

**OFFICE OF TAX APPEALS**  
**STATE OF CALIFORNIA**

In the Matter of the Appeal of: )  
S. MIZRAHIE ) OTA Case No. 18010782  
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**OPINION**

Representing the Parties:

For Appellant: S. Mizrahie

For Respondent: Mira V. Coutinho, Tax Counsel

S. RIDENOUR, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, S. Mizrahie (appellant) appeals an action by respondent Franchise Tax Board (FTB) proposing additional tax of \$6,079.00, an accuracy-related penalty of \$1,215.80, and applicable interest for the 2011 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 demonstrated error in FTB’s proposed assessment for the 2011 tax year, which is based on a federal determination.
2. Whether appellant has demonstrated that the accuracy-related penalty should be abated.

**FACTUAL FINDINGS**

1. Appellant timely filed his 2011 California tax return, claiming married/RDP filing separately, and reporting total tax of \$32,583.
2. Subsequently, FTB received information that the IRS audited appellant’s 2011 federal tax return and made adjustments, including disallowing the entire claimed mortgage interest deduction of \$65,362.00. The federal adjustments resulted in the IRS assessing

- additional tax of \$18,302.00 and imposing a 20 percent accuracy-related penalty of \$3,660.40. Appellant did not notify FTB of the federal adjustments.
3. Based on the information provided by the IRS, FTB made corresponding adjustments to appellant's 2011 California tax return. FTB disallowed appellant's claimed mortgage interest deduction of \$65,362.00 and issued appellant a Notice of Proposed Assessment (NPA) dated February 1, 2016. The NPA proposed additional tax of \$6,079.00 and a 20 percent accuracy-related penalty of \$1,215.80, plus interest.
  4. On May 25, 2016, appellant protested the NPA, contending that the IRS improperly disallowed the deduction and he was taking the matter to U.S. Tax Court. Appellant requested that FTB suspend its action until the federal determination was final.
  5. In response, FTB sent appellant a letter indicating that since its proposed assessment is based on a federal determination, for FTB to place appellant's case in a pending status, appellant would need to provide FTB with documentation evidencing that the federal determination was in dispute and not yet final. FTB stated that if it did not receive a response by November 21, 2016, FTB would assume the original federal adjustments were correct and affirm the NPA.
  6. When FTB did not receive the requested information, it issued appellant a Notice of Action, dated April 25, 2017, affirming the NPA.
  7. Appellant timely appealed by letter dated May 25, 2017.
  8. On appeal, FTB received appellant's 2011 federal Individual Master File (IMF) transcript indicating that in March 2018, the IRS subsequently allowed a home mortgage interest deduction of \$31,843.00 and recalculated appellant's federal tax liability. The IRS reduced the additional tax assessed from \$18,302.00 to \$9,386.00, and reduced the accuracy-related penalty from \$3,660.40 to \$1,877.20. According to appellant's 2011 IMF transcript, the IRS assessed the penalty based on both substantial understatement of income tax and negligence.
  9. Based on the federal adjustment, FTB agreed to allow appellant a home mortgage interest deduction of \$31,843.00, revise the proposed assessed additional tax from \$6,079.00 to \$3,117.00, and reduce the accuracy-related penalty from \$1,215.80 to \$623.40, plus interest. FTB indicates that it is imposing the revised accuracy-related penalty of \$623.40 based on negligence.

## DISCUSSION

### Issue 1: Whether appellant has demonstrated error in FTB’s proposed assessment for the 2011 tax year, which is based on a federal determination.

A taxpayer shall either concede the accuracy of a federal determination or state how it is erroneous. (R&TC, § 18622(a).) If the IRS makes a change or correction to “any item required to be shown on a federal tax return, including any gross income, deduction, penalty, credit, or tax for any year,” the taxpayer must report the federal change to FTB within six months after the date it becomes final. (R&TC, § 18622(a).) A deficiency assessment based on a federal audit report is presumptively correct, and the taxpayer bears the burden of proving that the determination is erroneous. (*Appeal of Gorin*, 2020-OTA-018P.) Unsupported assertions are insufficient to satisfy a taxpayer’s burden of proof with respect to an assessment based on a federal action. (*Ibid.*) In the absence of credible, competent, and relevant evidence showing that FTB’s determination is incorrect, such determination must be upheld. (*Appeal of Bindley*, 2019-OTA-179P.)

Income tax deductions are a matter of legislative grace, and the taxpayer bears the burden of establishing entitlement to the deductions claimed. (*Appeal of Vardell*, 2020-OTA-190P, citing *New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435, 440.) To meet this burden, a taxpayer must point to an applicable statute authorizing the deduction and show by credible evidence that the deduction claimed falls within the scope of the statute. (*Appeal of Jindal*, 2019-OTA-372P; *Appeal of Dandridge*, 2019-OTA-458P.)

For the 2011 tax year, appellant claimed a mortgage interest deduction of \$65,362. While the entire amount was originally disallowed, the IRS, and subsequently FTB, allowed a home mortgage interest deduction of \$31,843 and continued to disallow \$33,519. In order to prevail in this appeal, appellant must show that either the IRS further reduced appellant’s disallowed claimed mortgage interest deduction, or, regardless of the federal action, appellant is entitled to a further reduction of the disallowed amount.

