

**OFFICE OF TAX APPEALS
STATE OF CALIFORNIA**

In the Matter of the Appeal of:
M. MUDGE

) OTA Case No. 21129212
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OPINION

Representing the Parties:

For Appellant: M. Mudge

For Respondent: Camille Dixon, Tax Counsel

S. BROWN, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, M. Mudge (appellant) appeals an action by respondent Franchise Tax Board (FTB) proposing additional tax of \$1,384.00 and an accuracy-related penalty of \$276.80, plus applicable interest, for the 2017 tax year.

Appellant waived the right to an oral hearing; therefore, the matter is being decided based on the written record.

ISSUES

1. Whether appellant has shown error in FTB’s proposed assessment, which is based on final federal adjustments.
2. Whether appellant has shown that the accuracy-related penalty should be abated.
3. Whether appellant has shown that interest should be abated.

FACTUAL FINDINGS

1. Appellant timely filed a California resident income tax return for the 2017 tax year, reporting California adjusted gross income (AGI) and itemized deductions.
2. FTB received information from the IRS showing that the IRS adjusted appellant’s federal income tax return for the 2017 tax year. The IRS disallowed \$12,581 of appellant’s

- itemized deduction for mortgage interest¹ and determined that appellant failed to report \$1,811 in taxable pension income; as a result, the IRS assessed additional tax of \$3,781 and imposed an accuracy-related penalty of \$756, plus applicable interest. Appellant did not report these changes to FTB.
3. Based on this information from the IRS, FTB adjusted appellant's California AGI to include the \$1,811.00 in taxable pension income and disallowed \$12,581.00 of appellant's claimed mortgage interest deduction when computing her California taxable income. On February 18, 2021, FTB issued appellant a Notice of Proposed Assessment (NPA) that proposed additional tax of \$1,384.00, an accuracy-related penalty of \$276.80, and applicable interest.
 4. Appellant timely protested the NPA and provided an IRS Form 1098 (Mortgage Interest Statement) issued to P. Mudge and I. Mudge for the 2017 tax year and a First American Property Profile that lists her as the owner of the property. Appellant stated that although her parents are listed on the Form 1098, appellant "is making all the mortgage payments and is on the title."
 5. On August 31, 2021, FTB sent appellant a protest determination letter, stating that since the federal information did not show that the IRS cancelled or reduced its assessment, FTB's proposed assessment was correct. On October 28, 2021, FTB issued a Notice of Action, affirming the NPA.
 6. This timely appeal followed.
 7. On appeal, FTB provides an IRS Account Transcript and an IRS CP200 Data Sheet, both dated December 31, 2021, indicating that the federal determination has still not been abated or revised.

DISCUSSION

Issue 1: Whether appellant has shown error in FTB's proposed assessment, which is based on federal adjustments.

When the IRS changes or corrects a taxpayer's federal tax return, the taxpayer shall report each change or correction, and shall concede the accuracy of the federal determination or

¹ Appellant claimed a mortgage interest deduction of \$14,214, but the IRS Wage and Income Transcript shows that the mortgage lender reported only \$1,633 in mortgage interest received from appellant as payor; thus, the IRS disallowed the remaining \$12,581 of appellant's claimed mortgage interest deduction.

state how the determination is 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.) Income tax deductions are a matter of legislative grace, and a taxpayer who claims a deduction has the burden of proving by credible evidence that he or she is entitled to that deduction. (*Appeal of Dandridge*, 2019-OTA-458P.) Unsupported assertions are insufficient to satisfy a taxpayer’s burden of proof. (*Appeal of Gorin, supra.*)

R&TC section 17041(a)(1) provides, in pertinent part, that tax shall be imposed upon the entire taxable income of every resident of California. R&TC section 17071 generally incorporates Internal Revenue Code (IRC) section 61, which defines “gross income” as “all income from whatever source derived.” Gross income is includable in taxable income unless it is otherwise deductible. (R&TC, § 17073.) Generally, California conforms to section 163 of the IRC regarding the deductibility of mortgage and other interest. (See R&TC, § 17201.)

Here, FTB proposed to assess additional tax based on the federal adjustments detailed in the CP2000 Data Sheet and IRS Account Transcript. Appellant has not raised any argument disputing the adjustment for \$1,811 in taxable pension income and has not provided evidence establishing error in FTB’s determination. Although appellant alleged that she was making all the mortgage payments and provided a First American Property Profile that lists her as the owner of the property, the Form 1098 lists P. Mudge and I. Mudge as the payors. Appellant has not provided any other evidence to support her position that she is entitled to claim the \$12,581 as a mortgage interest deduction; appellant did not provide any response to FTB’s brief and did not respond to the Office of Tax Appeals’ request for additional briefing on this topic.²

Consequently, appellant has not met her burden of proof to establish error in FTB’s proposed assessment.

