

**OFFICE OF TAX APPEALS  
STATE OF CALIFORNIA**

In the Matter of the Appeal of: ) OTA Case No. 21118978  
M. ESPINOZA AND )  
M. ESPINOZA )  
\_\_\_\_\_ )

**OPINION**

Representing the Parties:

For Appellants: M. Espinoza and M. Espinoza

For Respondent: Camille Dixon, Tax Counsel

T. STANLEY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, M. Espinoza and M. Espinoza (appellants) appeal an action by respondent Franchise Tax Board (FTB) proposing additional tax of \$1,021 and applicable interest, for the 2017 taxable year.

Appellants waived the right to an oral hearing; therefore, the Office of Tax Appeals (OTA) decides the matter based on the written record.

**ISSUE**

Have appellants shown error in FTB’s proposed assessment of additional tax, which is based on a federal determination?

**FACTUAL FINDINGS**

1. Appellants filed a timely 2017 California Resident Income Tax Return.
2. Subsequently, FTB received information from the IRS that adjustments had been made to appellants’ federal tax liability. Specifically, the IRS increased appellants’ income by \$12,738 relating to the following eight securities sales during 2017:
  - The Growth Fund of America proceeds of \$3,019 and \$20,920.
  - American Balanced Fund proceeds of \$3,854 and \$145.

- Europacific Growth Fund proceeds of \$5,000, \$4,373, \$3,786, and \$5,474.<sup>1</sup>
3. FTB followed the IRS adjustments and proposed to increase appellants' income by the same \$12,738. FTB issued a Notice of Proposed Assessment (NPA) for additional tax of \$1,021, plus interest.
  4. Appellants protested the NPA, which FTB denied because the IRS assessment had not been reduced or canceled. FTB issued a Notice of Action affirming the NPA.
  5. On appeal, appellants provide a copy of their 2017 Form 1099-B, Proceeds from Broker and Barter Exchange Transactions, (Form 1099-B) issued by American Funds Service Company (AFSC) which lists the following mutual fund shares (securities) sales and basis, including:
    - The Growth Fund of America reported net proceeds of \$3,019.86 with a basis of \$1,548.39. The 1099-B indicates appellants' basis as reflected on the 1099-B (\$1,548.39) was not reported to the IRS.<sup>2</sup>
    - The Growth Fund of America reported net proceeds of \$20,920.14 with a basis of \$15,172.54.
    - American Balanced Fund reported net proceeds of \$145.10 with a basis of \$106.53. The 1099-B indicates appellants' basis as reflected on the 1099-B (\$106.53) was not reported to the IRS.<sup>3</sup>

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<sup>1</sup>The proceeds from these eight securities transactions as listed on the IRS report total \$46,571. While the computation of the \$12,738 adjustment resulting from these securities transactions is not entirely clear or evident from the IRS report, it appears that, among other things, the IRS reduced appellants' basis in several of the securities transactions to \$0.

<sup>2</sup> The basis was reported on appellants' copy of their 2017 AFSC Form 1099-B. The Form 1099-B informs appellants that the basis for some transactions will be reported to the IRS while the basis for others will not be reported to the IRS. The Form 1099-B instructs taxpayers that: "**Cost basis for covered shares (generally shares acquired on or after January 1, 2012):** The cost basis provided on this form uses the accounting method you elected for the sale of covered shares. If you did not elect an accounting method for covered shares, the cost basis was calculated using Average Cost. **Cost basis for noncovered shares (generally shares acquired before January 1, 2012):** If cost basis information is provided for sales of noncovered shares, it is for your information only and will not be reported to the IRS. The Average Cost accounting method is used when calculating cost basis on noncovered shares." (Bold and underline in original.)

Except for securities which are stock in a corporation, brokers must report basis for any reportable stock transaction occurring on or after January 1, 2012, when the average basis method is permissible under Internal Revenue Code (IRC) section 1012. (IRC, § 6045(g)(3)(C)(i), (ii).) Brokers are not required to report basis for securities acquired prior to January 1, 2012. (*Ibid.*) Appellants' copy of their 2017 AFSC Form 1099-B shows that the average basis method was used and reports the basis for transactions for which basis was not reported to the IRS.

<sup>3</sup> Same comment as in footnote two.

- American Balanced Fund reported net proceeds of \$3,854.90 with a basis of \$3,401.62.
- Europacific Growth Fund reported net proceeds of \$5,000.00 with a basis of \$3,663.03. The 1099-B indicates appellants' basis as reflected on the 1099-B (\$3,663.03) was not reported to the IRS.<sup>4</sup>
- Europacific Growth Fund reported net proceeds of \$4,373.65 with a basis of \$2,994.47. The 1099-B indicates appellants' basis as reflected on the 1099-B (\$2,994.47) was not reported to the IRS.<sup>5</sup>
- Europacific Growth Fund reported net proceeds of \$3,786.35 with a basis of \$2,833.46.
- Europacific Growth Fund reported net proceeds of \$5,474.20 with a basis of \$4,111.65.

