

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:

A. ULMER) OTA Case No. 18053082
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)**OPINION ON PETITION FOR REHEARING**

Representing the Parties:

For Appellant:

A. Ulmer

For Respondent:

Gi Nam, Tax Counsel

K. GAST, Administrative Law Judge: On January 17, 2020, the Office of Tax Appeals (OTA) issued an Opinion in which we largely sustained respondent Franchise Tax Board's (FTB) proposed assessment for the 2015 tax year, except we modified it by lowering FTB's estimate of appellant's income.¹ FTB timely filed a petition for rehearing (petition), arguing that its original estimate was correct.²

A rehearing may be granted where one of the following five grounds exists, and the substantial rights of the filing party (here, FTB) are materially affected: (a) an irregularity in the appeal proceedings which occurred prior to the issuance of the written opinion and prevented fair consideration of the appeal; (b) an accident or surprise which occurred during the appeal proceedings and prior to the issuance of the written opinion, which ordinary caution could not have prevented; (c) newly discovered, relevant evidence, which the filing party could not have reasonably discovered and provided prior to the issuance of the written opinion; (d) insufficient evidence to justify the written opinion or the opinion is contrary to law; or (e) an error in law. (Cal. Code Regs., tit. 18, § 30604(a)-(e).)

¹ Administrative Law Judge (ALJ) John O. Johnson replaced ALJ Sara A. Hosey, who wrote the original Opinion in this matter. For ease of reading, references herein to "we" or "our" refer to the three-ALJ panel that decided the original Opinion.

² Appellant did not file a petition for rehearing.

FTB bases its petition on the fourth ground; that is, there is insufficient evidence to justify our Opinion or the Opinion is contrary to law.³ Upon consideration of FTB's petition, we conclude the grounds set forth therein do not meet the requirements for a rehearing.

The Written Opinion Is Not Contrary to Law

Since FTB primarily contends our Opinion is contrary to law, we will address that contention first. To find that the Opinion is contrary to law, we must determine whether the Opinion is unsupported by any substantial evidence. (*Appeals of Swat-Fame, Inc., et al.*, 2020-OTA-045P at p. 3 (*Swat Fame*).) This requires a review of the Opinion to indulge in all legitimate and reasonable inferences to uphold it. (*Ibid.*) The relevant question is not over the quality or nature of the reasoning behind the Opinion, but whether the Opinion can or cannot be valid according to the law. (*Ibid.*) In our review, we consider the evidence in the light most favorable to the prevailing party (here, appellant). (*Ibid.*)

FTB argues that, contrary to our Opinion, it did meet its initial burden of showing why its proposed assessment was reasonable and rational and therefore we erred by failing to shift the burden to appellant to prove error. FTB renews its contention that because appellant had not filed a 2015 tax return, it was authorized, under Revenue and Taxation Code (R&TC) section 19087(a), to estimate her California gross income to be \$84,840. This amount represents six times \$14,140, which is appellant's total 2015 mortgage interest payments on California rental real estate she owned, as reported on federal Form 1098. FTB asserts this 6:1 ratio is derived from studies showing a statistical relationship between income reported on the tax return to mortgage interest paid. In FTB's view, this was "more than sufficient" for it to meet its initial burden of proving its proposed assessment was reasonable and rational. We disagree.

In our Opinion, we found no evidence in the record that appellant (or her spouse) were California residents. Therefore, as nonresidents, they are taxable in this state only on their California source income. The record only revealed that appellant derived gross rental income of \$20,400 and paid mortgage interest of \$14,140 on her California rental real estate, for total net

³ FTB's petition also asserts that, under the fifth ground, our Opinion "is based on an error in law." However, consistent with California Code of Civil Procedure section 657, we interpret the fifth ground to refer to an error in law occurring during the appeal proceedings, as opposed to a legal error in the Opinion. (*Appeal of Wilson Development, Inc.* (94-SBE-007) 1994 WL 580654.) FTB does not argue that there was an error in law during the proceedings. Thus, we interpret FTB's "error in law" contention to be based solely on the last clause of the fourth ground; namely, that our Opinion is contrary to law.

rental income of \$6,260 for 2015. Thus, the objective evidence established California gross income far less than the \$84,840 that FTB had estimated, even assuming its 6:1 ratio properly applies to mortgage interest paid for rental property.⁴ While we acknowledge the California return that appellant ultimately filed during this appeal failed, along with the attached federal return, to include a Schedule E or in any other way report the California rental income, we do not believe that omission alone shows that she had California income far greater than \$6,260. Accordingly, viewing the evidence most favorable to appellant, FTB has not established that our Opinion is contrary to law.

