

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 19054762
J. STRINGFELLOW AND)
R. COPE)
_____)

OPINION

Representing the Parties:

For Appellants: J. Stringfellow
R. Cope
Keesha Scott-Hagan, Tax Appeals
Assistance Program (TAAP)¹

For Respondent: Joel Smith, Tax Counsel III

For Office of Tax Appeals: Neha Garner, Tax Counsel III

T. LEUNG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, J. Stringfellow and R. Cope (appellants) appeal actions by respondent Franchise Tax Board (FTB) proposing \$5,211.00 in additional tax, a \$778.00 late filing penalty, and applicable interest for the 2012 taxable year, \$3,039.00 in additional tax, a \$460.50 late filing penalty and applicable interest for the 2013 taxable year, and \$4,785.00 in additional tax and applicable interest for the 2014 taxable year.

Although this matter was originally scheduled to be heard electronically, appellants elected to waive their rights to an oral hearing; therefore, this appeal is being decided based on the written record.

ISSUES

1. Whether appellants have demonstrated error in the proposed assessments for the 2012, 2013 and 2014 taxable years (taxable years at issue), which are based on IRS adjustments.

¹ Appellants filed their own opening brief. Ana Erickson of TAAP filed appellants’ reply brief.

2. Whether the late filing penalties for the 2012 and 2013 taxable years should be waived.

FACTUAL FINDINGS

1. Appellants filed their 2012 California personal income tax return (Form 540) late, on March 15, 2014.
2. Appellants filed their 2013 Form 540 late, on April 15, 2015.
3. The IRS audited appellants' federal income tax returns (Form 1040) for each of the taxable years at issue and made various adjustments. Appellants did not notify FTB of the federal adjustments. Subsequently, the IRS informed FTB of its Form 1040 adjustments with respect to each of the taxable years at issue.
4. Based upon this information, FTB issued Notices of Proposed Assessment (NPA's) for each of the taxable years at issue. To the extent allowable under state law, FTB followed the IRS determinations and made several adjustments, including the disallowance of deductions totaling \$63,712, \$66,257, and \$59,437 for the 2012, 2013, and 2014 taxable years, respectively.²
5. After applying the 2012 adjustments, appellants' 2012 taxable income increased by \$56,030.00. Based on the revised taxable income, FTB proposed an assessment of tax in the amount of \$5,211.00 and imposed a late filing penalty of \$778.00 plus interest of \$1,020.07, for a total of \$7,009.07.
6. After applying the 2013 adjustments, appellants' 2013 taxable income increased by \$32,310.00. Based on the revised taxable income, FTB proposed an assessment of tax in the amount of \$3,039.00, and imposed a late filing penalty of \$460.50, plus interest of \$475.01, for a total of \$3,974.51.
7. After applying the 2014 adjustments, appellants' 2014 taxable income increased by \$51,453.00. Based on the revised taxable income, FTB proposed an assessment of tax in the amount of \$4,785.00, plus interest of \$427.42, for a total of \$5,212.42.
8. Recent information received from the IRS does not indicate that it has reduced or canceled its adjustments, and does not indicate that the IRS is in the process of reconsidering the adjustments.

² These amounts included Schedule C car and truck expenses, Schedule C repairs and maintenance expenses, Schedule A net miscellaneous deductions, remaining Schedule A itemized deductions, and improper IRA deductions.

9. Appellants indicated by letter that they wanted to discuss their protest via telephone before they had a hearing. After FTB was unsuccessful in contacting appellants, it sent a notice to them, asking appellants what action they would like to take to continue their protest hearing process. When FTB did not receive a response, it issued Notices of Action, affirming the NPAs for each of the taxable years at issue.

DISCUSSION

Issue 1: Whether appellants have demonstrated error in the proposed assessments for the taxable years at issue, which are based on IRS adjustments.

A taxpayer shall either concede the accuracy of a federal determination or state wherein it is erroneous. (R&TC, § 18622(a).) It is well settled that a deficiency determination based on a federal audit report is presumptively correct and that the taxpayer bears the burden of proving that the determination is erroneous. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509, 514; *Appeal of Vardell*, 2020-OTA-190P.)

