

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 18083627
R. CARPENTIER AND)
D. CARPENTIER)
_____)

OPINION

Representing the Parties:

For Appellants: R. Carpentier
For Respondent: Anne Mazur, Specialist

C. AKIN, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, R. Carpentier and D. Carpentier (appellants) appeal an action by respondent Franchise Tax Board (FTB) proposing to assess additional tax of \$7,029 and an accuracy-related penalty of \$1,405.80, plus applicable interest, for the 2013 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, which is based on federal adjustments.
2. Whether appellants have established that the accuracy-related penalty was improperly imposed or should be abated.

FACTUAL FINDINGS

1. Appellants filed a joint 2013 California income tax return (Form 540), reporting California adjusted gross income (AGI) and itemized deductions.
2. FTB subsequently received information from the Internal Revenue Service (IRS) in the form of a FEDSTAR IRS Data Sheet (Fedstar Sheet), indicating that the IRS adjusted appellants’ 2013 federal income tax return. As applicable to this appeal, the Fedstar

Sheet indicated that the IRS increased appellants' taxable interest income by \$45, allowed additional Schedule E mortgage interest of \$6,309, and disallowed claimed deductions related to Schedule E taxes of \$5,609, Schedule A home mortgage interest of \$36,000, Schedule A real estate taxes of \$8,318, and Schedule A unreimbursed employee expenses of \$45,120. The IRS increased appellants' 2013 federal taxable income by \$89,173,¹ assessed additional tax of \$10,115, and imposed an accuracy-related penalty of \$2,023.

3. Based on the IRS information, FTB made corresponding adjustments to appellants' California taxable income and issued a Notice of Proposed Assessment (NPA) to appellants. The NPA increased appellants' 2013 California taxable income by \$88,783 and proposed additional tax of \$7,029 and an accuracy-related penalty of \$1,405.80, plus applicable interest.
4. Appellants timely protested the NPA, asserting that the federal changes were incorrect. Appellants contended that they had business expenses which were mistakenly reported on Schedule E (used to report income or loss from rentals, royalties, and pass-through entities) instead of Schedule C (used to report income or loss from a sole proprietorship). Appellants further asserted that they had "resubmitted" information to the IRS and were now "clear."
5. Because the IRS had not cancelled or otherwise revised the federal determination, FTB issued a Notice of Action affirming the NPA.
6. This timely appeal followed.
7. On appeal, appellants provided FTB a signed copy of the Agreement Page from FTB's opening brief. However, FTB declined to accept the signed Agreement Page because the additional tax amount of \$7,029 was crossed out by appellants and \$4,635 was handwritten in its place. Appellants also included a note indicating that they were amending their 2013 taxes, and when claiming business expenses on Schedule C (as opposed to Schedule A and/or Schedule E, as filed), appellants asserted they only owe \$4,635 in tax, the accuracy-related penalty, and interest.

¹ The federal adjustment amount also includes \$390 attributable to state and local tax refunds that are not taxable by California.

8. Appellants have not filed an amended return for the 2013 tax year with FTB and have not provided a copy of an amended return to the Office of Tax Appeals.
9. Also on appeal, FTB provided an IRS Account Transcript dated December 24, 2019, which indicates that the federal determination, including the accuracy-related penalty, has not been cancelled or revised.

DISCUSSION

Issue 1 - Whether appellants have shown error in FTB's proposed assessment, which is based on federal adjustments.

R&TC section 18622(a) requires a taxpayer to concede the accuracy of a federal determination or to state where the change is erroneous. It is well settled that a deficiency assessment based on a federal adjustment to income is presumed correct, and a taxpayer bears the burden of proving that FTB's determination is erroneous. (*Appeal of Brockett* (86-SBE-109) 1986 WL 22731; *Todd v. McColgan* (1949) 89 Cal.App.2d 509, 514.) Unsupported assertions are insufficient to satisfy a taxpayer's burden of proof. (*Appeal of Magidow* (82-SBE-274) 1982 WL 11930.) In the absence of credible, competent, and relevant evidence showing that FTB's determination is incorrect, it must be upheld. (*Appeal of Seltzer* (80-SBE-154) 1980 WL 5068.)

