

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:
Y. LAM

) OTA Case No. 20015745
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OPINION

Representing the Parties:

For Appellant: H. Lam

For Respondent: Joel Smith, Tax Counsel III

C. AKIN, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, Y. Lam (appellant) appeals an action by respondent Franchise Tax Board (FTB) proposing \$4,720 of additional tax, a late-filing penalty of \$1,180, and applicable interest, for the 2017 tax year.

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

ISSUES

1. Whether appellant has shown error in FTB’s proposed assessment of tax.
2. Whether appellant has shown that the late-filing penalty should be abated.

FACTUAL FINDINGS

1. Appellant, a resident of California, did not file a 2017 California income tax return.
2. Through its Integrated Non-Filer Compliance Program, FTB obtained computer information from the Internal Revenue Service, as set forth on a federal Form 1098 from Capital One N.A. (Capital One), that appellant paid mortgage interest for the 2017 tax year in the amount of \$16,086 for a property located in Arcadia, California (the Arcadia Property). Appellant is listed on the Form 1098 as the only “Payer/Borrower” for the Arcadia Property.

3. Based on this information, FTB estimated appellant's income for the 2017 tax year to be \$96,522. This amount was computed by multiplying the amount of reported mortgage interest paid (\$16,086) by six.¹ FTB calculated this six-to-one ratio of income to mortgage interest paid based on its study of millions of tax returns filed by California residents reporting Schedule A mortgage interest deductions for interest paid with respect to primary residences in California.
4. FTB issued appellant a notice dated April 26, 2019, requesting that appellant file a return or explain why no return was required.²
5. When appellant neither filed a return nor supplied information showing he had no filing requirement, FTB issued a Notice of Proposed Assessment (NPA) for the 2017 tax year on based on the information received from Capital One. The NPA set forth proposed tax of \$4,720 and a late-filing penalty of \$1,180, plus applicable interest. The proposed tax was based upon FTB's estimate of appellant's income as \$96,522.
6. Appellant filed a timely protest, asserting he had no filing requirement for the 2017 tax year. Appellant contended that his last working year was 2016 and that he retired and applied for social security benefits in 2017.³
7. In response, FTB sent appellant a letter dated October 18, 2019, requesting that appellant provide documentation of the funding sources appellant used to meet his mortgage obligations and living expenses in 2017.
8. When appellant did not respond to FTB's letter dated October 18, 2019, FTB issued a Notice of Action affirming the NPA.
9. This timely appeal followed.

¹ We note that \$16,086 times 6 equals \$96,516, not \$96,522 as computed by FTB. FTB has not provided an explanation of this \$6 difference; however, this \$6 difference does not appear to have any effect on the resulting tax or penalty amounts computed and proposed to be assessed by FTB.

² For the 2017 tax year, the minimum California adjusted gross income filing threshold for a single filer with no dependents was \$17,029.

³ Because social security benefits are not subject to California income tax (see R&TC section §17087(a)), the social security income received by appellant during 2017 will not impact his filing requirement for the 2017 tax year.

DISCUSSION

Issue 1 - Whether appellant has shown error in FTB's proposed assessment of tax.

R&TC section 17041 imposes a tax upon the entire taxable income of every resident of this state. R&TC section 18501 requires every individual subject to the Personal Income Tax Law to make and file a return with FTB “stating specifically the items of the individual’s gross income from all sources and the deduction and credits allowable” R&TC section 19087(a) provides in relevant part:

If any taxpayer fails to file a return, or files a false or fraudulent return with intent to evade the tax, for any taxable year, the Franchise Tax Board, at any time, 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.

When FTB makes a proposed assessment based on an estimate of income, FTB’s initial burden is to show why its proposed tax assessment is reasonable and rational. (*Appeal of Myers* (2001-SBE-001) 2001 WL 37126924.) Federal courts have held that the taxing agency need only introduce some evidence linking the taxpayer with the unreported income. (See *Rapp v. Commissioner* (9th Cir. 1985) 774 F.2d 932.) When a taxpayer fails to file a valid return, FTB’s use of income information from third party sources to estimate a taxpayer’s taxable income is a reasonable and rational method of estimating taxable income. (See *Appeal of Bailey* (92-SBE-001) 1992 WL 44503.) Once FTB has met its initial burden, the proposed assessment is presumed correct and the taxpayer has the burden of proving it wrong. (*Todd v. McColgan* (1949) 89 Cal.App 2d 509.)

