OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18042970
J. NAVAR	)
	)
	)
	)
	)

OPINION

Representing the Parties:

For Appellant: J. Navar

For Respondent: Brian Werking, Tax Counsel III

A. ROSAS, Administrative Law Judge: Under Revenue and Taxation Code (R&TC) section 19045, appellant J. Navar appeals respondent Franchise Tax Board's action proposing an assessment of $15,285 in tax and a late-filing penalty of $3,821.25, plus interest, for tax year 2015.[1]

Office of Tax Appeals (OTA) Administrative Law Judges Andrea L.H. Long, Jeffrey I. Margolis and Alberto T. Rosas held an oral hearing for this matter on July 23, 2020. The hearing was scheduled to take place in Cerritos, California; however, in response to emergency conditions related to the COVID-19 pandemic, the panel held this hearing remotely using interactive videoconferencing. At the conclusion of the hearing, the record was closed and this matter was submitted for decision.

ISSUES

1. Whether respondent established that the proposed assessment based on estimated income was reasonable and rational, and, if so, whether appellant established that the proposed assessment was erroneous.

[1] As stated in respondent's Prehearing Conference Statement dated January 21, 2020, and at the July 23, 2020 oral hearing, respondent subsequently reduced the proposed tax and penalty to the following amounts: additional tax of $4,863 and a late-filing penalty of $1,215.75, plus applicable interest.

2. Whether appellant established reasonable cause to abate the late-filing penalty.
3. Whether appellant established that interest should be abated.

FACTUAL FINDINGS

1. Appellant did not file a California income tax return for tax year 2015.
2. Respondent received information reported by J.P. Morgan Chase Bank, N.A., on four separate Forms 1098 for tax year 2015, attributing mortgage interest payments to appellant in the amounts of $22,172, $8,737, $6,665 and $723.
3. This mortgage interest information indicated to respondent that appellant may have a California filing requirement. However, respondent's records revealed that appellant had not filed a 2015 California tax return.
4. On June 26, 2017, respondent issued a Notice of Proposed Assessment (NPA) for tax year 2015. Using a 6:1 ratio of income to mortgage interest paid, the NPA estimated appellant's total income as $229,788. Based on a taxable income calculation of $191,490, the NPA proposed to assess total tax of $15,285 and a late-filing penalty of $3,821.25, plus applicable interest.
5. Appellant protested the NPA. In a telephone conversation in October 2017, appellant informed respondent that he recalled filing a 2015 California income tax return, and that he would check his records and submit a copy of that return. Appellant also indicated that if he had not filed a 2015 tax return, he would do so.
6. Appellant did not file a 2015 California income tax return. On February 27, 2018, respondent issued a Notice of Action affirming the NPA. Appellant timely appealed.
7. After appellant filed his appeal, the parties agreed that the mortgage interest payment in the sum of $22,172 should not be included in respondent's estimate of appellant's tax liability. Accordingly, respondent reduced the proposed tax and penalty amounts.

DISCUSSION

Issue 1 - Whether respondent established that the proposed assessment based on estimated income was reasonable and rational, and, if so, whether appellant established that the proposed assessment was erroneous.

Every individual subject to the California Personal Income Tax Law is required to make and file a return with respondent "stating specifically the items of the individual's gross income

from all sources and the deductions and credits allowable . . . ." (R&TC, § 18501.) If a taxpayer fails to file a return, respondent at any time "may make an estimate of *the net income, from any available information*, and may propose to assess the amount of tax, interest, and penalties due." (R&TC, § 19087(a), emphasis added.) If respondent proposes a tax assessment based on an estimate of income, respondent's initial burden is to show that its proposed assessment was reasonable and rational. (*Appeal of Myers* (2001-SBE-001) 2001 WL 37126924.)

A proposed assessment based on unreported income is presumed to be correct when the taxing agency introduces a minimal factual foundation to support the assessment. (*In re Olshan* (9th Cir. 2004) 356 F.3d 1078, 1084, citing *Palmer v. Internal Revenue Service* (9th Cir. 1997) 116 F.3d 1309, 1312 (*Palmer*); see also *Appeals of Bailey* (92-SBE-001) 1992 WL 44503.) When a taxpayer fails to file a valid return and refuses to cooperate in the ascertainment of his or her income, respondent is given "great latitude" in estimating income. (*Appeals of Tonsberg* (85-SBE-034) 1985 WL 15812.)

