OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeals of:	) OTA Case No. 20025839
S. CHATRAGADDA AND A. CHATRAGADDA	)
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	)

OPINION

Representing the Parties:

For Appellants:	S. Chatragadda and A. Chatragadda
For Respondent:	Brad J. Coutinho, Tax Counsel III
For Office of Tax Appeals:	William J. Stafford, Tax Counsel III

J. JOHNSON, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, appellants S. Chatragadda and A. Chatragadda's appeal actions of respondent Franchise Tax Board in proposing assessments of additional tax, penalties, and interest totaling $37,436.16, $28,853.70, and $33,068.95 for the 2013, 2014, and 2015 tax years, respectively.[1]

Appellants waived their right to an oral hearing and therefore this appeal is decided on the written record.

ISSUES

1. Whether appellants have demonstrated error in the proposed assessments of additional tax.
2. Whether the accuracy-related penalties were properly imposed or should be abated.

[1] The amounts of additional tax and penalties proposed for each year are listed in the Factual Findings below. The amounts listed above reflect the amounts listed on respondent's Notices of Action, and do not include additional interest that accrued after those notices were issued.

3. Whether appellants have established reasonable cause for failing to furnish information to respondent.
4. Whether appellants have demonstrated that interest should be abated.

FACTUAL FINDINGS

Tax Return Filings

1. Appellants filed a timely joint 2013 California Resident Income Tax Return, reporting an overpayment of $29,113, which respondent refunded.
2. Appellants filed a timely joint 2014 California Resident Income Tax Return, reporting an overpayment of $20,576, which respondent refunded.
3. Appellants filed a timely joint 2015 California Resident Income Tax Return, reporting an overpayment of $22,386, which respondent refunded.

Audit

4. Respondent audited appellants' California income tax returns for the 2013, 2014, and 2015 tax years. During audit, appellants failed to respond to respondent's request for information sent in June 2016. Respondent notified appellants that it had not received a response to its request for information and reiterated that respondent needed the requested information. Respondent thereafter issued an Information Document Request (IDR), informing appellants that they might be subject to failure to furnish penalties if the requested information was not provided by a set date.
5. After appellants failed to respond to the IDR, respondent issued a formal demand for information, which stated that respondent may impose failure to furnish information penalties under R&TC section 19133 if appellants fail to provide the information requested by a set date. Appellants, however, did not timely respond.
6. At the conclusion of its audit, respondent revised appellants' tax liabilities to include omitted wages. Further, respondent disallowed various deductions, including individual retirement account (IRA) contributions and health savings account expenses. Respondent imposed accuracy-related and failure to furnish information penalties. To reflect the adjustments made, respondent issued Notices of Proposed Assessment (NPAs) for the 2013, 2014, and 2015 tax years. In response, appellants filed a timely protest for each tax year.

Protest & Appeal

7. Following protest proceedings, respondent issued Notices of Action (NOAs) for the tax years at issue. The NOAs for 2013, 2014, and 2015 allowed some of the deductions that were disallowed at audit and made various adjustments to appellants' reported amounts relating to unreported or omitted wages, IRA activity, Schedule D amounts (capital gains and losses), itemized deductions, and a Schedule CA adjustment to adjusted gross income (AGI) (for 2013 and 2015 only).
8. The NOA for the 2013 tax year sets forth additional tax of $24,363, a failure to furnish information penalty of $1,025, an accuracy-related penalty of $4,872.60, and applicable interest.
9. The NOA for the 2014 tax year sets forth additional tax of $19,079, a failure to furnish information penalty of $1,135, an accuracy-related penalty of $3,815.80, and applicable interest.
10. The NOA for the 2015 tax year sets forth additional tax of $22,093.00, a failure to furnish information penalty of $1,846, an accuracy-related penalty of $4,418.60, and applicable interest.
11. After receiving the NOAs, appellants filed this timely appeal.
12. Respondent concedes on appeal that the failure to furnish information penalties set forth in the NOAs are incorrect and should be reduced from $1,025 to $777 for the 2013 tax year, from $1,135 to $1,093 for the 2014 tax year, and from $1,846 to $1,672 for the 2015 tax year.[2]

DISCUSSION

Issue 1: Whether appellants have demonstrated error in the proposed assessments of additional tax.

