OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **J. BAGLIN AND** **L. BAGLIN**	OTA Case No. 21088348

OPINION

Representing the Parties:

For Appellants: J. B aglin
L. Baglin

For Respondent: Topher Tuttle, Tax Counsel III
Maria Brosterhous, Tax Counsel IV

For Office of Tax Appeals: Steven Kim, Tax Counsel III

C. AKIN, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, J. Baglin and L. Baglin (appellants) appeal an action by respondent Franchise Tax Board (FTB) proposing additional tax of $812, plus applicable interest, for the 2016 tax year.

Appellants elected to have this appeal determined pursuant to the procedures of the Small Case Program. Those procedures require the assignment of a single Administrative Law Judge. (Cal. Code Regs., tit. 18, § 30209.1.) Office of Tax Appeals (OTA) Administrative Law Judge Cheryl L. Akin held an oral hearing for this matter in Sacramento, California, on July 19, 2022. At the conclusion of the hearing, OTA held the record open to allow for additional briefing. Thereafter, the record was closed and this matter was submitted for decision.

ISSUE

Whether appellants have established error in FTB's proposed assessment for the 2016 tax year, which was based on a final federal adjustment.

FACTUAL FINDINGS

1. Appellants timely filed a 2016 California Resident Income Tax Return (Form 540) reporting federal adjusted gross income (AGI) of $57,713.
2. Subsequently, FTB received information from the IRS indicating that the IRS had increased appellants' 2016 federal AGI by $20,270, from $57,713 to $77,983. Specifically, the IRS increased appellants' federal AGI to include interest income of $75, taxable dividends of $9, other income of $623, and securities income of $19,563.[1]
3. FTB issued appellants a Notice of Proposed Assessment (NPA) for the 2016 tax year based on the federal adjustments. The NPA increased appellants' income by $20,270, and proposed additional tax of $812, plus applicable interest.
4. Appellants protested the NPA indicating that they had resolved the issue with the IRS.[2]
5. FTB responded to appellants in a letter stating that the information received from the IRS did not indicate the federal adjustment was cancelled or reduced.
6. Appellants subsequently provided FTB with additional information from the IRS, including: an IRS Notice dated February 20, 2018 (IRS CP2501 Notice); and their IRS Account Transcript for the 2016 tax year dated June 3, 2021.
7. The IRS CP2501 Notice compared appellants' federal AGI as reported on their 2016 federal return to the income reported to the IRS by third parties. As relevant here, the IRS CP2501 Notice indicated that appellants had potentially failed to report proceeds of $12,000 and $141,274 from the sales of securities described as "FRANKLIN C TAX FR INC A" on January 29, 2016, and February 12, 2016, respectively.[3] (All caps in original.)

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[1] According to the 2016 IRS Wage and Income Transcript dated August 3, 2021, J. Baglin sold securities on January 29, 2016, and February 12, 2016, and received proceeds of $12,000 and $141,271, respectively. J. Baglin was issued an IRS Form 1099-B, Proceeds from Broker and Barter Exchange Transactions, for each of the sales. The transcript indicates that the type of gain on the sales was long-term, but does not indicate the cost basis for the securities sold. The transcript also reflects two additional sales of securities for proceeds of $505 and $143 (basis of $494 and $158) on February 12, 2016, and November 22, 2016, respectively. These transactions were properly reported by appellants, are not included in the IRS audit adjustment, and are not at issue in this appeal.

[2] With their protest, appellants submitted an IRS notice dated March 18, 2019, showing "increase in tax" of $105 and "increase in interest" of $7. This notice further indicates that appellants had previously paid $112 to the IRS, and no additional amount was due.

[3] The IRS CP2501 Notice also indicated that appellants failed to report interest of $75, taxable dividends of $9, and other income of $623.

8. The IRS Account Transcript dated June 3, 2021, indicated that appellants' federal AGI was ultimately increased by $20,270 to $77,983, and appellants were assessed additional tax of $105 on March 18, 2019.[4]
9. FTB issued to appellants a Notice of Action affirming the NPA.
10. This timely appeal followed.

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. A deficiency assessment based on a federal adjustment to income is presumed to be correct and a taxpayer bears the burden of proving with credible, competent, and relevant evidence that FTB's determination is erroneous. (*Appeal of Valenti*, 2021-OTA-093P.) Here, FTB's determination was based on information received from the IRS showing that the IRS had increased appellants' 2016 federal AGI by $20,270. Thus, appellants bear the burden of establishing error in FTB's proposed assessment based on this federal determination.