The federal Form 1098 reporting the mortgage interest paid by appellant constitutes substantive evidence linking appellant to unreported California income. FTB used that information to reasonably and rationally reconstruct appellant’s income based on its study and analysis of tax returns filed by California residents. Therefore, FTB met its initial burden. The proposed assessment is presumed correct and appellant has the burden of proving it wrong. (*Todd v. McColgan, supra.*) Unsupported assertions are not sufficient to satisfy a taxpayer’s burden of proof. (*Appeal of Magidow* (82-SBE-274) 1982 WL 11930.) A taxpayer’s failure to produce evidence that is within his or her control gives rise to a presumption that such evidence is unfavorable to his or her case. (*Appeal of Cookston* (83-SBE-048) 1983 WL 15434.)

Appellant asserts that he had no tax obligation for 2017 because he did not work and “had no earned income” during the year. Appellant contends that he “declared his retirement” and applied for social security benefits in 2017.⁴ Appellant further claims that the Capital One mortgage on the Arcadia property and his living expenses for 2017 were paid by his adult child, H. Lam. As evidence, appellant provides a copy of H. Lam’s 2017 tax return, which lists the Arcadia Property as H. Lam’s address and reports a Schedule A mortgage interest deduction of \$16,087 for the 2017 tax year. Appellant appears to offer this evidence to show that he did not pay the mortgage interest as indicated on the Form 1098 issued by Capital One and, therefore, FTB cannot or should not use that interest to estimate his taxable income. However, the tax return only establishes that H. Lam claimed a deduction for the payment of mortgage interest in 2017.⁵ It does not substantiate that the mortgage interest on the Arcadia property was in fact paid, in full or in part, by H. Lam, rather than appellant.⁶

In its brief, FTB invited appellant to provide documentation establishing that H. Lam made mortgage payments on appellant’s behalf. Such documentation could include cancelled checks or bank statements from H. Lam showing the payments H. Lam made to Capital One. Appellant has failed to provide any additional evidence. Consequently, we find that appellant’s assertions are not supported by the available evidence. Appellant’s unsupported assertions are not sufficient to overcome the presumption of correctness that applies to FTB’s deficiency assessment. (*Appeal of Magidow, supra.*) Accordingly, appellant has not met the burden of proving error in FTB’s proposed assessment.

Issue 2 - Whether appellant has shown that the late-filing penalty should be abated.

California imposes a penalty for the failure to file a return by its due date, unless the failure to file was due to reasonable cause and not due to willful neglect. (R&TC, § 19131.) The

⁴ Appellant also provides a social security benefit statement for 2017, which indicates that appellant received \$4,376 in social security benefits during 2017. However, the statement does not indicate when in 2017 appellant applied for or began receiving social security benefits.

⁵ While H. Lam needs to have paid this mortgage interest in order to be entitled to a deduction for it, simply reporting the deduction on the tax return does not mean that H. Lam was entitled to the deduction. We, however, need not make any finding as to whether H. Lam was entitled to the reported mortgage interest deduction as H. Lam is not a party to this appeal.

⁶ While appellant contends that the Arcadia property is jointly owned by appellant, his wife, and their adult child, H. Lam, the Form 1098 issued by Capital One for the 2017 tax year lists appellant as the sole “Payer/Borrow” for the property.

late-filing penalty is computed at 5 percent of the tax due, after allowing for timely payments, for every month elapsing from the due date of the return (without regard to any extension) to the filing date, up to a maximum of 25 percent. (*Ibid.*) To establish reasonable cause, a taxpayer “must show that the failure to file timely returns occurred despite the exercise of ordinary business care and prudence, or that cause existed as would prompt an [ordinarily] intelligent and prudent business[person] to have so acted under similar circumstances.” (*Appeal of Tons* (79-SBE-027) 1979 WL 4068.)

Appellant’s 2017 return was due on April 15, 2018. As of the filing date of this appeal, appellant has failed to file a tax return with FTB for the 2017 tax year. Appellant also has not made any arguments with respect to the late-filing penalty. Additionally, as discussed above, appellant has not substantiated his arguments that the mortgage interest and his living expenses were paid by H. Lam, and that appellant had no income or tax filing requirement for 2017 tax year. Accordingly, we find no basis for abatement of the penalty.

HOLDINGS

1. Appellant has not shown error in FTB’s proposed assessment of tax.
2. Appellant has not shown that the late-filing penalty should be abated.

DISPOSITION

FTB’s action is sustained.

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Cheryl Akin

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Cheryl L. Akin

Administrative Law Judge

We concur:

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Josh Lambert

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Josh Lambert

Administrative Law Judge

DocuSigned by:

Kenneth Gast

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Kenneth Gast

Administrative Law Judge

Date Issued: 10/22/2020