



4. Did FTB abuse its discretion when it denied additional interest abatement?<sup>2</sup>

#### FACTUAL FINDINGS

1. Appellants timely filed joint California income tax returns (Forms 540) for the 2008 and 2009 taxable years by their respective original due dates.
2. Appellants' 2008 and 2009 federal income tax returns were examined by the Internal Revenue Service (IRS), which resulted in several adjustments that increased appellants' taxable income and imposed the ARP.
3. After being informed by the IRS about the examination results,<sup>3</sup> FTB issued its notices of proposed assessment (NPAs) on December 28, 2012, reflecting comparable adjustments to appellants' 2008 and 2009 Forms 540.
4. Appellants protested the NPAs, stating they had requested the IRS reexamine their 2008 and 2009 federal returns. FTB placed a hold on appellants' 2008 and 2009 protests pending the outcome of the federal reexamination.
5. The IRS modified its initial adjustments to appellants' 2008 and 2009 federal returns at the conclusion of its reexamination.
6. FTB revised the 2008 and 2009 NPAs based on the modified federal adjustments and issued appellants Notices of Action (NOAs) on March 5, 2019.
7. The NOA for the 2008 taxable year revised appellants' total tax as reported from \$12,764.00 to \$21,620.00, for additional tax of \$8,856.00, and revised the ARP to \$1,771.20, plus interest.
8. The NOA for the 2009 taxable year revised appellants' total tax as reported from \$51,523.00 to \$79,110.00, for additional tax of \$27,587.00, and revised the ARP to \$5,517.40, plus interest.

---

<sup>2</sup> On appeal, FTB concedes it will abate the interest accrued from November 10, 2014, through March 5, 2019, for taxable years 2008 and 2009, due to its delay in processing appellants' protests.

<sup>3</sup> In essence, the IRS removed various expenses from appellants' 2008 and 2009 Schedules C because it concluded appellants were not carrying on a trade or business within the meaning of Internal Revenue Code (IRC) section 162.

## DISCUSSION

### Issue 1: Are FTB's proposed assessments barred by the statute of limitations?

Generally, FTB must issue an NPA within four years of the original due date of the Form 540 or the date the Form 540 is filed, whichever is later. (R&TC, § 19057.) For the 2008 taxable year, under the applicable four-year statute of limitations, FTB had until April 15, 2013, to issue an NPA, and for the 2009 taxable year, until April 15, 2014. Here, FTB issued appellants' NPAs for the 2008 and 2009 taxable years in 2012. Therefore, FTB's NPAs are timely because they were issued before the general four-year statute of limitations period expired.<sup>4</sup>

### Issue 2: Did appellants establish error in FTB's proposed assessments?

When the IRS makes changes to a taxpayer's federal tax return, the taxpayer must report those changes to FTB, and concede the accuracy of the federal changes or state why the changes are erroneous. (R&TC, § 18622(a).) A deficiency assessment based on a federal audit report is presumptively correct and a taxpayer bears the burden of proving that the determination is erroneous. (*Appeal of Gorin*, 2020-OTA-018P.) Unsupported assertions by a taxpayer are insufficient to satisfy the burden of proof with respect to an assessment based on a federal action. (*Ibid.*)

Here, FTB issued its deficiency assessments based on the final federal audit reports, as revised upon reaudit of appellants federal returns, and thus, FTB's assessments are presumptively correct. (*Appeal of Gorin*, *supra*.) Appellants do not argue, and the evidence does not suggest, that FTB erred in its revised assessments for the 2008 and 2009 taxable years. There is also no evidence indicating the IRS further modified the adjustments it made to appellants' 2008 and 2009 federal returns after FTB issued its NOAs to appellants in 2019. Therefore, appellants have not established that FTB's NPAs were erroneous.

---

<sup>4</sup> Appellants argue the only two dates which should be considered in regard to the general four-year statute of limitations period are May 19, 2014, which is the date appellants contend they entered into an agreement with the IRS, and January 19, 2015, which is the date appellants contend they mailed a letter to FTB stating the IRS concluded its reexamination. As provided under the R&TC, these are not the dates which trigger the statute of limitations in this appeal. (See R&TC, § 19057.)

Issue 3: Have appellants shown cause to abate the ARPs?

IRC section 6662(b)<sup>5</sup> provides, in part, that an ARP applies to the portion of the underpayment attributable to any substantial understatement of income tax. For individual taxpayers, a substantial understatement of tax exists if the amount of the understatement exceeds the greater of 10 percent of the tax required to be shown on the return, or \$5,000. (IRC, § 6662(d)(1).) IRC section 6662(a) provides for an ARP of 20 percent of the applicable underpayment. When based on a federal action, FTB's assessment of an ARP is presumptively correct. (See *Todd v. McColgan* (1949) 89 Cal.App.2d 509, 514, and *Appeal of Brockett* (86-SBE-109) 1986 WL 22731.)

For the 2008 taxable year, FTB proposed total tax of \$21,620.00, while appellants reported tax of \$12,764.00. Here, the amount of the understatement, \$8,856.00, exceeds both the \$5,000.00 and 10 percent thresholds, and FTB imposed an ARP of \$1,771.20, which is 20 percent of the understatement. Likewise, for the 2009 taxable year, FTB proposed total tax of \$79,110.00, while appellants reported tax of \$51,523.00. Here, the amount of the understatement, \$27,587.00, exceeds both the \$5,000.00 and 10 percent thresholds, and FTB imposed an ARP of \$5,517.40, which is 20 percent of the understatement. Therefore, FTB correctly imposed the ARP for the 2008 and 2009 taxable years for the substantial understatement of tax.