Appellant provides no substantive arguments contending that FTB’s revised proposed assessment is in error. Rather, appellant contends in his appeal letter, received May 25, 2017, that he is appealing the federal assessment. While the IRS and FTB subsequently reduced the disallowed amount, appellant has proffered no evidence or argument in response to the adjustment establishing that he is entitled to a further reduction of the disallowed amount. The

IMF does not show that the reduced federal determination was subsequently cancelled or revised, and appellant has not provided any evidence to show that the IRS is further examining his 2011 tax return and that the federal determination is not final. Thus, appellant has not met his burden of proving error in FTB’s proposed assessment for 2011, or in the federal determination upon which FTB based its proposed assessment.

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

R&TC section 19164, which conforms to the provisions of Internal Revenue Code (IRC) section 6662, provides for an accuracy-related penalty of 20 percent of the applicable underpayment. As relevant here, the accuracy-related penalty applies to the portion of the underpayment attributable to (1): negligence or disregard of rules and regulations (negligence), or (2) any substantial understatement of income tax (substantial understatement).<sup>1</sup> (IRC, § 6662(b).)

After reducing the disallowed claimed mortgage interest amount, the IRS assessed additional tax of \$9,386.00, and imposed an accuracy-related penalty \$1,877.20. The IRS imposed the penalty on two grounds: substantial understatement and negligence.<sup>2</sup> In order for substantial understatement to apply for California purposes, the amount of income tax reported on a California return must exceed the greater of 10 percent of the tax required to be shown on the return or \$5,000.<sup>3</sup> (R&TC, § 19164; IRC, § 6662(b).) Here, after reducing the disallowed claimed mortgage interest amount, FTB assessed additional tax of \$3,117.00, which does not exceed either 10 percent of the \$35,700.00 (i.e., \$32,583.00 reported + \$3,117.00 assessed) in tax

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<sup>1</sup> “Negligence” is defined to include “any failure to make a reasonable attempt to comply” with the provisions of the code. (IRC, § 6662(c).) “Disregard” is defined to include “careless, reckless, or intentional disregard.” (*Ibid.*) “Substantial understatement of income tax” exists when the understatement for a taxable year exceeds the greater of either 10 percent of the tax required to be shown on the return or \$5,000. (IRC, § 6662(d)(1)(A).)

<sup>2</sup> Appellant’s 2011 IMF transcript has an entry for transaction code 240 (which relates to the assessment of an accuracy-related penalty) along with penalty reference number (PRN) 680. While PRNs 786 and 787 pertain to assessment of the penalty solely for negligence and substantial understatement, respectively, PRN 680 pertains to assessment of the penalty for *both* (substantial understatement *and* negligence as a secondary consideration). (See [https://www.irs.gov/irm/part20/irm\\_20-001-005#idm1401692946735520](https://www.irs.gov/irm/part20/irm_20-001-005#idm1401692946735520).)

<sup>3</sup> The “amount of the tax required to be shown on the return” is synonymous with “the amount of income tax imposed” as defined in Treasury Regulation section 1.6664-2(b). (Treas. Reg. § 1.6664-4(b)(3).) Treasury Regulation section 1.6664-2(b) essentially provides that this is the amount of tax imposed on the taxpayer, determined without regard to, among other items, credits relating to tax withheld on wages and payments of tax or estimated tax by the taxpayer.

required to be shown on the return (i.e., \$3,570.00), or \$5,000.00. Therefore, the amount of income tax appellant reported on his 2011 California tax return does not meet the substantial understatement threshold. However, FTB did not impose the revised accuracy-related penalty of \$623.40 based on substantial understatement; rather, FTB imposed the penalty based on negligence. When FTB imposes the penalty based on negligence, and the proposed assessment is not based on a federal determination that imposed the penalty based on negligence, FTB must demonstrate that the unreported tax was due to negligence. However, when the proposed assessment is based on a federal determination that imposed the penalty based on negligence, FTB's imposition of the penalty based on negligence is presumed correct. (See *Appeal of Abney* (82-SBE-104) 1982 WL 11781.) Here, the proposed assessment is based on a federal determination that imposed the accuracy-related penalty based on both substantial understatement and *negligence*. Accordingly, FTB's imposition of the penalty based on negligence is presumed correct, and OTA finds that FTB properly imposed the accuracy-related penalty.

The accuracy-related penalty may be reduced or abated to the extent a taxpayer shows that: (1) there is substantial authority for the taxpayer's reporting position, (2) the position was adequately disclosed in the tax return (or a statement attached to the return) and there is a reasonable basis for treatment of the item, or (3) the taxpayer acted in good faith and had reasonable cause for the understatement. (*Appeals of Lovinck Investments N.V., et al.*, 2021-OTA-294P.) Appellant has not asserted any facts or legal authority to establish any of the potentially applicable defenses, nor has he otherwise satisfied his burden of proving error in FTB's imposition of the accuracy-related penalty. Accordingly, appellant has failed to establish that the penalty should be abated.

HOLDINGS

1. Appellant has not demonstrated error in FTB’s proposed assessment for the 2011 tax year, which is based on a federal determination.
2. Appellant has not demonstrated that the accuracy-related penalty should be abated.

DISPOSITION

FTB’s action is modified, in accordance with FTB’s concession on appeal, to reduce the proposed additional tax to \$3,117.00 and reduce the 20 percent accuracy-related penalty to \$623.40. Otherwise, FTB’s action is sustained.

DocuSigned by:  
*Sheriene Anne Ridenour*  
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 Sheriene Anne Ridenour  
 Administrative Law Judge

We concur:

DocuSigned by:  
*Cheryl L. Akin*  
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 Cheryl L. Akin  
 Administrative Law Judge

DocuSigned by:  
*Michael F. Geary*  
1A9B52EF88AC7...  
 Michael F. Geary  
 Administrative Law Judge

Date Issued: 2/3/2023