Here, respondent introduced a minimal factual foundation to support its revised assessment: respondent received information reported by J.P. Morgan Chase Bank, N.A., on three separate Forms 1098 for tax year 2015, attributing mortgage interest payments to appellant in the amounts of $8,737, $6,665 and $723 (rounded to $724), totaling $16,126. Respondent applied a 6:1 ratio of income to mortgage interest paid to estimate appellant's income to be $96,756 ($16,126 X 6) for tax year 2015.[2]

Appellant disagrees with the application of the mortgage interest payments totaling $16,126 and the use of the 6:1 ratio of income to mortgage interest paid, arguing that this 6:1 ratio does not apply to him. In his pleadings, appellant contends that friends in the mortgage industry informed him that California residents "have a 3:1 ratio at best." However, "[a] taxpayer is not in a good position to criticize respondent's estimate of his or her liability when he or she fails to file a required return and, in addition, subsequently refuses to submit information upon request." (*Appeals of Dauberger et al*. (82-SBE-082) 1982 WL 11759.) In giving respondent great latitude in estimating income, we conclude that respondent's use of a 6:1 ratio

[2] Based on a 1098 Mortgage Interest Study Report from November 2019, respondent reviewed approximately 48.7 million tax returns for tax years 2007 through 2017 for individuals who filed California income tax returns and claimed a mortgage interest deduction on Schedule A of their federal income tax return. As part of this study, respondent found an average income to mortgage interest ratio of 10.25:1. For tax year 2015 specifically, respondent reviewed approximately 4.2 million returns and found an average income to mortgage interest ratio of 15.08:1.

of income to mortgage interest paid was reasonable. Accordingly, we conclude that respondent met its initial burden of establishing that its proposed assessment was reasonable and rational.

Once respondent has met its initial burden of showing a reasonable and rational basis for its determination, the taxpayer has the burden of proving that the determination is arbitrary or erroneous. (*Rapp v. Commissioner* (9th Cir. 1985) 774 F.2d 932, 935; *Todd v. McColgan* (1949) 89 Cal.App.2d 509, 514.) The applicable standard is by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(c).) That is, a party must establish by documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (*Concrete Pipe and Products of California, Inc. v. Construction Laborers Pension Trust for Southern California* (1993) 508 U.S. 602, 622.) In other words, the preponderance of the evidence standard means more than 50 percent. (*Union Pacific Railroad Co. v. State Bd. of Equalization* (1991) 231 Cal.App.3d 983, 1000.) Unsupported assertions are insufficient to satisfy the taxpayer's burden of proof. (*Appeal of Magidow* (82-SBE-274) 1982 WL 11930.)

It is undisputed that appellant failed to file a 2015 return. During the July 23, 2020 oral hearing, appellant decided not to testify as a witness; accordingly, all of his unsworn statements were made for purposes of argument only. It is well established that argument is not evidence. (*People v. Cash* (2002) 28 Cal.4th 703, 734; *Hoffman v. Brandt* (1966) 65 Cal.2d 549, 552; *Mel Williamson, Inc. v. United States* (1982) 229 Ct. Cl. 846, 848; Evid. Code, § 140.) Thus, appellant must satisfy his burden of proof utilizing the exhibits that were admitted into evidence. In reviewing those exhibits, we conclude that appellant has not presented any evidence to prove that respondent's determination is erroneous. To the contrary, the evidence indicates that appellant paid to J.P. Morgan Chase Bank, N.A., mortgage interest payments in 2015 totaling $16,126.[3]

In the absence of a tax return for tax year 2015, we rely on the mortgage interest reported and the statistical information concerning the 6:1 ratio; and we find that there is a "reasonable inference that the [appellant] must have had sufficient income to support" himself and to pay this mortgage interest. (*Palmer*, *supra*, 116 F.3d 1309 at p. 1313.)

[3] Moreover, although the NPA was based on mortgage interest information, respondent's evidence also indicates that appellant sold real property in January 2015, for a gross sales price of $550,000; however, we note that this evidence is not relevant to the issue pertaining to the estimated income based on the 6:1 ratio of income to mortgage interest paid.

In short, because respondent met its initial burden, the burden shifted to appellant to establish that the proposed assessment was arbitrary or erroneous. However, appellant provided no evidence to show error in respondent's estimate of his taxable income. Therefore, we sustain respondent's determination, as revised, in the sum of $4,863 in tax.

