

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 220911435
R. CO AND)
T. CO)
_____)

OPINION

Representing the Parties:

For Appellants: R. Co and T. Co
For Respondent: Eric A. Yadao, Tax Counsel IV

A. KLETTER, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, R. Co (appellant-husband) and T. Co (collectively, appellants) appeal actions by respondent Franchise Tax Board (FTB) proposing to assess an accuracy-related penalty (ARP) of \$1,678.60 for the 2017 tax year, and applicable interest for the 2016 and 2017 tax years.¹

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

ISSUES

1. Whether appellants are entitled to interest abatement.
2. Whether the ARP was properly imposed for the 2017 tax year.

¹ On appeal, appellants concede the tax assessments of \$4,681 and \$8,393 for the 2016 and 2017 tax years, respectively.

FACTUAL FINDINGS2016 Tax Year

1. Appellants timely filed their joint 2016 California Resident Income Tax Return (return).
2. FTB received information from the IRS in 2019 indicating that it had audited appellants' 2016 federal income tax return and increased appellants' federal income.² The IRS assessed additional federal tax based on the federal adjustments and imposed a federal ARP. Appellants did not report the federal changes to FTB.
3. To the extent allowable by California law, FTB made comparable adjustments to appellants' 2016 return and issued appellants a Notice of Proposed Assessment (NPA) on March 17, 2021, that proposed to assess additional tax, plus interest.^{3, 4}
4. FTB did not propose a California ARP for the 2016 tax year.

2017 Tax Year

5. Appellants timely filed their joint 2017 return.
6. FTB received information from the IRS in 2019 indicating that it had audited appellants' 2017 federal income tax return and increased appellants' federal income.⁵ The IRS assessed additional federal tax based on the federal adjustments and imposed a federal ARP. Appellants did not report the federal changes to FTB.
7. To the extent allowable by California law, FTB made comparable adjustments to appellants' 2017 return and issued appellants an NPA on March 17, 2021, that proposed to assess additional tax, plus interest.

² As the 2016 federal and California adjustments were conceded, they are not discussed in detail here, but included a reduction in appellants' reported wage income, inclusion in income of an early withdrawal from a pension (early withdrawal income), assessment of additional tax on the early withdrawal income, and a reduction in appellants' itemized deductions.

³ For the 2016 and 2017 tax years, R&TC section 17024.5(a)(1) provides that for Personal Income Tax Law purposes, California conforms to the Internal Revenue Code (IRC) as effective on January 1, 2015. Thus, references to the IRC are to the IRC as effective on January 1, 2015.

⁴ R&TC section 17085(c)(1) conforms to IRC section 72, which provides that if a taxpayer receives an early distribution from a qualified retirement plan, the early withdrawal income is subject to a 10 percent tax (early distribution tax), if, among other things, the taxpayer received the distribution before the age of 59½, but the R&TC modifies the early distribution tax to 2.5 percent of the early withdrawal income.

⁵ As the 2017 federal and California adjustments were conceded, they are not discussed in detail here, but included the addition of unreported interest income, inclusion in income of early withdrawal income, assessment of additional tax on the early withdrawal income, and a reduction in appellants' itemized deductions.

8. FTB also proposed a California ARP of \$1,678.60 for the 2017 tax year.
Protest and Appeal of the 2016 and 2017 Tax Years
9. Appellants protested both NPAs, claiming that the tax rate was excessive.
10. FTB affirmed the NPAs in position letters dated May 16, 2022, including an explanation of the IRS adjustments and the calculation of appellants' tax rate. FTB provided appellants an opportunity to provide new information supporting their position. When appellants failed to respond, FTB issued Notices of Action affirming the NPAs.
11. This timely appeal followed.

DISCUSSION

Issue 1: Whether appellants are entitled to interest abatement.

Imposing interest is mandatory, and respondent cannot abate interest except where authorized by law. (R&TC, § 19101; *Appeal of Balch*, 2018-OTA-159P.) Interest is not a penalty; it is compensation for the use of money. (*Ibid.*) There is no reasonable cause exception to the imposition of interest. (*Appeal of Gorin*, 2020-OTA-018P.) Generally, to obtain relief from interest, taxpayers must qualify under R&TC section 19104, 19112, or 21012.⁶ (*Appeal of Balch, supra.*) Pursuant to R&TC section 19104, FTB is authorized to abate or refund interest if there has been an unreasonable error or delay in the performance of a ministerial or managerial act by an employee of FTB.