There Is Sufficient Evidence to Justify the Written Opinion

To find that there is insufficient evidence to justify the Opinion, we must find that, after weighing the evidence in the record, including reasonable inferences based on that evidence, we clearly should have reached a different result. (*Swat-Fame, supra*, at p. 3.)

FTB asserts there is insufficient evidence to justify our Opinion because appellant's "evidence should be deemed discredited and disregarded." FTB argues that appellant's late-filed California tax return cannot be relied upon because it omitted California rental income and erroneously claimed a home mortgage interest deduction for that property on Schedule A rather than on Schedule E. FTB further alleges that appellant lacks credibility because she argued on appeal that she did not derive California rental income, which FTB proved to be false because it, and not appellant, offered into evidence a rental agreement for the California property showing in-state rental income.

However, as discussed above, we are not persuaded by FTB's argument that an omission of California rental income from appellant's California and federal returns, by itself, means she derived income from in-state sources far greater than what the rental agreement showed, even if it was FTB, not appellant, that introduced the agreement into the record.


⁴ We note that the studies, which FTB provides with its petition for the first time in this appeal, appear to relate to mortgage interest claimed on federal Schedule A, which is used to report home mortgage interest. However, the interest at issue here undisputedly relates to an investment property that is reported on Schedule E, not Schedule A. More significantly, even if FTB were justified in concluding that the interest paid on appellant's mortgage on the California property suggested that she earned income of six times that amount to fund the mortgage payments, this still would not satisfy FTB's burden of providing a rational basis for its determination that the income she earned to fund the mortgage payments was *California source income*, since the evidence is undisputed that she resided and worked outside of California during the year at issue.

FTB also claims that it has shown that appellant’s California return was “a false or fraudulent return [filed] with intent to evade the tax” within the meaning of R&TC section 19087(a),” and that “OTA did not follow the law and require that appellant file a 2015 tax return that is not false or fraudulent.” But R&TC section 19087(a) provides that when a taxpayer files a false or fraudulent return, FTB—*not* OTA— “may require a return or an amended return under penalties of perjury or 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.” Accordingly, we reject FTB’s contention that OTA erred by not requiring appellant to file an amended return pursuant to R&TC section 19087(a).⁵


⁵ Moreover, FTB has the burden of proving fraud by clear and convincing evidence (Cal. Code Regs., tit. 18, § 30219(b)), and FTB’s proof of omitted gross rental income, without more, fails to establish that appellant’s California return was “a false or fraudulent return with intent to evade the tax” within the meaning of R&TC section 19087(a).

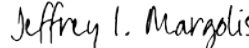
Lastly, we disagree with FTB’s contention that only if appellant files a corrected return including the omitted income will she be able “to shift the burden [back to FTB] and [require it] to adjust or withdraw the assessment.” In our Opinion, we held that FTB had not provided a rational basis for its determination that appellant’s California source income was greater than the amount of gross rental derived from appellant’s California rental property, less the mortgage interest expense paid for that property. Hence the burden of proof never shifted to appellant to refute FTB’s determination of California source income in excess of that amount. FTB’s own evidence showed that appellant and her spouse were California nonresidents who realized no more than \$6,260 of net rental income from their California rental property. We fail to see how our Opinion impedes FTB’s rights and duties to ensure taxpayers file valid and accurate returns, and nothing in our Opinion prevents FTB from proposing assessments of tax in similar situations, so long as its proposed assessment has a rational basis and is reasonable in amount. Accordingly, there is sufficient evidence to justify our Opinion.

For the foregoing reasons, FTB’s petition is denied.

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Kenneth Gast
Administrative Law Judge

We concur:

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John O. Johnson
Administrative Law Judge

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Jeffrey I. Margolis
Administrative Law Judge

Date Issued: 10/12/2020