Issue 2 – Whether appellant established reasonable cause to abate the late-filing penalty.

Respondent imposes a penalty when a taxpayer does not timely file a return, unless it is shown that the failure to timely file was due to reasonable cause and not due to willful neglect. (R&TC, § 19131(a).) A taxpayer has the burden of establishing reasonable cause. (*Appeal of Scott* (82-SBE-249) 1982 WL 11906.) As a general matter, for a taxpayer to establish that a failure to act was due to reasonable cause, the taxpayer must show that the failure occurred despite the exercise of ordinary business care and prudence, or that cause existed as would prompt an ordinarily intelligent and prudent businessperson to have so acted under similar circumstances. (*Appeal of Bieneman* (82-SBE-148) 1982 WL 11825.) Here, appellant did not present any argument or evidence as to the existence of reasonable cause. Thus, we sustain respondent's imposition of a late-filing penalty, as revised, in the sum of $1,215.75.

Issue 3 – Whether appellant established that interest should be abated.

Tax is due on the original due date of the return without regard to any filing extension. (R&TC, § 19001.) If a taxpayer does not pay the tax by the original due date of the tax return, or if respondent assesses additional tax, the law provides for charging interest on the balance due. (R&TC, § 19101.) Imposing interest is mandatory, and respondent cannot abate interest except where authorized by law. (*Appeal of Balch*, 2018-OTA-159P.) Interest is not a penalty; it is compensation for the use of money. (*Ibid*.) To obtain waiver or abatement of interest, appellant must qualify under R&TC sections 19104, 19112, or 21012. Based on the evidence and appellant's arguments, none of these statutory provisions apply. Therefore, appellant did not establish that he qualified for any waiver or abatement of interest.

HOLDINGS

1. Respondent established that the proposed assessment based on estimated income was reasonable and rational. After the burden of proof shifted, appellant did not establish that the proposed assessment was erroneous.
2. Appellant did not establish reasonable cause to abate the late-filing penalty.
3. Appellant did not establish that interest should be abated.

DISPOSITION

Respondent revised the proposed assessment as follows: the proposed assessment of additional tax was reduced from $15,285 to $4,863; the late-filing penalty was reduced from $3,821.25 to $1,215.75; and interest will be reduced accordingly. We sustain respondent's action as revised.

DocuSigned by:
Alberto T. Rosas
2281E8D466014D1...
Alberto T. Rosas
Administrative Law Judge

I concur:

DocuSigned by:
Andrea LH Long
272945E7B372445...
Andrea L.H. Long
Administrative Law Judge

Concurring opinion of J. MARGOLIS, writing separately:

I concur in the result reached in this appeal but write separately regarding respondent's use of mortgage interest studies to satisfy its initial burden of establishing that its determination has a rational basis and was not arbitrary and excessive. Those studies indicate that respondent's review of millions of returns showed that there was (at least) a 6:1 ratio between the amount of total income reported on a return and the amount of mortgage interest claimed on a Schedule A. However, the Forms 1098 at issue in this appeal appear to have been issued with respect to investment and/or commercial properties. That interest would be reported on Schedule E (or Schedule C), not Schedule A.[1] Respondent has not shown that its studies apply to interest claimed with respect to interest that is reportable on Schedules E and C. Accordingly, respondent's studies are not sufficient to make the requisite showing in this appeal that its determination is supported by a rational basis and was not arbitrary and excessive in amount.

However, respondent remedied this defect by introducing evidence at the hearing showing that appellant sold California property for a gross sales price of $550,000 during the year at issue. Appellant was offered the opportunity to provide information that his gain from the sale of this property was less than $550,000, but he refused to avail himself of that opportunity. Respondent's evidence that appellant had $550,000 of gross proceeds from the sale of property provides a rational basis for respondent's determination that appellant had gross income of *at least* $96,756 during 2015. Hence, the burden of proof shifted to appellant to establish error in respondent's determination. Appellant failed to sustain that burden of proof.

DocuSigned by:
Jeffrey I. Margolis
5E9822FBB1BA41B...

Jeffrey I. Margolis
Administrative Law Judge

Date Issued: 8/25/2020

[1] In fact, respondent admitted in its opening brief that the mortgage interest at issue probably related to properties that would be reportable on a Schedule E.