

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:
R. MORRIS

) OTA Case No. 18093839
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OPINION

Representing the Parties:

For Appellant:

R. Morris

For Respondent:

Phillip C. Klean, Tax Counsel III
Nancy Parker, Tax Counsel IV

For Office of Tax Appeals:

Andrew Jacobson, Tax Counsel III

T. STANLEY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, R. Morris (appellant) appeals an action by respondent Franchise Tax Board (FTB) proposing additional tax of \$22,279.00, a late-filing penalty of \$5,548.21 and an accuracy-related penalty of \$4,455.80, plus applicable interest, for the 2006 taxable year.

Office of Tax Appeals (OTA) Administrative Law Judges Teresa A. Stanley, John O. Johnson, and Suzanne B. Brown held an oral hearing for this matter in Sacramento, California, on September 21, 2022. At the conclusion of the hearing, OTA closed the record, and this matter was submitted for an Opinion.

ISSUES

1. Is FTB’s proposed assessment for taxable year 2016 barred by the statute of limitations?
2. Has appellant shown error in FTB’s proposed assessment which is based on federal adjustments?
3. Has appellant shown that he is entitled to abatement of the late-filing penalty?
4. Has appellant established a basis to further reduce or abate the accuracy-related penalty?¹

¹ On appeal, FTB concedes that the accuracy-related penalty should be reduced from \$4,455.80 to \$1,494.00 because the IRS failed to revise the federal penalty to conform to the U. S. Tax Court’s decision holding

FACTUAL FINDINGS

1. On July 15, 2008, appellant late-filed a 2006 California Resident Income Tax Return.
2. FTB accepted the tax reported on appellant's 2006 return but reduced appellant's claimed withholding credits and imposed a late-filing penalty, plus applicable interest.
3. The IRS subsequently audited and adjusted appellant's 2006 federal return. As reflected on an IRS Form 5278, Statement - Income Tax Changes, dated September 17, 2012, the IRS revised appellant's 2006 reported taxable income by \$274,906 to \$257,893. The IRS's adjustments to income were based on the following items: (1) Schedule C-1 gross receipts or sales of \$198,499 (insurance contract); (2) Schedule C-2 gross receipts or sales of \$80,309 (sale of church property); (3) disallowed itemized deductions of \$2,708; (4) disallowed exemptions of \$2,200; and (5) reduced adjusted gross income by \$8,810 (one-half of self-employment tax). The IRS assessed additional tax and imposed a late-filing penalty and an accuracy-related penalty.
4. Appellant did not report the federal adjustments to FTB.
5. Appellant appealed his 2006 federal assessment (as well as a 2007 assessment not at issue here) to the U. S. Tax Court (USTC). The USTC found in the matter of *Morris v. Commissioner* (Docket No. 21413-11) that for the 2006 taxable year, appellant: (1) realized income from the sale of a church building and from services provided under an insurance contract; (2) was liable for a late-filing penalty; and (3) was subject to an accuracy-related penalty with respect to the insurance contract income only. In a Bench Opinion dated June 27, 2012, the USTC found that, with respect to the church building, appellant relied in good faith on his professional tax advisor and his business partner based on appellant's lack of sophistication in tax matters and general lack of higher education; as a result, the USTC reduced the 2006 accuracy-related penalty.
6. Following the USTC decision, the IRS adjusted appellant's 2006 tax liability and penalties, which it reported to FTB on June 9, 2015. In accordance with appellant's federal adjustments, FTB issued a Notice of Proposed Assessment (NPA) dated February 9, 2016, which increased appellant's 2006 reported taxable income. The NPA

that appellant relied in good faith on a tax adviser and that there was reasonable cause with respect to a portion of the underpayment of federal tax. At the oral hearing, FTB conceded that the accuracy-related penalty was computed incorrectly and agreed to a further reduction to \$1,283, which is the amount of the penalty at issue.

proposed an additional tax of \$22,279.00, a late-filing penalty of \$5,548.21, and an accuracy-related penalty of \$4,455.80, plus interest.

7. FTB denied appellant's protest and issued a Notice of Action affirming the NPA.
8. Appellant filed this timely appeal.

DISCUSSION

Issue 1: Is FTB's proposed assessment barred by the statute of limitations?

In general, FTB must issue a proposed assessment within four years of the date the taxpayer files a California tax return. (R&TC, § 19057.) A taxpayer is required to report federal changes to income or deductions to FTB within six months of the date the federal changes become final. (R&TC, § 18622.) If neither the taxpayer nor the IRS notifies FTB of the federal changes within six months of a final federal determination, FTB may issue a proposed assessment within four years of the date when it received notification of the federal changes. (R&TC, § 19060(b).)

