

**OFFICE OF TAX APPEALS
STATE OF CALIFORNIA**

In the Matter of the Appeal of:
J. SANTOYO

) OTA Case No. 19034473
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OPINION

Representing the Parties:

For Appellant: J. Santoyo

For Respondent: Eric R. Brown, Tax Counsel III

For Office of Tax Appeals: Carmen Vera, Graduate Student Assistant

A. LONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, J. Santoyo (appellant) appeals an action by the Franchise Tax Board (respondent) proposing additional tax of \$45,340 for the 2012 tax year.

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

ISSUE

Whether appellant has established error in respondent’s proposed assessment of additional tax, which is based on federal adjustments.

FACTUAL FINDINGS

1. On February 15, 2008, appellant entered into a Retention Bonus Agreement with his employer. This agreement provided that any amount received in conjunction with the retention bonus would be subject to withholdings and treated as ordinary income.
2. In November 2012, appellant’s employer sent a memorandum to all holders of its retention bonus stating, among other things, that the retention awards were subject to withholding tax and were to be treated as ordinary income, subject to limited exceptions.

3. In late 2012, appellant exercised his retention bonus and received \$398,800.54, which was reported on Form 1099-MISC.
4. Appellant filed a timely California income tax return with the filing status of single for tax year 2012. Appellant did not report his retention bonus on either his California return or his federal return.
5. Subsequently, respondent received information from the IRS, indicating that the IRS adjusted appellant's Schedule C by increasing gross receipts or sales by \$398,000, which increased appellant's federal adjusted gross income and federal taxable income. The IRS assessed additional tax due and imposed an accuracy-related penalty.
6. Respondent correspondingly issued a Notice of Proposed Assessment (NPA) to appellant based on the IRS's adjustments, which increased appellant's taxable income. This resulted in a proposed additional tax of \$46,856 and an accuracy-related penalty of \$9,371.20, plus interest. Appellant protested the NPA, asserting that his IRS deficiency was without merit, and therefore, respondent's assessment was erroneous.
7. During the pendency of appellant's protest with respondent, appellant appealed his federal audit with the United States Tax Court. The IRS and appellant executed a Counsel Settlement Memorandum, which states, among other things, that the correct amount at issue is \$386,218 and not \$398,800, based upon a corrected Form 1099-MISC from appellant's employer. Additionally, the memorandum states that appellant conceded to the characterization of his retention bonus as ordinary income.
8. Respondent sent a Notice of Action to appellant revising the NPA based on the settlement with the IRS. Respondent reduced taxable income and total tax and decreased the proposed additional tax from \$46,586 to \$45,340. Respondent also removed the accuracy-related penalty.
9. This timely appeal followed.

DISCUSSION

Pursuant to R&TC 18622(c), a taxpayer must “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 the taxpayer bears the burden of proving that the determination is erroneous. (*Appeal of Gorin*, 2020-OTA-018P.)

R&TC section 17041 imposes a tax “upon the entire taxable income of every resident of this state.” R&TC section 17071 incorporates Internal Revenue Code (IRC) section 61, which defines “gross income” as “all income from whatever source derived” Tax rates for ordinary income is based on a taxpayer’s tax bracket, which varies based on the taxpayer’s taxable income and the taxpayer’s filing status. (R&TC, § 17041; IRC, § 1.) The federal tax rate for 2012 for a single taxpayer ranged from 10 percent to 35 percent, and the California tax rate for 2012 for a single taxpayer ranged from 1.10 percent to 10.3 percent. (IRC, § 1; R&TC, § 17041.) In contrast, federal capital gains tax rates depend on the length of time the taxpayer held the capital asset. The federal tax rate for capital gains for 2012 ranged from 15 percent to 31 percent. (IRC, § 1.) For California purposes, California statutes do not provide a different tax rate for capital gains; capital gains are taxed as ordinary income.


Here, there is no dispute that appellant’s retention bonus is taxable. Appellant argues that his bonus should be taxed as capital gains instead of as ordinary income. However, there are no differing capital gains rates for California purposes. In fact, if respondent imposed the federal taxable gains rate to the retention bonus, appellant would be assessed an even higher amount in additional taxes because the capital gains rates are higher than California tax rates for ordinary income. Additionally, appellant’s memorandum from his employer specifically states that appellant’s retention bonus would be recognized as ordinary income. As such, appellant has not established error in the federal adjustment.

HOLDING

Appellant has not established error in respondent’s proposed assessment of additional tax based on federal adjustments.


DISPOSITION

Respondent’s action is sustained in full.

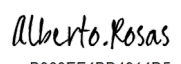
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Andrea L.H. Long
Administrative Law Judge

We concur:

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Sara A. Hosey
Administrative Law Judge

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Alberto T. Rosas
Administrative Law Judge

Date Issued: 10/5/2021