BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
ROBERT E. AND ARGENTINA SORENSON)

For Appellants: Irv M. Gross
Attorney at Law

For Respondent: Mark McEvilly
Counsel

O P I N I O N

This appeal is made pursuant to section 18593 of the Revenue and Taxation Code from the action of the. Franchise Tax Board on the protest of Robert E. and Argentina Sorenson against proposed assessments of additional personal income tax in the amounts of **$8,271.30** and **$5,738.04** for the years 1970 and 1971, respectively, and on the protest of Robert E. Sorenson against a proposed assessment of additional personal income tax and penalties in the amounts of $715.00 and $357.50, respectively, for the year 1972.

The issues for determination in this appeal are: (1) whether appellants have sustained their burden of proving that respondent's determination, which was based on corresponding federal action, was incorrect; and (2) whether appellant Robert E. Sorenson has established that the penalties imposed by respondent for failure to file a 1972 return and for failure to file a return after notice and demand were proper.

Appellants filed timely federal and California personal income tax returns for 1970 and 1971. During those years appellant Robert E. Sorenson was employed as the president of Direct Mail Company of America, Inc. (DMCA). On February 3, 1973, United States postal inspectors searched the offices of DMCA and confiscated many papers, files and documents. On the same date, federal agents seized the bank accounts of DMCA and the Sorensons. Among the documents confiscated were the Sorensons' income tax returns for prior years and financial statements dealing with the years in issue. On April 30, 1973, the Internal Revenue Service (IRS) issued jeopardy assessments against appellants in the amounts of $550,172.17 and $577,210.23 for the years 1970 and 1971, respectively. The basis for the IRS's assessments was its determination that appellants had been diverting funds from DMCA's sales to their personal use. In addition, the IRS assessed a 50 percent fraud penalty for both 1970 and 1971.

Appellants petitioned to the United States Tax Court for a redetermination of the deficiency. In August 1975 an agreement was reached in the tax court between appellants and the IRS. The net federal adjustments were reduced for 1970 from $550,172.17 to $83,266.00, and for 1971 from $577,210.23 to $72,471.00. The 50 percent fraud penalty was also assessed and agreed to by appellants for both years. Thereafter, respondent issued notices of proposed assessment for 1970 and 1971 based entirely upon the final federal income determination. Respondent did not assess a fraud penalty, however. Appellants challenge these assessments on the ground that the income figure established at the federal level was arrived at only for purposes of settlement.

Appellant Robert E. Sorenson has never filed an income tax return for 1972, although he was granted extensions of time until October 15, 1973. On October 16, 1973, an untimely request for an indefinite extension of time was filed on appellant's behalf. The

reason given for the request was the unavailability of appellants' books and records, which were seized in 1973 by federal authorities during the investigation by the United States postal authorities. These materials were returned to appellants in 1977 prior to the filing of this appeal. Respondent denied the request as untimely and because appellant had already been granted the maximum extension allowed by statute. (See Rev. & Tax. Code, § 18433(a).) At the same time, respondent demanded that appellant file a 1972 return. Thereafter, since no return was filed, respondent computed appellant's income from available information and issued a notice of proposed assessment. Respondent also assessed a 25 percent penalty for failure to file a return (Rev. & Tax. Code, § 18681) and a 25 percent penalty for failure to file a return after notice and demand (Rev. & Tax. Code, § 18683).

Appellant protested the assessment and requested that further action be deferred pending the resolution of the federal tax matters and the pending federal postal investigation. Respondent agreed to the deferral. Subsequently, the federal matters were resolved, and once again, respondent requested that appellant file a 1972 return. When no return was forthcoming, respondent affirmed its previous assessment. Although appellant has appealed from respondent's action, he does not question the amount of income attributed to him, merely contesting the two penalties imposed by respondent.