Appellants assert the issue has been resolved with the IRS, resulting in a federal income tax assessment of only $105, and question whether FTB has properly followed this resolution by the IRS. In this regard, appellants provide evidence indicating that the IRS initially proposed to include a much larger amount in appellants' federal AGI for 2016. The IRS CP2501 Notice provided by appellants indicated that the IRS initially reported to appellants that they had potentially underreported their 2016 federal AGI by a total of $153,978, consisting of the following: (1) proceeds of $12,000 and $141,271 from the sales of securities described as "FRANKLIN CA TX FR INC A"; (2) $75 of interest; (3) $9 of taxable dividends; and (4) $623 of other income. (All caps in original.) Ultimately, however, the IRS only increased appellants' federal AGI by a total of $20,270, which includes securities income of only $19,563, instead of the $153,271 ($12,000 plus $141,271) noted per the IRS CP2501 Notice.[5] While the reason for this change is not entirely clear from the record, the IRS CP2501 Notice invited appellants to

[4] The IRS Account Transcript shows that appellants paid the tax and interest totaling $112 in advance on November 2, 2018.

[5] The other adjustments per the IRS CP2501 Notice (i.e., interest income of $75, taxable dividends of $9, and other income of $623) were not modified or changed. Appellants do not provide any specific arguments related to these other adjustments, and they will not be discussed further in this Opinion.

provide information regarding their basis in the securities, and in a letter to the IRS dated June 5, 2018, appellants indicated that they received the securities from J. Baglin's parents at the close of probate in 2015. Thus, the IRS may have permitted appellants a step-up in basis in the securities to their fair market value at the time the securities were inherited from J. Baglin's parents pursuant to Internal Revenue Code (IRC) section 1014.[6]

FTB properly followed the federal adjustment by increasing appellants' income by $20,270, not the full $153,978 initially noted by the IRS in the IRS CP2501 Notice issued to appellants.[7] Appellants have not provided any evidence of their basis in these securities in this appeal. As such, appellants have not established that they are entitled to any additional basis in these securities beyond the $133,708 gain reduction ($153,271 minus $19,563) already allowed by the IRS. Additionally, OTA notes that the IRS has not subsequently withdrawn or modified its federal assessment.[8]

On appeal, appellants also argue that the sales of securities in 2016 were simply rollovers from one account to another, and that they did not receive any income from the sale because any proceeds were deposited back into another investment account. Generally, gross income means all income from whatever source derived, including gains derived from dealings in property such as securities. (IRC, § 61(a)(3); R&TC, §17071.) One exception to this general rule includes rollover contributions from certain qualified accounts such as an individual retirement account (IRA). A rollover contribution, where a distribution from a qualified account for the benefit of an individual is paid into another qualified account for the benefit of the same individual, is not included in a taxpayer's gross income. (See IRC, § 408(d); R&TC, § 17501(a).)

However, there is no evidence showing that the securities at issue in this appeal were sold from a qualified account (such as an IRA) and that the proceeds from the sale were paid into

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[6] California conforms per R&TC section 18031.

[7] To the extend appellants are confused by the amount of FTB's proposed additional tax assessment (i.e., $812 which exceeds the IRS additional tax assessment of only $105), OTA notes that the IRC provides for a lower tax rate on federal capital gains as compared to federal ordinary income. This rate may be as low as zero percent for certain taxpayers falling within specified income thresholds. (See IRC, § 1(h).) California, however, does not have a different or lower tax rate for capital gains. This difference between federal and California tax law may explain why FTB's proposed tax assessment exceeds the federal tax assessment for the 2016 tax year, even though they are both based on the same $20,270 increase in taxable income.

[8] Appellants' 2016 IRS Account Transcript dated June 3, 2021, continues to show federal AGI of $77,983 and federal taxable income of $54,783. This exceeds appellants' federal AGI of $57,713 and federal taxable income of $34,513 as reported on appellants' original federal tax return by $20,270 ($77,983 - $57,713; $54,783 - $34,513).

another qualified account for the same individual. Rather, the evidence suggests that the transactions did not involve a rollover contribution. For each of the sales at issue here, J. Baglin was issued a Form 1099-B, which is used to report proceeds from brokerage transactions, instead of a Form 1099-R, which would have been used to report distributions from qualified plans, including IRAs. Additionally, according to emails from appellants' investment advisor dated July 21, 2022, and September 22, 2022, appellants sold $12,000 of shares in the Franklin California Tax-Free Income Fund (ticker symbol: FKTFX) in 2016, which the advisor states was a taxable event. As both the $12,000 and $141,271 securities sale transactions were made from the same account and involve the same type of securities, appellants have failed to establish that either sale was a qualified rollover contribution that should be excluded from income under IRC section 408(d).

HOLDING

Appellants have failed to establish error in FTB's proposed assessment for the 2016 tax year, which was based on a final federal adjustment.

DISPOSITION

FTB's action is sustained.

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Cheryl L. Akin
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Cheryl L. Akin
Administrative Law Judge

Date Issued: 12/21/2022