Gross income means all income from whatever source derived, unless specifically excluded. (R&TC, §§ 17071, 17085; Internal Revenue Code (IRC), §§ 61(a)(8)-(10), 72, 408(d).) The taxpayer bears the burden of establishing entitlement to any deductions claimed,

[2] After protest, respondent allowed some of the deductions previously disallowed in the NPAs. This resulted in a reduction of the understatement of taxable income, total tax, and the amount of the proposed assessment of additional tax reflected on the NOAs. Respondent made a corresponding reduction to the accuracy-related penalty but did not recalculate the failure to furnish information penalty before issuing the NOAs.

and must establish by credible evidence, other than mere assertions, that the deduction claimed falls within the scope of a statute authorizing the deduction. (*Appeal of Robinson*, 2018-OTA-059P.)

On appeal, appellants agree that errors were made on their returns for the years at issue, including underreporting taxable income and claiming deductions in excess of what was allowed. Appellants now request that they be entitled to deduct the amount to which they are entitled (and a waiver of penalties and interest, discussed *infra*). The below is an analysis of respondent's adjustments as they pertain to unreported taxable income and adjustments to deductions to determine whether appellants have shown error in respondent's actions. Appellants' submissions on appeal consist of briefing with no evidentiary exhibits aside from the NOAs.

1. Unreported Wages

Respondent's proposed assessment is based on a finding that appellants only reported as little as 31 percent and, at most, 78 percent of their taxable wages, depending on the year, based on appellant-husband's Form W-2s for the years at issue. During protest, respondent explained that the nonstatutory stock options and restricted stock units exercised by appellant-husband are a form of compensation, citing IRC section 83(a) and Treasury Regulation section 1.83-7(a). Appellants appear to agree with respondent's adjustments in this regard, stating that respondent clarified for them how they mistakenly reported the exercise of various stock options as capital gains rather than ordinary income. Appellants have not shown error in respondent's proposed adjustments to appellants' taxable wages.

2. IRA Contributions

For the 2013, 2014, and 2015 tax years, appellants reported IRA deductions of $17,000,[3] $17,499, and $18,000, respectively. Appellants' AGI amounts for the 2013, 2014 and 2015 tax years exceed the statutory limits and, therefore, appellants' contributions to traditional IRA

[3] For the 2013 tax year, appellants listed an IRA deduction of $17,000 as an adjustment to gross income on their federal return, but, due to a math error, appellants applied an IRA deduction of only $1,700 when calculating their federal AGI. The NPA for the 2013 tax year lists an adjustment of $17,000 (i.e., the amount listed on appellants' Schedule CA filed with their California return); however, the NOA for the 2013 tax year correctly lists the IRA deduction adjustment as only $1,700 (i.e., the actual amount used in the calculations of their AGI on their federal return and therefore the true amount claimed). To the extent appellants claimed additional IRA deductions on their Schedule CA beyond what was already claimed when calculating their federal AGI, those were properly denied as well.

accounts are not deductible.[4] Appellants have not provided evidence demonstrating error in the IRA deduction adjustments made by respondent.

3. Schedule D Net Capital Loss

For the 2015 tax year, appellants reported a net Schedule D capital loss of $170,819.57. Pursuant to Internal Revenue Code (IRC) section 1211(b), which California conforms to at R&TC section 18151, capital losses are limited to $3,000 per year. Appellants concede on appeal that they mistakenly reported the full loss despite the allowed limit of $3,000, and note that this error was an oversight based on the fact that they prepared their tax filing manually. Appellants have not demonstrated error in the foregoing adjustment.