R&TC section 17041(a)(1) provides, in pertinent part, that tax shall be imposed upon the entire taxable income of every resident of California. R&TC section 17071 incorporates Internal Revenue Code (IRC) section 61, which defines "gross income" as "all income from whatever source derived," including interest income.

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. (*New Colonial Ice Co., Inc. v. Helvering* (1934) 292 U.S. 435; *Appeal of Myers* (2001-SBE-001) 2001 WL 37126924.) In order to carry that burden, a taxpayer must point to an applicable statute and show by credible evidence that the transactions in question come within its terms. (*Appeal of Telles* (86-SBE-061) 1986 WL 22792.)

While appellants contend the federal changes were incorrect, appellants do not deny receiving the unreported interest income of \$45, nor do they contend that they properly reported this interest income on their 2013 federal and California returns. Appellants also contend they have business expenses which were mistakenly reported on Schedule A and/or Schedule E,

instead of Schedule C, and that they need to file an amended return to correct this.² However, appellants have failed to file an amended return or provide any explanation or documentation substantiating the claimed Schedule A and Schedule E deductions, which were disallowed by the IRS and FTB.

Additionally, while appellants contend that they are “working with [the] federal gov[ernment] about the same issue,” appellants’ 2013 IRS Account Transcript indicates that the federal determination has not been cancelled or revised and that appellants have agreed to, and are making installment payments on, the federal assessment. The IRS Account Transcript also indicates that a collections due process hearing was requested by appellants on November 2, 2017, and resolved by the IRS on November 1, 2018. This IRS collection due process notice and hearing also supports that the 2013 federal assessment is final. A collection due process hearing only occurs after a final liability has been established and gives a taxpayer the right to challenge the proposed collection action, not the existence of the federal tax liability.

Thus, appellants have not met their burden of proving error in FTB’s proposed assessment for 2013, or the federal determination upon which FTB based its proposed assessment.

Issue 2 - Whether appellants have established that the accuracy-related penalty was improperly imposed or should be abated.

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)(2) provides, in relevant part, that the penalty applies to “any substantial understatement of income tax.” For individuals, 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).) An “understatement” means the excess of the amount required to be shown on the return for the taxable year over the tax imposed which is shown on the return, reduced by any rebate. (IRC, § 6662(d)(2)(A).)

² While appellants contended at protest that they have business expenses which were mistakenly reported on Schedule E, instead of Schedule C, on appeal appellants state that they “should have included Schedule C not Schedule A.” Because appellants have not provided any additional evidence or explanation, it is unclear which of the disallowed Schedule A and Schedule E expenses appellants contend should be allowed as business expenses on Schedule C.

Here, FTB correctly calculated and imposed an accuracy-related penalty of 20 percent of the applicable understatement of tax in the amount of \$1,405.80 (i.e., \$7,029 x 0.20), since appellants' understatement of \$7,029 exceeds \$5,000, which is greater than 10 percent of the tax required to be shown on the return (i.e., \$7,911 x 0.10 = \$791.10).

It is well settled that an FTB determination based on a federal audit report is presumptively correct, and the burden is on the taxpayer to prove that the determination is erroneous. (*Appeal of Brockett, supra.*) Appellants have provided no argument or evidence establishing a basis to abate the accuracy-related penalty and have not argued or shown error in FTB's determination to impose the accuracy-related penalty. Additionally, the evidence in the appeal record shows that the IRS concluded its examination of appellants' 2013 tax return without revising or abating the accuracy-related penalty. Appellants also do not provide any argument or evidence establishing that any exceptions to the accuracy-related penalty apply. (See, e.g., IRC, § 6662(d)(2)(B); Treas. Reg. §§ 1.6664-1(b)(2) & 1.6664-4.) Accordingly, appellants have failed to show that the accuracy-related penalty should be abated.

HOLDINGS

1. Appellants have failed to demonstrate error in FTB’s proposed assessment of additional tax, which is based upon federal adjustments.
2. Appellants have failed to establish that the accuracy-related penalty was improperly imposed or should be abated.

DISPOSITION

FTB’s action is sustained.

DocuSigned by:



Cheryl L. Akin
Administrative Law Judge

We concur:

DocuSigned by:



Kenneth Gast
Administrative Law Judge

DocuSigned by:



Andrew J. Kwee
Administrative Law Judge

Date Issued: 8/26/2020