

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 21047704
M. REYNOLDS AND)
J. REYNOLDS)
_____)

OPINION

Representing the Parties:

For Appellants: M. Reynolds
J. Reynolds
For Respondent: Kristin K. Yeager, Program Specialist

T. STANLEY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, M. Reynolds and J. Reynolds (appellants) appeal an action by respondent Franchise Tax Board (FTB) proposing additional tax of \$1,840, and applicable interest, for the 2016 taxable year.

Appellants waived the right to an oral hearing; therefore, we decide the matter based on the written record.

ISSUE

Have appellants established error in FTB’s proposed assessment?

FACTUAL FINDINGS

1. Appellants filed a timely 2016 California Resident Income Tax Return on which they claimed an overpayment of \$2,276, which FTB refunded to appellants.
2. Thereafter, FTB received information from the IRS showing that appellants’ federal gross income had increased, as relevant here, by \$18,214 based on an unreported retirement distribution from Vanguard Fiduciary Trust Company (\$52 taxable distribution paid to J. Reynolds) and from National Financial Services (\$18,162 taxable distribution paid to M. Reynolds). The Forms 1099-R (Distributions from Pensions, Annuities, Retirement

or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.) reported that the payments were early distributions with no known exception.

3. Based on the federal changes, FTB adjusted appellants' 2016 tax liability and issued a Notice of Proposed Assessment (NPA). The NPA increased appellants' income by \$18,214, reduced appellants' itemized deductions by \$411,¹ and proposed to assess additional tax of \$1,840, including a premature distribution tax of \$455 (2.5 percent of the \$18,214 early distributions).
4. Appellants protested, and FTB issued a Notice of Action affirming the NPA.
5. This timely appeal followed.

DISCUSSION

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 Gorin*, 2020-OTA-018P.)

R&TC section 17041(a) 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,” including retirement income. (IRC, § 61(a)(9), (11).) Generally, unless an exception applies, a distribution from a qualified retirement plan or an individual retirement account (IRA) is included in income for the year of distribution. (IRC, §§ 402(a), 408(d).)² IRC section 72(t)(1) provides that if a taxpayer receives an early distribution from a qualified retirement plan, as described in IRC sections 402 and 408, the early distribution is subject to a 10 percent tax (in addition to the income tax otherwise imposed), if, among other things, the taxpayer received the distribution before the age of 59½. (IRC, §§ 4974(c), 72(t)(2)(A)(i).) R&TC section 17085(c)(1) adopts IRC section 72(t) for California tax purposes but reduces the rate of the early distribution tax from 10 percent to 2.5 percent.

¹ Job expenses and miscellaneous deductions are limited to those in excess of 2 percent of a taxpayer's adjusted gross income (AGI). Appellants claimed \$512 deductions based on their reported AGI, which FTB reduced by \$411 to \$110 based on appellants' adjusted AGI.

² R&TC sections 17501 and 17504 incorporate IRC section 402 in relevant part. R&TC sections 17507 and 17508 incorporate IRC section 408 in relevant part.

Appellants do not dispute that they underreported their income by failing to include retirement distributions in their 2016 income. Instead, appellants claim that they have already paid more than enough taxes, and that they have not been reimbursed for penalties and fees from their “large payoff.” Appellants assert that they were “finally able to pay it all off” and appeal for a refund of “interest and fees.”

Appellants have not paid the California tax liability for 2016, so it appears that the “large payoff” was made to the IRS to satisfy appellants’ federal assessment.³ California proposed to assess additional tax of \$1,840 because of the increase in appellants’ adjusted gross income after including the retirement distributions they received. The California tax liability remains unpaid and continues to accrue interest. Because appellants do not contest the inclusion of their retirement distributions in income, and after our review of the records submitted in this appeal, we find that the tax was properly imposed.

Appellants refer to a refund of both “interest and fees.” FTB did not assess any fees. It did, however, impose an additional tax based on the early distribution of retirement funds. This additional tax of \$455 is included in the \$1,840 total additional tax proposed per the NPA. As indicated above, unless appellants show that an exception applies to this additional tax, which they have not done, the early distribution tax applies (2.5 percent of the distributions totaling \$18,214). While appellants make arguments that are essentially reasonable cause arguments,⁴ there is no reasonable cause exception to imposition of the additional tax based on early retirement distributions. (See IRC, § 72.)

Similarly, there is no reasonable cause exception to the imposition of interest. (*Appeal of Gorin, supra.*) To obtain relief from interest, a taxpayer must qualify under one of three statutes: R&TC section 19104, 19112, or 21012. (*Ibid.*) Appellants do not allege that any of these statutory exceptions apply, and we find that none do. Appellants request a “refund” of interest paid. Appellants have not paid interest to FTB on the proposed assessment. Rather, appellants paid interest on the additional tax assessed by the IRS. Therefore, we find no basis to abate

³ Appellants paid \$7,199 to the IRS on October 23, 2019.

⁴ Appellants assert that their family had several significant challenges within the eight months preceding this appeal; namely, that their son almost died in an automobile accident, their bills were astronomical, appellant-wife was laid off, and appellant-wife was diagnosed with breast cancer. We do not address whether these unfortunate circumstances might constitute reasonable cause because that is not one of the exceptions to the imposition of additional tax under IRC section 72.

appellants’ interest for 2016, and interest will continue to accrue on the unpaid balance until it is paid in full.

HOLDING

Appellants have not established error in FTB’s proposed assessment.

DISPOSITION

FTB’s action is sustained.

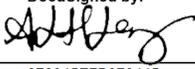
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Teresa A. Stanley
Administrative Law Judge

We concur:

DocuSigned by:

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Cheryl L. Arkin
Administrative Law Judge

DocuSigned by:

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Andrea L.H. Long
Administrative Law Judge

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