4. Itemized Deductions (2013-2015 tax years)[5]

a. Medical Deduction (2015 tax year)

For the 2015 tax year, appellants reported medical expenses of $4,300 and a medical expense deduction of $1,774. Appellants' medical expenses of $4,300, however, do not exceed 7.5 percent of their AGI, and therefore, respondent properly disallowed the deduction of $1,774 for the 2015 tax year. (IRC, § 213 [as incorporated by R&TC section 17201 and modified by R&TC section 17241(a)].)

b. State and Local Tax Deductions (2013 and 2014 Tax Years)

For the 2013 tax year, appellants reported a deduction of $185,808.48 for state income taxes paid; however, California does not allow a deduction for state income taxes paid. In addition to the state income taxes paid, respondent disallowed other claimed deductions for which there is no legal basis under California income tax law, consisting of $12,147 for Medicare, $706 for "CA VPDI," $7,049 for social security, and $8,900 for sales tax. Based on the foregoing, respondent made an adjustment (rounded) of $161,429 to appellants' reported state income tax deduction of $185,808.48. Appellants have not shown error in this adjustment.

[4] California generally conforms to the contribution limitation as set by the IRS for the years at issue in IRS Publication 590 (2013) and IRS Publication 590-A (2014, 2015). (R&TC, § 17501.) For each year at issue, appellants' AGI was at least $50,000 over the respective annual threshold.

[5] Appellants assert on appeal that they have "standard deductions, mortgage interest, taxes paid, property taxes, retirement contribution, job expenses and miscellaneous expenses," requesting that they deduct whatever amounts to which they are entitled. For purposes of our review, we focus our analysis on the adjustments made by respondent in reaching its proposed assessments of additional tax, and cannot analyze any other deductions appellants might have available to them that were not claimed on their returns or otherwise supported on appeal.

For the 2014 tax year, respondent denied the following deduction amounts, for which appellants have not demonstrated error: Medicare deduction of $5,780, California disability insurance deduction of $711, social security deduction of $7,254, and general sales tax deduction of $7,500. Appellants have likewise not shown error in respondent's disallowance of these claimed deduction items.

c. Charitable Contributions (2013-2015 Tax Years)

For the 2013, 2014, and 2015 tax years, appellants reported charitable contribution deductions of $2,998, $2,998, and $4,998, respectively. Appellants, however, have not provided any evidence or asserted any specific arguments demonstrating why they believe they are entitled to deduct such amounts for California income tax purposes, and we find no such evidence in the appeal record.

d. Estimated Taxes (2013 Tax Year)

For the 2013 tax year, appellants reported a $166 adjustment to their federal AGI, an amount equal to the estimated tax payment they made for that year, and which they included as a payment on their return separately from the adjustment to AGI in the same amount. Appellants, however, have not provided any evidence demonstrating that they are entitled to deduct the $166 for California income tax purposes, and we find no such evidence in the appeal record. Accordingly, we find no error in respondent's adjustment here.

Issue 2: Whether the accuracy-related penalties were properly imposed or should be abated.

R&TC section 19164, which generally incorporates the provisions of IRC section 6662, provides for an accuracy-related penalty of 20 percent of the applicable underpayment. The penalty applies to the portion of the underpayment attributable to (1) negligence or disregard of rules and regulations, or (2) any substantial understatement of income tax. (IRC, § 6662(b).)

Respondent imposed accuracy-related penalties on the basis of appellants' substantial understatements. For an individual, there is a "substantial understatement of income tax" when the amount of the understatement for a taxable year exceeds the greater of 10 percent of the tax required to be shown on the return, or $5,000. (IRC, § 6662(d)(1).)

Here, appellants should have reported a California tax of $49,462 for the 2013 tax year, but they understated their tax by $24,363. Appellants should have reported a California tax of

$23,711 for the 2014 tax year, but they understated their tax by $19,079. Appellants should have reported a California tax of $23,093.00 for the 2015 tax year, but they reported a tax of $0.00. Accordingly, the understatements were substantial.

The accuracy-related penalties may be reduced or abated if appellants can show: (1) there is substantial authority for appellants' reporting position, (2) the position was adequately disclosed in the tax return (or a statement attached to the return)[6] and there is a reasonable basis for treatment of the item, or (3) that they acted in good faith and had reasonable cause for the understatement.[7] (IRC, §§ 6662(d)(2)(B), 6664(c)(1); R&TC, § 19164(d); Cal. Code Regs., tit. 18, § 19164(a).)