Since appellant's 2006 return was filed on July 15, 2008, the deadline for issuing the NPA under the general statute of limitations was July 15, 2012. However, it is undisputed that the IRS adjusted appellant's 2006 taxable year account, which means that the specific statute of limitations under R&TC section 19060 applies in place of the general statute of limitations under R&TC section 19057. (See *Ordlock v. FTB* (2016) 38 Cal.4th 897, 910.) The IRS issued the final federal determination on March 25, 2013. The IRS notified FTB of the determination on June 9, 2015, more than six months after it became final. FTB, therefore, must issue its NPA within four years after notification of the final federal determination. (R&TC, § 19060(b); *Appeal of Valenti*, 2021-OTA-093P.) Because the NPA was issued on February 9, 2016, it was issued timely.

Issue 2: Has appellant demonstrated error in FTB's proposed assessment, which is based on federal adjustments?

When the IRS makes changes or corrections to an individual's tax return and the changes increase the amount of California tax owed, the taxpayer must report the federal changes and either concede the accuracy of the federal determination or prove that the federal adjustments are erroneous. (R&TC, § 18622(a).) An FTB deficiency assessment based on a federal audit report

is presumed to be correct, and appellant bears the burden of proving that the determination is erroneous. (*Appeal of Gorin*, 2020-OTA-018P.)

Appellant does not request specific adjustments to the 2006 tax liability. Rather, appellant makes general claims that: (1) he recently located an organizational agreement, which appellant asserts shows that his partners took advantage of him; (2) appellant paid an accountant to prepare his tax returns and assumes they were done correctly; and (3) appellant never received the money attributed to him because there was a note secured by the property and some of the payment was in the form of real property. Appellant alleges that a partner, Mr. Cherry, bought out his interest in the church property sales proceeds for \$50,000, and that is all the cash he received. Appellant further asserts that he lacks the funds to pay the amount assessed by FTB and that if OTA sustains the proposed assessment, he will be forced to file for bankruptcy.

The organizational agreement submitted by appellant is dated October 15, 2006, which is after the sale of the church property at issue, which occurred on September 12, 2006. Therefore, it does not appear that the agreement is relevant to the issue of the taxability of the sales proceeds. With respect to appellant's payment to an accountant, OTA cannot reduce a tax assessment based on an accountant's alleged inaccuracy.² Appellant's reliance on the accountant is only relevant to the imposition of the accuracy-related penalty, as discussed below. Regarding appellant's argument that he did not receive the money claimed as gain on his federal tax return, appellant did not provide documentation to support that allegation. On the contrary, appellant did establish that he received some payments during 2006 and admits that his name was added to the title of another real property. The amount included in appellant's income for 2006 includes the cash value received, appellant's share of the proceeds from the promissory note, and the fair market value of appellant's share of the real property. Based on the foregoing, appellant has not met his burden to show that the additional income as determined by the USTC, and relied upon by the IRS and FTB, is incorrect.³

² OTA's record does not show what information appellant provided to the accountant to support the basis of \$200,000 claimed on appellant's 2006 tax return. Moreover, appellant states that Mr. Cherry told him that he "is only going to be taxed on the installment sale." It is unclear whether Mr. Cherry's statement was intended to relay that installment payments would be taxed when received instead of being taxable in 2006. It is also unclear whether appellant provided such information to the tax preparer to aid in the preparation of the original return or for the purpose of filing an amended return.

³ With respect to the adjustment for unreported income earned from services provided pursuant to an insurance contract, appellant concedes that he owes taxes on this income. OTA does not, therefore, address that further. Similarly, the other federal adjustments for self-employment tax, itemized deductions, and exemption

OTA does not have the legal authority to strike down a valid tax assessment on the grounds that payment will be difficult for the taxpayer.⁴ (*Appeal of Robinson*, 2018-OTA-059P.) OTA's function in the appeals process is to determine the correct amount of a taxpayer's California income tax liability. (*Ibid.*) Furthermore, OTA has no jurisdiction to determine the dischargeability in bankruptcy of a tax obligation. (See Cal. Code Regs., tit. 18, § 30104(h); see also *Appeal of Smith* (81-SBE-145) 1981 WL 11870, citing *Fotochrome, Inc. v. Commissioner* (1972) 57 T.C. 842.) Therefore, based on all the evidence and the earlier conclusion that the liability was correctly assessed, no additional adjustment to the amount of appellant's 2006 assessment is warranted.