² In a letter dated September 13, 2022, the Office of Tax Appeals requested that appellant submit any evidence or argument showing error in FTB’s proposed assessment, including: evidence that appellant is entitled to claim the mortgage interest deduction; evidence of appellant’s payment of the mortgage payments; evidence that appellant’s parents did not claim this same mortgage interest deduction on their returns for the 2017 tax year; and evidence that appellant was liable under the mortgage and had an equitable ownership interest in the residence. Appellant did not respond to this request.

Issue 2: Whether appellant has shown that the accuracy-related penalty should be abated.

R&TC section 19164 generally incorporates the provisions of IRC section 6662 and imposes an accuracy-related penalty of 20 percent of the applicable underpayment. As relevant here, 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 an individual, there is a “substantial understatement of income tax” when the amount of the understatement for a taxable year exceeds the greater of 10 percent of the tax required to be shown on the return, or \$5,000. (IRC, § 6662(d)(1).)

Here, appellant’s understatement of California income tax is \$1,384, which is less than \$5,000.³ Therefore, appellant’s understatement does not constitute a substantial understatement of California income tax. Accordingly, the accuracy-related penalty is only applicable for California purposes if there is another basis for its imposition, such as negligence.

FTB states that it imposed the accuracy-related penalty pursuant to R&TC section 19164 based upon the IRS’s imposition of the federal accuracy-related penalty. FTB states that because the federal deficiency is less than \$5,000, it is presumed that the federal accuracy-related penalty is imposed due to negligence. When FTB proposes a penalty based on a federal penalty determination, the FTB’s determination is presumptively correct. (*Appeal of Abney* (82-SBE-104) 1982 WL 11781.) IRC section 6662(b) provides, in relevant part, that the penalty applies to the portion of the underpayment attributable to negligence or disregard of rules and regulations. “Negligence” is defined to include “any failure to make a reasonable attempt to comply” with the provisions of the code. (IRC, § 6662(c).) “Negligence” also includes any failure by the taxpayer to keep adequate books and records or to substantiate items properly. (Treas. Reg. § 1.6662-3(b)(1).)

An accuracy-related penalty based upon negligence can be abated upon a showing of reasonable basis or reasonable cause and good faith. (IRC, § 6664(c)(1); Treas. Reg. §§ 1.6664-1(b)(2) & 1.6664-4.) The taxpayer bears the burden of proving any defenses to the imposition of the accuracy-related penalty. (*Recovery Group, Inc. v. Commissioner*, T.C. Memo. 2010-76.)

³ The tax required to be shown on appellant’s return is \$5,211.00, and 10 percent of that amount is \$521.10. Thus, a substantial understatement for purposes of the accuracy-related penalty is an understatement greater than \$5,000.00.

Appellant’s protest letter to FTB states that appellant was making all the mortgage payments and is on the title to the property, and requests that FTB “abate the negligence penalty and interest” and grant a “one time exception.” Although appellant provided the First American Property Profile that lists her as the owner of the property, she has not provided any evidence that she was the person who made the mortgage payments; appellant also did not respond to the Office of Tax Appeals’ request for additional briefing or evidence on this topic. Given these circumstances, it is unclear whether appellant had reasonable cause to claim the mortgage interest deduction. Moreover, appellant provided no explanation regarding the failure to report taxable pension income. Accordingly, appellant has not established that she is entitled to abatement of the accuracy-related penalty.

Issue 3: Whether appellant has shown that interest should be abated.

With respect to interest, its imposition is mandatory and accrues regardless of the reason for the deficiency. (R&TC, § 19101(a); *Appeal of Balch*, 2018-OTA-159P.) Imposition of interest is not a penalty, but is compensation for appellant’s use of money after it should have been paid to the state. (*Appeal of Moy*, 2019-OTA-057P.) There is no reasonable cause exception to imposition of interest. (*Appeal of Moy, supra.*) Thus, to obtain interest relief, appellant must qualify under one of the waiver provisions: R&TC section 19104 (pertaining to unreasonable error or delay by FTB in the performance of a ministerial or managerial act); or section 21012 (pertaining to reasonable reliance on written advice of FTB). Appellant does not allege, and the record does not reflect, that any of these waiver provisions are applicable here. Accordingly, there is no basis for relieving interest.

HOLDINGS

1. Appellant has not demonstrated error with the proposed assessment of additional tax, which was based upon federal adjustments.
2. The accuracy-related penalty is not abated.
3. Interest is not abated.

DISPOSITION

FTB’s action is sustained.

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Suzanne B. Brown
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Suzanne B. Brown
 Administrative Law Judge

We concur:

DocuSigned by:

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Richard Tay
 Administrative Law Judge

DocuSigned by:
Kenneth Gast
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Kenneth Gast
 Administrative Law Judge

Date Issued: 12/21/2022