

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 19115504
L. COLLIER)
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OPINION

Representing the Parties:

For Appellant: L. Collier

For Respondent: Eric R. Brown, Tax Counsel III

H. LE, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, L. Collier (appellant) appeals an action by the respondent Franchise Tax Board (FTB) proposing additional tax of \$4,086 and an accuracy-related penalty of \$817.20, plus applicable interest, for the 2015 tax year.¹

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

ISSUES

1. Whether appellant has demonstrated error in the proposed assessment of additional tax, which is based upon federal adjustments.
2. Whether the accuracy-related penalty should be abated.

¹ Office of Tax Appeals (OTA) did not record as an appeal appellant’s correspondence for tax years 2013 and 2014 because these were filed after the 30-day statutory period allowed to file an appeal under R&TC section 19045. The Notice of Action (NOA) for tax year 2013 was issued on October 1, 2019, with an appeal by date of October 31, 2019. The NOA for tax year 2014 was issued on September 3, 2019, with an appeal by date of October 3, 2019. Appellant’s appeal correspondence is dated November 19, 2019, and received by OTA on November 20, 2019, which is beyond the 30-day period to appeal. Accordingly, OTA does not have jurisdiction in this matter for the 2013 and 2014 tax years.

FACTUAL FINDINGS

1. Appellant filed a timely 2015 California resident income tax return and claimed the head of household (HOH) filing status.
2. Subsequently, the Internal Revenue Service (IRS) provided a FEDSTAR IRS Data Sheet to FTB for the 2015 tax year showing numerous federal adjustments, including the following: (1) the IRS disallowed appellant's filing status of HOH and changed it to "single"; (2) the IRS disallowed \$7,048 in other unreimbursed employee expenses; (3) for Schedule C expenses, the IRS disallowed \$1,090 for legal and professional services, \$11,261 for rent or lease vehicles, machinery, and equipment, \$15,948 for travel, \$10,158 for meals and entertainment, \$10,853 for car and truck expenses, and \$9,423 for other expenses; and (4) the IRS assessed an accuracy-related penalty of \$3,460.80. The FEDSTAR IRS Data Sheet does not show whether the accuracy-related penalty was based on negligence or the existence of a substantial understatement of federal tax.
3. Based on these federal adjustments, on February 20, 2019, FTB issued a Notice of Proposed Assessment (NPA) to appellant showing numerous conforming adjustments, including the following: (1) FTB disallowed appellant's HOH filing status and changed it to "single," and disallowed \$4,044 of the standard deduction; (2) for Schedule C expenses, FTB disallowed \$1,090 for legal and professional services, \$11,261 for rent or lease vehicles, machinery, and equipment, \$26,106 for travel, meals, and entertainment, \$10,853 for car and truck expenses, and \$9,423 for other expenses; and (3) FTB imposed a 20 percent accuracy-related penalty of \$1,210.80. FTB revised appellant's total tax to \$7,069 and proposed additional tax of \$6,054. The NPA stated that the accuracy-related penalty was calculated as "20 percent of the additional California tax on the same adjustments to which the [IRS] applied the federal accuracy penalty."
4. Appellant protested FTB's NPA on April 22, 2019, indicating that the IRS was still reviewing the 2013, 2014 and 2015 tax years.
5. FTB acknowledged receipt of appellant's protest letter on August 28, 2019, and explained that it had received information from the IRS regarding subsequent changes to appellant's federal tax liability. The IRS revised appellant's federal adjusted gross income (AGI) and changed the filing status to HOH, with one exemption allowed. Based on these federal adjustments, FTB revised appellant's account to apply the revised federal

AGI and allow the HOH filing status with a revised allowable exemption of one to appellant's California return. As a result, appellant's revised California total tax liability was reduced to \$5,101 and the amount of proposed additional tax was correspondingly reduced from \$6,054 to \$4,086 and the accuracy-related penalty reduced from \$1,210.80 to \$817.20. FTB invited appellant to provide additional information or FTB would affirm its NPA. FTB received no response from appellant to its August 28, 2019 letter.

6. FTB issued an NOA on October 23, 2019, affirming the NPA. This timely appeal followed.

DISCUSSION

Issue 1: Whether appellant has demonstrated error in the proposed assessment of additional tax, which is based upon federal adjustments.

R&TC section 18622(a) provides 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 report 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.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof with respect to an assessment based on a federal action. (*Appeal of Magidow* (82-SBE-274) 1982 WL 11930.)