When a proposed FTB assessment is based on a final federal adjustment, a taxpayer can satisfy the burden of proof in one of two ways: (1) show that the IRS has changed or eliminated its adjustments; or (2) produce evidence that the IRS's or FTB's adjustments are incorrect or inapplicable. If the IRS does reconsider and change its audit determination for the year at issue, the law permits the taxpayer to notify FTB at the time of the federal changes and request that FTB make corresponding state changes. (See R&TC, §§ 18622, 19311.)

Here, FTB's adjustments to appellants' California taxable income and proposed additional California tax liability followed the IRS adjustments indicated on the 2012, 2013, and 2014 federal audit reports. According to appellants' 2012, 2013, and 2014 federal account transcripts, the IRS made several adjustments and disallowances of Schedule C and other deductions. Appellants stated that they intended to hire an attorney to help dispute the matter with the IRS. However, the recently obtained account transcripts show that the IRS assessments are the same amounts as indicated on the federal audit reports. Furthermore, there is no evidence of any pending action by the IRS. Therefore, based on the evidence in the appeal record, the panel finds that the IRS has neither cancelled nor revised its assessments.

Nevertheless, while FTB follows federal adjustments to the extent allowable by law, a federal action does not necessarily bind FTB to follow adjustments it believes to be erroneous.

(*Appeal of Der Wienerschnitzel International, Inc.* (79-SBE-063) 1979 WL 4104.) Therefore, we next examine whether appellants have shown that FTB’s adjustments are incorrect or inapplicable.

Income tax deductions are a matter of legislative grace, and taxpayers who claim a deduction have the burden of proving by competent evidence that they are entitled to that deduction. (*New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435, 440.) To sustain their burden of proof, taxpayers must be able to point to an applicable deduction statute and show that they came within its terms. (*Appeal of Dandridge*, 2019-OTA-458P.) Unsupported assertions cannot satisfy the taxpayers’ burden of proof. (*Ibid.*; *Appeal of Gorin*, 2020-OTA-018P.)

A taxpayer may deduct unreimbursed employee expenses as ordinary and necessary business expenses. (R&TC, § 17201(a); Internal Revenue Code (IRC), § 162.) A deduction is allowed for “all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business” (IRC, § 162(a); see also *Roberts v. Commissioner*, T.C. Memo. 2012-197 (*Roberts*)). By contrast, personal, living, or family expenses are generally nondeductible. (R&TC, § 17201(c); IRC, § 262(a).) The expenses must be both ordinary and necessary business expenditures directly related to the taxpayer’s trade or business. (*Deputy v. du Pont* (1940) 308 U.S. 488, 497; Treas. Reg. § 1.162-1(a).) A taxpayer has the burden of showing that a particular expense is not a personal, living, or family expense. (*Heineman v. Commissioner* (1984) 82 T.C. 538, 542.) A taxpayer is required to keep books and records sufficient to establish matters reported on a return. (*Higbee v. Commissioner* (2001) 116 T.C. 438, 440.)

Appellants stated that they had all of the documentation supporting the itemized deductions and appropriate write-offs for each respective taxable year’s federal audit adjustments. Appellants argue that they are entitled to business expense deductions for their company “Dyshelle Clothing” for the taxable years at issue, and for a personal notary business operated by appellant-wife for the 2014 taxable year. Appellants provided spreadsheets to support their claimed deductions. Appellants also contend that they are entitled to a deduction for union dues paid by appellant-husband, and provided one pay stub each from 2012, 2013, and 2014 to support their position.

However, appellants did not provide documentation such as receipts, invoices, cancelled checks, business bank statements, or personal statements showing that these expenses were

related to the conduct of a trade or business. Furthermore, there is no evidence to indicate appellant-wife engaged in the clothing or notary public businesses for the taxable years at issue.³ Without more evidence, this panel cannot determine whether any of the disallowed business expenses constitute ordinary and necessary expenses paid or incurred during the taxable years at issue. (IRC, § 162(a); *Roberts, supra.*)⁴

Appellants also assert that they can claim appellant-husband's union dues as a deduction under Assembly Bill 2577. But Assembly Bill 2577, from the 2017-2018 legislative session, did not become law and cannot be the basis for appellants' deduction claim. Therefore, this panel finds that appellants have failed to show that FTB erroneously disallowed any deductions or expenses in reliance on the federal determination.