On appeal, appellants have not raised any specific arguments concerning the accuracy-related penalties, and we see no basis to abate or reduce the penalties.

Issue 3: Whether appellants have established reasonable cause for failing to furnish information to respondent.

R&TC section 19133 imposes a penalty when a taxpayer fails to provide information upon respondent's notice and demand to do so, unless the failure is due to reasonable cause and not willful neglect. Here, appellants have not explained why they did not respond to the IDR or subsequent formal demand for information, and they have not provided any justification to support a finding of reasonable cause to abate the failure to furnish information penalties. Therefore, the failure to furnish information penalties shall only be reduced as conceded to by respondent on appeal.

Issue 4: Whether appellants have demonstrated that interest should be abated.

Under California law, taxes are due and payable as of the original due date of the taxpayer's return without regard to the extension to file the return. (R&TC, §§ 18567(b); 19001.) If tax is not paid by the original due date, or if respondent assesses additional tax and that assessment becomes due and payable, R&TC section 19101 requires the charging of interest

[6] To qualify as an adequate disclosure, Treasury Regulations generally require that the taxpayer disclose the details of his or her position on either a Federal Form 8275, a Form 8275-R, or a qualified amended return. (Treas. Reg. § 1.6662-4(f).)

[7] A determination of whether a taxpayer acted with reasonable cause and in good faith is made on a case-by-case basis and depends on the pertinent facts and circumstances, including the taxpayer's efforts to assess the proper tax liability, the taxpayer's knowledge and experience, and the extent to which the taxpayer relied on the advice of a tax professional. (Treas. Reg. § 1.6664-4(b)(1).)

on the resulting balance due. Interest is not a penalty but is simply compensation for a taxpayer's use of money after the due date of the tax, and there is no reasonable cause exception to the imposition of interest. (*Appeal of Gorin*, 2020-OTA-018P.)

To obtain relief from the imposition of interest, under the facts presented, a taxpayer must establish eligibility for waiver or abatement of interest under R&TC section 19104. Under R&TC section 19104, respondent is authorized to abate interest if there has been an unreasonable error or delay in the performance of a ministerial or managerial act by an employee of respondent. Such abatement can only occur if no significant aspect of the error or delay can be attributed to the taxpayer, and after respondent first contacts the taxpayer in writing with respect to the deficiency or payment. (R&TC, § 19104(b)(1).)

Appellants argue that this matter could have been easily resolved with the filing of "amendments with corrections," but contend that they were not given that opportunity. Appellants assert that this matter has dragged for years, resulting in them paying accrued interest.

Appellants have not specified how they were prevented from correcting the errors on their return, and what role respondent played in preventing corrections. To the contrary, it appears respondent was actively attempting to have appellants provide accurate information through its series of document requests, to which appellants did not respond. The first request was issued in June 2016, just two months after the 2015 return was filed and well within the statute of limitations in which respondent can issue proposed assessments for the years at issue. While the protest period lasted over two years, it appears that time involved multiple correspondence between the parties and resulted in adjustments being made to the proposed assessments and penalties in appellants' favor.

Based on the facts presented, we find no unreasonable error or delay caused by respondent's actions, and therefore must find that respondent did not abuse its discretion in denying interest abatement.

HOLDINGS

1. Appellants have not demonstrated error in the proposed assessments of additional tax.
2. Appellants have not demonstrated that the accuracy-related penalties were improperly imposed or should be abated.
3. Appellants have not demonstrated reasonable cause for the failure to furnish information.
4. Appellants have not demonstrated that interest should be abated.

DISPOSITION

The failure to furnish information penalties, as conceded to by respondent on appeal, shall be reduced from $1,025 to $777 for the 2013 tax year, from $1,135 to $1,093 for the 2014 tax year, and from $1,846 to $1,672 for the 2015 tax year. Respondent's actions are otherwise sustained.

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John O Johnson
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John O. Johnson
Administrative Law Judge

We concur:

DocuSigned by:
Amanda Vassigh
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Amanda Vassigh
Administrative Law Judge

DocuSigned by:
Sara A Hosey
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Sara A. Hosey
Administrative Law Judge

Dated: 1/12/2022