The taxpayer bears the burden of establishing entitlement to any deductions claimed. (*Appeal of Janke* (80-SBE-059) 1980 WL 4988.) Additionally, deductions are a matter of legislative grace, and a taxpayer bears the burden of proving entitlement to a deduction. (*Deputy v. du Pont* (1940) 308 U.S. 488; *New Colonial Ice Co., Inc. v. Helvering* (1934) 292 U.S. 435.) To support a deduction, the taxpayer must establish by credible evidence, other than mere assertions, that the deduction claimed falls within the scope of a statute authorizing the deduction. (*Appeal of Telles* (86-SBE-061) 1986 WL 22792.)

Here, FTB properly proposed an assessment of additional tax based upon federal adjustments. The evidence establishes that the IRS disallowed as a deduction certain expenses for legal services, vehicle lease, travel and meals, car/truck expenses, and other expenses. Although appellant argues that the claimed deductions relate to expenses incurred in the ordinary course of business and are allowable under Internal Revenue Code (IRC) section 162, appellant

has not provided any evidence to show error in the federal adjustments or FTB's determination based upon those adjustments.² As such, appellant has not satisfied the burden of showing error in FTB's proposed assessment.

Issue 2: Whether the accuracy-related penalty should be abated.

R&TC section 19164 generally incorporates the provisions of IRC section 6662 and imposes an accuracy-related penalty of 20 percent of the applicable underpayment. As relevant here, the penalty applies to any portion of an underpayment attributable to negligence or disregard of rules and regulations, or any "substantial understatement of income tax." (IRC, § 6662(b)(1) & (2).) For an individual, there is a "substantial understatement of income tax" when the amount of the understatement for a taxable year exceeds the greater of ten percent of the tax required to be shown on the return, or \$5,000. (IRC, § 6662(d)(1).)

Here, FTB indicated in its opening brief that its basis for imposing the accuracy-related penalty is a substantial understatement of tax.³ However, appellant's \$4,086 understatement of California income tax does not constitute a substantial understatement of tax because it is less than \$5,000.⁴ Accordingly, the accuracy-related penalty is only applicable for California purposes if there is another basis for its imposition, such as negligence.⁵ FTB has not asserted that the federal penalty was based on negligence,⁶ nor has it independently raised affirmative allegations of negligence on the part of appellant. Accordingly, we find that there was no substantial understatement of tax and that appellant is not liable for the accuracy-related penalty.

² Appellant submitted an undated "Request for Audit Reconsideration" letter addressed to the IRS to reconsider its denial of certain expenses. Although the letter lists certain exhibits, such as a letter from appellant's employer about the company's reimbursement policy and receipts, invoices and bills, no such documents have been submitted to OTA. In its opening brief, FTB invited appellant to submit documentation that the IRS has accepted appellant's request for audit reconsideration and noted that appellant has offered no documents to substantiate claimed expenses. Appellant provided no reply in response.

³ FTB mentions the substantial understatement of tax and cites to IRC section 6662(d)(2)(B), a provision dealing with substantial understatement, but FTB does not mention, or cite to a provision relating to, negligence as a basis to impose the accuracy-related penalty.

⁴ Since \$5,000 is greater than 10 percent of the tax required to be shown on appellant's return (10 percent x \$5,101 = \$510), appellant's understatement must exceed \$5,000 for the accuracy-related penalty to apply.

⁵ While the accuracy-related penalty may be imposed on various bases, such as an overstatement of pension liabilities, the only basis for the accuracy-related penalty that appears potentially relevant here is negligence.

⁶ FTB based its NPA, and its imposition of the accuracy-related penalty, on the FEDSTAR IRS Data Sheet, which does not show whether the accuracy-related penalty was based on negligence or the existence of a substantial understatement of federal tax.

HOLDINGS

1. Appellant has failed to demonstrate error in the proposed assessment of additional tax, which is based upon federal adjustments.
2. Appellant is not liable for the accuracy-related penalty.

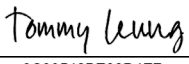
DISPOSITION

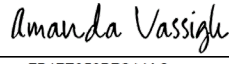
FTB’s tax deficiency determination is sustained, but its imposition of the accuracy-related penalty is reversed.

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 Huy "Mike" Le
 Administrative Law Judge

We concur:

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 Tommy Leung
 Administrative Law Judge

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 Amanda Vassigh
 Administrative Law Judge

Date Issued: 9/16/2020