Issue 2: Whether the late filing penalties for the 2012 and 2013 taxable years should be waived.

A penalty is imposed when a taxpayer fails to file a tax return on or before its due date, computed at 5 percent of the tax due, after allowing for timely payments, for every month that the return is late, up to a maximum of 25 percent. (R&TC, § 19131; *Appeal of Xie*, 2018-OTA-076P; *Appeal of Myers* (2001-SBE-001) 2001 WL 37126924.) Here, appellants filed late tax returns for the 2012 and 2013 taxable years.

For the 2012 taxable year, the late-filed tax return reported a tax due of \$3,112, and FTB computed the late filing penalty as \$778 (i.e., \$3,112 x 25 percent.) The maximum penalty of 25 percent was properly imposed since appellants' return was filed more than five months past its due date of April 15, 2013. For the 2013 taxable year, the late-filed tax return reported a tax due of \$1,842.00, and FTB computed the late filing penalty as \$460.50 (i.e., \$1,842.00 x 25 percent.) The maximum penalty of 25 percent was properly imposed since appellants' return was filed more than five months past its due date of April 15, 2014.

The penalty shall be imposed unless the taxpayer establishes that the late filing was due to reasonable cause and was 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

³ FTB notes that a business search for "Dyshelle" on the California Secretary of State website did not yield any results. FTB also notes that appellant-wife held an active notary public commission from February 27, 2016, to February 26, 2020, which is outside the taxable years at issue.

⁴ It is noted that some of the expenses appellants listed are for travel and meals which are subject to the higher standard of substantiation under IRC section 274(d).

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; *Appeal of Tons* (79-SBE-027) 1979 WL 4068.) A late filing penalty imposed by FTB is presumed to be correct, and the burden of proof is on the taxpayer to establish that reasonable cause exists to support a waiver of the penalty. (*Appeal of Head and Feliciano, supra.*; *Appeal of Tons, supra.*) Each taxpayer has a personal and non-delegable obligation to file a tax return by the due date. (*U.S. v. Boyle* (1985) 469 U.S. 241, 252.)


Generally, financial difficulties do not constitute reasonable cause for failing to file a timely tax return. (*Barber v. Comm'r*, T.C. Memo. 1997-206.) Illness or other personal difficulties do not constitute reasonable cause when the difficulties simply caused the taxpayer to sacrifice the timeliness of one matter so that other matters could be pursued. (*Appeal of Halaburka* (85-SBE-025) 1985 WL 15809; *Appeal of Orr* (68-SBE-010) 1968 WL 1640.) The taxpayer has the burden to prove that the difficulties experienced prevented the taxpayer from complying with its tax obligations. (*Appeal of Myers, supra.*; *Appeal of James* (83-SBE-009) 1983 WL 15396; see also *Stine v. U. S.* (Fed.Cl. 2012) 106 Fed.Cl. 586 [requiring “continuous incapacity”]; *Appeal of Halaburka, supra* [requiring “continuously prevented”].) Here, there is no evidence that financial difficulties prevented them from timely filing their tax returns. Furthermore, appellants’ contention that they opted to focus on issues related to prior taxable years is not reasonable cause to waive the late filing penalties. Accordingly, there is no basis to waive the late filing penalties.

HOLDINGS


1. Appellants have not demonstrated error in the proposed assessments for the taxable years at issue, which are based on IRS adjustments.
2. The late filing penalties for the 2012 and 2013 taxable years should not be waived.

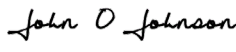
DISPOSITION

FTB’s actions are sustained.

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 Tommy Leung
 Administrative Law Judge

We concur:

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 Administrative Law Judge

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 John O. Johnson
 Administrative Law Judge

Date Issued: 12/14/2022