Here, appellants contend that FTB unreasonably delayed to March 17, 2021, its issuance of the NPAs to appellants. However, R&TC section 19104(b)(1) requires that any error or delay occur *after* FTB contacts appellants in writing about the deficiency. The record indicates that FTB's first written contact to appellants for each tax year was each respective NPA, and appellants have not provided any evidence to the contrary. Thus, the interest leading up to the March 17, 2021 issuance of the NPAs is not subject to abatement. Further, R&TC section 19104(b)(1) requires that no significant aspect of the error or delay be attributable to the taxpayer. Here, appellants did not report the federal changes to FTB as R&TC section 18622 requires. FTB became aware of the federal changes only in 2019 when the IRS reported the changes to it, and FTB timely assessed tax based on the federal changes. Because a significant

⁶ Relief pursuant to R&TC section 21012 is not applicable here because FTB did not provide appellants with any written advice.

aspect of the delay was attributable to appellants, no abatement is warranted under R&TC section 19104.

Under R&TC section 19112, FTB may waive interest for any period for which FTB “determines that an individual or fiduciary demonstrates inability to pay that interest solely because of extreme financial hardship caused by significant disability or other catastrophic circumstance.” Appellants argue that appellant-husband was jobless in 2018 and 2019 and was adversely affected by the pandemic in 2020 in finding a job and is now in a “dire situation.” However, OTA does not have authority to review FTB’s interest determinations based on a claim of financial hardship. (*Appeal of Moy*, 2019-OTA-057P.)

Based on the evidence in the record, OTA concludes that none of the statutory provisions for abatement apply. Thus, appellants have not demonstrated any grounds for interest abatement.

Issue 2: Whether the ARP was properly imposed for the 2017 tax year.

R&TC section 19164, which incorporates the provisions of Internal Revenue Code (IRC) section 6662, provides for an ARP of 20 percent of the portion of an underpayment of the tax that was required to be shown on the taxpayer’s return. As relevant here, the penalty applies to the portion of the underpayment attributable to: (1) negligence or disregard of rules and regulations; or (2) any substantial understatement of income tax. (IRC, § 6662(b)(1), (2).) For individual taxpayers, 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)(A).)

There are various exceptions to the imposition of the ARP. The ARP shall be reduced by the portion of the understatement attributable to the tax treatment of any item if the relevant facts affecting the item’s tax treatment are adequately disclosed and there is a reasonable basis for the tax treatment of such item. (IRC, § 6662(d)(2)(B)(ii).) Additionally, the ARP will not be imposed to the extent that a taxpayer has shown that a portion of the underpayment was due to reasonable cause and the taxpayer acted in good faith with respect to that portion of the underpayment. (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.)

When respondent imposes a penalty, it is presumed to have been imposed correctly. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Xie*, 2018-OTA-076P.) However, a

taxpayer may rebut the presumption that a penalty was properly imposed by providing credible and competent evidence supporting abatement of the penalty for reasonable cause. (*Appeal of Xie, supra.*) Unsupported assertions are not sufficient to satisfy a taxpayer’s burden of proof. (*Appeal of Moren, 2019-OTA-176P.*) To establish reasonable cause, the taxpayer must show that an ordinarily intelligent and prudent businessperson would have acted similarly under the circumstances. (*Ibid.*)

The record supports that the ARP was properly imposed. The understated tax of \$8,393 for the 2017 tax year exceeds \$5,000, so it is a “substantial understatement of income tax” as that term is used in the law. (IRC, § 6662(b)(2).) The penalty appears to have been correctly calculated (i.e., \$1,678.60 is 20 percent of \$8,393.00).

Appellants argue they had reasonable cause for the understatement because there was a “technical glitch in data entry using TurboTax.” In the context of reasonable cause based on tax preparation software, the U.S. Tax Court has held that a taxpayer must provide evidence that demonstrates the tax preparation software had a programming flaw or instructional error to establish reasonable cause. (*Morales v. Commissioner, T.C. Memo. 2012-341; Appeal of Mauritzson, 2021-OTA-198P.*) That is because tax preparation software is only as good as the information one inputs into it. (*Appeal of Mauritzson, supra.*) In other words, appellants must show that the error was due to the tax preparation software and not appellants’ own error. (*Ibid.*)


Here, appellants have not provided neither evidence of what they input into the tax preparation software nor evidence regarding the technical glitch that they allege occurred. Appellants have the burden to provide credible and competent evidence; their unsupported assertion that there was a glitch that caused the substantial understatement of tax does not satisfy their burden of proof. (*Appeal of Xie, supra; Appeal of Moren, supra.*) Based on the foregoing, appellants have not met their burden of proof to show that they acted with ordinary business case and prudence and have not established reasonable cause for abatement of the ARP.

HOLDINGS

1. Appellants are not entitled to interest abatement.
2. The ARP was properly imposed for the 2017 tax year.

DISPOSITION

FTB's actions are sustained.

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Asaf Kletter
Administrative Law Judge

Date Issued: 2/9/2023