The sales and basis amounts for these eight transactions total \$46,574.20 and \$33,831.69, respectively resulting in net long-term capital gains of \$12,742.51.

6. The Wage and Income Transcript provided by FTB on appeal confirms that the basis amounts for four of appellants' eight securities transactions was reported to the IRS, and the remaining four were not reported to the IRS.
7. On appeal, appellants also provide a copy of their federal income tax return for 2017. On their federal Schedule D, Capital Gains and Losses, appellants reported proceeds of \$34,035.59 and \$12,538.61 (total proceeds of \$46,574.20). After subtracting basis of \$25,219.27 and \$8,312.42 (total basis of \$33,831.69), appellants reported net long-term capital gains of \$8,516.32 and \$4,226.19 (total long-term capital gains of \$12,742.51).

### 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. FTB's deficiency determination based on a federal audit report is presumptively correct, and appellants bear the burden of proving error in FTB's determination. (*Appeal of Gorin*, 2020-OTA-018P.) In the absence of credible evidence showing that FTB's determinations are incorrect, they must be upheld. (*Appeal of Valenti*, 2021-

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<sup>4</sup> Same comment as in footnote two.

<sup>5</sup> Same comment as in footnote two.

OTA-093P.) While FTB may propose an assessment based on a final federal determination, it is not bound to do so. (Cal. Code Regs., tit. 18, § 19059(d); *Appeal of Der Wienerschnitzel International, Inc.* (79-SBE-063) 1979 WL 4104.)

Appellants assert that they correctly reported their long-term capital gains transactions on the federal Schedule D attached to their federal tax return. Appellants claim that the IRS erred by using a basis of \$0 for shares sold in several of the reported securities transactions.<sup>6</sup>

FTB counters that appellants have not met their burden to show error in the final federal determination. In support, FTB submitted appellants' updated federal account transcript, as of May 12, 2022, showing that appellants' federal tax liability has not been canceled or reduced. The burden on appeal does not require that appellants prove that the IRS canceled or modified its determination. Rather, appellants' burden is to show error in FTB's proposed assessment. One way in which error may be shown is by demonstrating that the federal determination was modified or canceled. Appellants may also overcome the presumption of correctness by showing on appeal that the federal determination upon which FTB based its proposed assessment is incorrect or that FTB's determination itself is incorrect.

On appeal, appellants submitted their copy of a Form 1099-B. The statement shows clearly that AFSC reported basis on four securities transactions to the IRS. The statement also shows clearly that AFSC did not report basis on four other securities transactions to the IRS. The statement instructs taxpayers that AFSC generally does not report basis when securities (except for securities which are stock in a corporation) were acquired prior to January 1, 2012. As noted above, AFSC used the average cost method to calculate appellants' basis in its securities. AFSC was not required to report basis to the IRS on sales of securities acquired prior to January 1, 2012. (See Internal Revenue Code, § 6045(g)(3)(C)(ii).) The AFSC Form 1099-B issued to appellants does, however, report the basis in the securities acquired prior to January 1, 2012, which appellants sold during the 2017 taxable year. Appellants correctly reported on their

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<sup>6</sup> Appellants request that OTA “notify the IRS to remove the lien on [their] 2020 tax refund and to generate the full refund.” OTA only has jurisdiction over appeals from an action by FTB regarding California taxes. OTA has no connection with the IRS or any authority to direct the IRS to make changes at the federal level. Appellants may provide the same information directly to the IRS that they provided in this appeal (appellants' copy of the AFSC Form 1099-B).

federal Schedule D the total sales proceeds, the basis, and the net long-term capital gain as shown on their copy of the 1099-B issued by AFSC.<sup>7</sup>


Since appellants have shown that they had basis in securities that was not reported to the IRS on the Form 1099-B included in appellants’ federal Wage and Income Transcript, they have shown error in the federal determination. Moreover, appellants have shown that FTB’s proposed assessment was based on an incorrect federal determination and is therefore itself erroneous.

HOLDING


Appellants have shown error in FTB’s proposed assessment of additional tax, which is based on a federal determination.


DISPOSITION

FTB’s action is reversed.

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Teresa A. Stanley  
Administrative Law Judge

We concur:

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Asaf Kletter  
Administrative Law Judge

DocuSigned by:  
  
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Josh Lambert  
Administrative Law Judge

Date Issued: 9/23/2022

<sup>7</sup> Appellants’ Forms 1099-B reported on the federal Wage and Income Transcript, as well as on the AFSC Form 1099-B, report certain sales as “wash” sales. Neither party claims that any further adjustment is required based on the nature of the sale of appellants’ shares in securities.