The first question is whether appellants have sustained their burden of proving that respondent's determination based on federal action was incorrect. Section 18451 of the Revenue and Taxation Code provides, in part, that a taxpayer shall either concede the accuracy of a federal determination or state wherein it is erroneous. It is well settled that a determination by the Franchise Tax Board based upon a federal audit is presumed to be correct, and the burden is on the taxpayer to overcome that presumption. (Todd v. McColgan, 89 Cal.App.2d 509 [201 P.2d 414] (1949); Appeal of Willard D. and Esther J. Schoellerman, Cal. St. Bd. of Equal., Sept. 17, 1973.) Contrary to appellants' suggestion, the mere fact that the final federal action may have resulted from a settlement agreement does not alter the presumption of correctness which attaches to respondent's determination. Appellants' mere assertion of the incorrectness of the federal determination does not shift the burden to respondent to justify the

deficiency assessment and the correctness thereof. (See Todd v. McColgan, supra; Appeal of Herbert C. Brenner, etc., Cal. St. Bd. of Equal., March 8, 1976.) Appellants have not presented any evidence or offered any explanation to show either that the federal action was erroneous or that respondent's action based thereon was incorrect. Accordingly, we must conclude that respondent's proposed assessment of additional personal income tax for 1970 and 1971 was correct.

The final question is whether appellant Robert E. Sorenson has established that the penalties imposed by respondent for failure to file a 1972 return and failure to file a return after notice and demand were improperly assessed.

Section 18681 of the Revenue and Taxation Code provides for a graduated penalty, not to exceed 25 percent of the tax due, for failure to file a timely return, unless it is shown that the failure is due to reasonable cause and not willful neglect. The propriety of the penalty presents an issue of fact to which the burden of proof is on the taxpayer. (Otho J. Sharpe, ¶ 56,262 P-H Memo. T.C. (1956); Appeal of La Salle Hotel Co., Cal. St. Bd. of Equal., Nov. 23, 1966.)

In attempting to satisfy his burden, appellant maintains that the failure to file was due to reasonable cause since certain records were seized by agents of the federal government. We do not believe that this assertion, standing alone, satisfies appellant's burden of proof. Initially, we note that appellant has never filed a 1972 return, notwithstanding the fact that his records were returned to him prior to this appeal. Nor has appellant established that the records were either indispensable to the preparation of the 1972 return or, if they were, that he was denied access to them during the entire time of the seizure. (See The Nirosta Corp., 8 T.C. 987 (1947); James J. Donohue, ¶ 66,149 P-H Memo. T.C. (1966).) Based upon these facts, we cannot conclude that appellant's failure to file was due to the exercise of ordinary care and prudence which an ordinarily intelligent businessman would have exercised. (Appeal of William T. and Joy P. Orr, Cal. St. Bd. of Equal., Feb. 5, 1968.) Therefore, we conclude that respondent properly assessed a penalty for failure to file a return.

Section 18683 of the Revenue and Taxation Code authorizes respondent to assess a 25 percent penalty

where a taxpayer fails to file a return after notice and demand unless the failure is due to reasonable cause and not willful neglect. As related above, appellant has never filed a 1972 return despite repeated requests from respondent to do so. For the reasons discussed above concerning the section 18681 penalty, we conclude that respondent's action in asserting a penalty for failure to file after notice and demand was also correct.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Robert E. and Argentina Sorenson against proposed assessments of additional personal income tax in the amounts of $8,271.30 and $5,738.04 for the years 1970 and 1931, respectively, and on the protest of Robert E. Sorenson against a proposed assessment of additional personal income tax and penalties in the amounts of $715.00 and $357.50, respectively, for the year 1972 be and the same is hereby sustained.

Done at Sacramento, California, this 6th day of January, 1981, by the State Board of Equalization, with Members Dronenburg, Bennett, Nevins and Reilly present.

Ernest J. Dronenburg, Jr., Chairman

William M. Bennett, Member

Richard Nevins, Member

George R. Reilly, Member

_____, Member