Issue 3: Has appellant shown that he is entitled to abatement of the late-filing penalty?

California imposes a penalty for failing to file a valid return on or before the due date, unless the taxpayer shows that the failure is due to reasonable cause and not due to willful neglect. (R&TC, § 19131.) To establish reasonable cause, the taxpayer must show that the failure to file timely returns occurred despite the exercise of ordinary business care and prudence, or that such cause existed as would prompt an ordinarily intelligent and prudent businessperson to have so acted under similar circumstances. (*Appeal of Head and Feliciano*, 2020-OTA-127P.)

There is no dispute that appellant did not timely file a return for 2006, which was due on or before April 15, 2007. Appellant's tax return was untimely filed on July 15, 2008. Appellant has not disputed FTB's calculation of the late-filing penalty. Finally, appellant has neither raised any arguments nor provided any evidence showing he had reasonable cause for the late filing of his 2006 return. Therefore, we find that appellant has failed to establish reasonable cause to abate the late-filing penalty.

credits are not separately argued on appeal, and, finding no error in those adjustments based on the record provided, they are not further addressed herein.

⁴ As to appellant's assertion that he resolved his federal liability when the IRS accepted an offer in compromise, when this appeal is final, appellant may contact FTB directly to inquire into FTB's installment payment or offer in compromise programs.

Issue 4: Has appellant established a basis to further reduce or abate the accuracy-related penalty?

Internal Revenue Code (IRC) section 6662, incorporated by R&TC section 19164, with modifications, provides for an accuracy-related penalty of 20 percent of the applicable underpayment. IRC section 6662(b) provides, in relevant part, that the penalty applies to the portion of the underpayment attributable to any substantial understatement of income tax. A substantial understatement of tax exists if the understated amount exceeds the greater of 10 percent of the tax required to be shown on the return or \$5,000. (IRC, § 6662(d)(1).) An “understatement” is defined as the excess of the amount of tax required to be shown on the return for the taxable year over the amount of the tax imposed which is shown on the return, reduced by any rebate. (IRC, § 6662(d)(2).) The accuracy-related penalty does not apply to any portion of an underpayment if it is shown that there was reasonable cause for the underpayment and the taxpayer acted in good faith with respect to the underpayment. (IRC, § 6664(c)(1).)

Appellant implies that there is reasonable cause to reduce or abate the accuracy-related penalty because he relied on an accountant to prepare his 2006 tax return. Appellant has not provided any argument or evidence other than what was already considered by the USTC. The USTC found reasonable cause to abate the portion of the penalty related to the sale of the real property based on appellant’s lack of sophistication, general lack of education, and reliance upon a tax preparer and trusted friend. The USTC did not relieve appellant of the portion of the penalty related to the failure to report income from services performed in 2006 pursuant to an insurance contract. In fact, appellant admits that he underreported that income.⁵

FTB notes that the IRS failed to reduce the accuracy-related penalty at the federal level. FTB followed the USTC judgment and reduced the penalty from \$4,455.80 to \$1,494.00 using the highest progressive rate for 2006 of 9.3 percent. At OTA’s request, FTB recalculated the penalty using the 2006 progressive rate schedule, resulting in a decrease in the amount of the penalty to \$1,283.00.

Appellant did not offer any arguments or evidence to establish that the remaining penalty should be reduced or abated. Rather, appellant admits that he should have reported the income

⁵ Although appellant testified that the net income received was \$130,000, the USTC judgment states that the relevant amount is \$113,322.


from the insurance contract. Therefore, OTA finds that no further adjustment to the penalty is warranted.

HOLDINGS

1. FTB’s proposed assessment for taxable year 2016 is not barred by the statute of limitations.
2. Appellant has failed to establish error in FTB’s proposed assessment, which is based on federal adjustments.
3. Appellant has failed to show that the late-filing penalty should be abated.
4. Appellant has not established a basis to further reduce or abate the accuracy-related penalty.

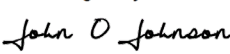
DISPOSITION

Except as conceded by FTB that the accuracy-related penalty should be reduced from \$4,455.80 to \$1,283.00, FTB’s action is sustained.


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 Teresa A. Stanley
 Administrative Law Judge

We concur:

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 John O. Johnson
 Administrative Law Judge

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 Suzanne B. Brown
 Administrative Law Judge

Date Issued: 12/20/2022