

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 21078126
J. REFF AND)
J. REFF)
_____)

OPINION

Representing the Parties:

For Appellants: J. Reff
For Respondent: Joel Smith, Tax Counsel III

T. LEUNG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, J. Reff and J. Reff (appellants) appeal an action by respondent Franchise Tax Board (FTB) proposing additional tax of \$3,329.00, an accuracy-related penalty (ARP) of \$665.80, and applicable interest, for the 2009 taxable year.

Appellants waived their rights to an oral hearing; therefore, this matter is being decided based on the written record.

ISSUES

1. Whether FTB’s action, based on a federal audit, should be sustained.
2. Whether interest should be waived.

FACTUAL FINDINGS

1. Appellants’ 2009 federal income tax return was examined by the IRS, which resulted in a final federal determination. Appellants did not inform FTB about the federal adjustments.
2. After learning about the final federal determination from the IRS, FTB made comparable adjustments to appellants’ 2009 California personal income tax return and issued a Notice of Proposed Assessment (NPA) to appellants in 2020. The NPA imposed additional tax of \$3,329, and an accuracy-related penalty (ARP), plus applicable interest.

3. Appellants filed a protest, which FTB denied. FTB then issued a Notice of Action (NOA) affirming the NPA, which appellants appealed.

DISCUSSION

Issue 1: Whether FTB’s action, based on a federal audit, should be sustained.

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 taxpayers are insufficient to satisfy their burden of proof with respect to a proposed assessment based on a federal action. (*Ibid.*)

Here, FTB issued its NPA based on a final federal determination, and thus, FTB’s proposed assessment is 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 2009 taxable year. Instead, appellants assert during protest and appeal that they were unaware of their obligation to inform FTB about the IRS adjustments and, due to the amount of time that has elapsed, no longer have any records and seek relief from paying the ARP and interest. There is also no evidence indicating the IRS further modified the adjustments it made to appellants’ 2009 federal return after FTB issued its NOA to appellants. Therefore, appellants have not established that FTB’s NPA was erroneous.

With respect to the ARP, Internal Revenue Code (IRC) section 6662(b)¹ provides, in part, that an ARP applies to the portion of the underpayment attributable to any substantial understatement of income tax. As relevant here,² the penalty applies to any portion of an underpayment attributable to negligence or disregard of rules and regulations, or any “substantial understatement of income tax.” (IRC, § 6662(b)(1) & (2).) 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).) In

¹ IRC section 6662 is incorporated in California law by R&TC section 19164.

² While the ARP may be imposed for various reasons, such as an overstatement of pension liabilities, the only reasons for the ARP that appear potentially relevant here are negligence and substantial understatement of income tax.

other words, the understatement must be at least \$5,000. IRC section 6662(a) provides for an ARP of 20 percent of the applicable underpayment.

Here, FTB indicated in its position letter to appellants that the ARP was imposed in accordance with the federal audit report. However, appellants' \$3,329 understatement of California income tax does not constitute a substantial understatement because it is less than \$5,000. Accordingly, the accuracy-related penalty is only applicable for California purposes if there is another basis for its imposition, such as negligence. FTB has neither shown that the federal ARP was based on negligence, nor has it independently raised affirmative allegations of negligence on the part of appellants. Accordingly, since there was no substantial understatement of tax and no negligence shown, appellants are not liable for the ARP.

Issue 2: Whether interest should be waived.

The imposition of interest is mandatory. (R&TC, § 19101(a).) Interest is not a penalty but is compensation for a taxpayer's use of money which should have been paid to the state. There is no reasonable cause exception to the imposition of interest. (*Appeal of Gorin*, 2020-OTA-018P.) To obtain relief from interest a taxpayer must qualify under one of the waiver provisions of R&TC sections 19104 (pertaining to unreasonable error or delay by respondent in the performance of a ministerial or managerial act), 19112 (pertaining to extreme financial hardship caused by significant disability or other catastrophic circumstance), or 21012 (pertaining to reasonable reliance on the written advice of a legal ruling by FTB's chief counsel). (*Appeal of Moy*, 2019-OTA-057P.) Appellants have not alleged, and the record does not reflect, that any of these waiver provisions are applicable here.³ Accordingly, we find there is no basis for waiving interest.


³ FTB stopped charging interest between December 11, 2018, and October 2, 2020, pursuant to R&TC section 19116.

HOLDINGS

1. With the exception of the ARP, FTB’s action, based on an IRS examination, is sustained.
2. Interest is not waived.


DISPOSITION

Except for the ARP, which is waived, FTB’s action is sustained.


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 Tommy Leung
 Administrative Law Judge

We concur:

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 Keith T. Long
 Administrative Law Judge

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 Suzanne B. Brown
 Administrative Law Judge

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