The taxpayer bears the burden of proving any defense to the imposition of the ARP. (*Higbee v. Commissioner* (2001) 116 T.C. 438, 447; *Recovery Group, Inc. v. Commissioner*, T.C. Memo. 2010-76.) A taxpayer may reduce or eliminate the ARP if the taxpayer successfully establishes one of three exceptions: (1) the taxpayer had substantial authority for the treatment of any item giving rise to the understatement; (2) the relevant facts affecting the item's tax treatment are adequately disclosed and there is a reasonable basis for the tax treatment of such item; or (3) the underpayment was due to reasonable cause and the taxpayer acted in good faith with respect to such portion of the underpayment. (IRC, §§ 6662(d)(2)(B), 6664(c)(1).)

Appellants argue that FTB unreasonably delayed issuing the NOAs for the 2008 and 2009 taxable years, and that FTB told appellants no additional penalties would accrue after July 12, 2018. For these reasons, appellants argue the amount of the ARP that accrued after

---

<sup>5</sup> IRC section 6662 is incorporated in California law by R&TC section 19164.

July 12, 2018, should be abated. Appellants' argument is unpersuasive, however, because the ARP is not a temporal imposition—i.e., the ARP is calculated based on the amount of the understatement of tax, not the passage of time. Thus, even if FTB unreasonably delayed issuing the NOAs, the ARP would not increase over time due to the delay. In other words, FTB's alleged delayed actions did not increase the ARP.

As discussed above, appellants did not show error in FTB's assessments of the ARPs for the 2008 and 2009 taxable years, and the evidence does not otherwise suggest any of the exceptions apply. Therefore, appellants have not shown cause to abate the ARPs imposed for the 2008 and 2009 taxable years.

Issue 4: Did FTB abuse its discretion when it denied additional interest abatement?

Charging interest on a tax deficiency is mandatory and there is no reasonable cause exception. (R&TC, § 19101; *Appeal of Gorin, supra.*) However, FTB may abate all or a part of any interest on a deficiency to the extent that interest is attributable, in whole or in part, to any unreasonable error or delay by FTB in the performance of a ministerial or managerial act. (R&TC, § 19104(a)(1).) If FTB denies a taxpayer interest abatement under R&TC section 19104(a)(1), OTA may only review FTB's determination for abuse of discretion. (*Appeal of Gorin, supra.*) To show an abuse of discretion, a taxpayer must establish FTB exercised its discretion arbitrarily, capriciously, or without sound basis in law or fact. (*Ibid.*) An error or delay can only be considered when no significant aspect of the error or delay is attributable to the taxpayer and after FTB contacted the taxpayer in writing with respect to the deficiency or payment. (R&TC, § 19104(b)(1); *Appeal of Goren, supra.*)

Appellants argue that FTB unreasonably delayed issuing the NOAs for the 2008 and 2009 taxable years and assert that FTB told them no additional interest would accrue after July 12, 2018. Appellants also contend that the time it has taken to resolve the tax issues arising from their 2008 and 2009 Forms 540 has been stressful and detrimental to their health.

On appeal, FTB agreed to abate interest which accrued from November 10, 2014, to March 5, 2019, due to its delay in processing appellants' protests. By law, interest cannot be abated before FTB's first written contacts regarding the deficiencies, which were the NPAs issued on December 28, 2012. Accordingly, interest may only be abated after December 28, 2012.

In appellants' protest of the NPAs, they stated they had requested the IRS reexamine their 2008 and 2009 federal returns. FTB then placed a hold on its proposed assessments pending conclusion of the federal reexamination. FTB was not informed that the IRS modified the original federal adjustments until January 22, 2015, when appellants notified FTB that the IRS reexamination had concluded. Therefore, any delay in processing the audit of appellants' 2008 and 2009 Forms 540 through January 22, 2015, is attributable to appellants as they underwent a reexamination by the IRS. Similarly, the evidence does not suggest an unreasonable delay by FTB after issuing the NOAs on March 5, 2019, and the date appellants filed this appeal on April 22, 2019.

Accordingly, FTB did not abuse its discretion in denying appellants additional interest abatement.

#### HOLDINGS

1. FTB's proposed assessments are not barred by the statute of limitations.
2. Appellants have not established error in FTB's proposed assessments.
3. Appellants have not shown cause to abate the ARPs.
4. FTB did not abuse its discretion by not granting additional interest abatement.

#### DISPOSITION

Based on its concession on appeal, FTB's actions are modified to abate interest that accrued from November 10, 2014, through March 5, 2019. In all other respects, FTB's actions are sustained.

DocuSigned by:

*Tommy Leung*

0C90542BE88D4E7...

Tommy Leung  
Administrative Law Judge

We concur:

DocuSigned by:

*Andrea L.H. Long*

272945E7B372445...

Andrea L.H. Long  
Administrative Law Judge

DocuSigned by:

*E. Scott Ewing*

2D8DE82EB65E4A6...

Elliott Scott Ewing  
Administrative Law Judge

Date Issued: 6/9/2021