaling \$133,250. The adjustments increased appellant's taxable income, and, as a result, the IRS assessed additional federal tax of \$459,623 and \$21,239 in 2008 and 2009, respectively. Appellant did not notify FTB of the federal adjustments.
4. Consistent with the federal adjustments, FTB issued a Notice of Proposed Assessment (NPA) on November 17, 2015, proposing adjustments and tax assessments for 2008 and 2009, as well as an accuracy-related penalty for 2008.
5. The NPA for 2008 indicated a proposed increase in appellant's taxable income by \$1,192,497 ((disallowed Schedule C – Other Expenses of \$1,107,506) - (adjustment of

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<sup>2</sup> The \$250 tax liability represents additional tax on an early distribution from a qualified retirement plan that appellant self-reported.

- self-employed AGI \$14,830) + (itemized deduction limitation adjustment \$68,093) + (interest expense \$31,728)), from \$229,293 to \$1,421,790. The NPA for 2008 indicated proposed additional tax of \$115,936.00 and an accuracy-related penalty of \$23,187.20, plus applicable interest.
6. The NPA for 2009 increased appellant's taxable income by \$133,250 ((disallowed Schedule C - Other Expenses of \$98,917) + (IRA Distribution of \$25,000) + (Wages of \$2,250) + (\$11,509 in Other Income) – (\$6,987 adjustment of self-employed AGI) + (disallowed medical deduction of \$2,561)), from -\$85,073 to \$48,177. The 2009 NPA indicated proposed additional tax of \$846, plus applicable interest.
  7. Appellant timely protested the NPAs.
  8. Appellant's 2008 and 2009 federal Account Transcripts do not show any adjustments to the assessments or any pending claims or adjustments.
  9. After determining that the information appellant submitted did not show that the federal assessments had been cancelled or reduced, FTB issued Notices of Action (NOAs) dated July 27, 2018, affirming the tax and penalty identified in the NPAs. This timely appeal followed.

### DISCUSSION

#### Issue 1: Whether appellant has demonstrated error in the proposed assessments for 2008 and 2009, which are based on federal determinations.

R&TC section 18622(a) provides in pertinent part that a taxpayer 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 is presumptively correct and that a taxpayer bears the burden of proving that the determination is erroneous. (*Appeal of Brockett* (86-SBE-109) 1986 WL 22731; *Todd v. McColgan* (1949) 89 Cal.App.2d 509.) 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. (See *New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435; *Appeal of Walshe* (75-SBE-073) 1975 WL 3557.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof with respect to an assessment based on federal action. (*Appeal of Magidow* (82-SBE-274) 1982 WL 11930.)

Here, appellant provided the 2008 Form 1120 Corporate Income Tax Return for his corporation “Net Equity Advisors, Inc.” Appellant asserts that the corporation dealt in sales of securities but the brokerage house required that he provide his social security number for transactions, and that the 1099 was issued to him personally because of this requirement. He asserts that the sales were for his corporation and properly reported on the corporate return. However, appellant has not provided corroborating documentation that would prove that the 1099 income of \$1,107,506.00 reported to him was part of the income included in the \$1,134,680.18 of gross receipts reported on the 2008 California Form 100 for Net Equity Advisors, Inc. He has also not provided any financial records that would demonstrate an entitlement to the disallowed deductions, such as bank statements, cancelled checks, affidavits, contracts or periodic statements from the brokerage, etc. that would demonstrate that the income belonged to the entity rather than appellant individually. Furthermore, appellant has not provided any documentation that supports his position for the corresponding adjustment in 2009 related to the sales of securities or the other income adjustments. Without corroborating evidence, the Office of Tax Appeals has no basis to conclude that FTB 's proposed assessments are incorrect.

Appellant’s 2008 and 2009 federal Account Transcripts do not show any adjustments to the assessments or any pending claims or adjustments. Appellant has provided no evidence showing error in the final federal assessment or in FTB’s proposed assessment based on the final federal assessment. Consequently, appellant has not satisfied his burden of showing error in the final federal assessment or overcome the presumption of correctness in FTB ’s determination based on the final federal assessment.

Issue 2: Whether appellant has demonstrated that the accuracy-related penalty imposed on tax year 2008 should be abated.

R&TC section 19164, which incorporates the provisions of Internal Revenue Code (IRC) section 6662, provides for an accuracy-related penalty of 20 percent of the applicable underpayment. As relevant here, the penalty applies to the part of the underpayment attributable to any substantial understatement of income tax. (IRC, § 6662(b).) For an individual, a substantial understatement of tax exists if the amount of the understatement exceeds the greater of 10 percent of the tax required to be shown on the return or \$5,000. (IRC, § 6662(d)(1).) An “understatement” means the excess of the amount required to be shown on the return for the

taxable year over the amount of the tax imposed which is shown on the return, reduced by any rebate. (IRC, § 6662(d)(2).) When FTB assesses an accuracy-related penalty based on increases to tax following a federal action, the assessment of the penalty is presumptively correct. (*Appeal of Abney* (82-SBE-104) 1982 WL 11781.)

FTB correctly imposed an accuracy-related penalty of 20 percent of the applicable underpayment in the amount of \$23,187.20 (i.e., \$115,936.00 x .20). The 2008 adjustments resulted in a substantial understatement of tax for appellant's 2008 taxable year. Appellant has not met his burden to establish a defense to the accuracy-related penalty or show that the penalty does not otherwise apply. Appellant has failed to show either substantial authority to justify the understatement or adequate disclosure of the understatement specifying a reasonable basis. (See IRC, § 6662(d)(2)(B).) Additionally, appellant's 2008 federal Account Transcript shows no indication that the federal accuracy-related penalty was revised or abated. Accordingly, appellant has failed to produce credible and competent evidence to show that FTB improperly imposed an accuracy-related penalty or that the penalty should be abated.

HOLDINGS

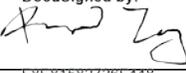
1. Appellant has not demonstrated error in the proposed assessments for tax years 2008 and 2009.
2. Appellant has not demonstrated that the accuracy-related penalty imposed on tax year 2008 should be abated.

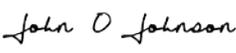
DISPOSITION

Based on the foregoing, FTB’s action is sustained.

DocuSigned by:  
  
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 Amanda Vassigh  
 Administrative Law Judge

We concur:

DocuSigned by:  
  
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 Richard Tay  
 Administrative Law Judge

DocuSigned by:  
  
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 John O. Johnson  
 Administrative Law Judge

Date Issued: 7/16/2020