

**OFFICE OF TAX APPEALS
STATE OF CALIFORNIA**

In the Matter of the Appeal of:) OTA Case No. 220710722
A. MARTIN AND)
N. MARTIN)
_____)

OPINION

Representing the Parties:

For Appellants: Bryan Daugherty, CPA

For Respondent: Andrea Watkins, Legal Assistant

A. KLETTER, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, A. Martin and N. Martin (appellants) appeal an action by respondent Franchise Tax Board (FTB) proposing additional tax of \$1,267, and applicable interest, for the 2017 tax year.

Appellants elected to have this appeal determined pursuant to the procedures of the Small Case Program (SCP). 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.

ISSUE

Whether appellants have shown error in FTB’s proposed assessment of additional tax, which is based upon a final federal determination.

FACTUAL FINDINGS

1. Appellants timely filed their joint 2017 California Resident Income Tax Return (return).
2. FTB subsequently received information from the IRS indicating that the IRS had increased appellants’ federal income for the 2017 tax year based on \$14,434 in unreported income from two early withdrawals (early withdrawal income) of \$9,695 and

\$4,739 from A. Martin’s qualified retirement plans reported on federal Forms 1099-R.^{1, 2} The \$9,695 in early withdrawal income was reported as taxable but marked with an early distribution exception code. The \$4,379 in early withdrawal income was reported as a loan from appellant A. Martin’s retirement plan to her (transfer). The IRS assessed additional tax on the transfer (early distribution tax).³ The IRS income adjustments became a final federal determination.

3. FTB issued a Notice of Proposed Assessment (NPA) following the federal adjustment including appellants’ unreported early withdrawal income of \$14,434 and proposing additional tax.⁴ FTB also proposed an early distribution tax on the transfer.
4. Appellants protested the NPA, claiming that the sole pension or annuity income was a nontaxable rollover from another pension or annuity plan.
5. FTB acknowledged the protest and affirmed its position in a letter dated April 15, 2021. The April 15, 2021 letter explained that FTB’s adjustments were based on a final federal determination and requested a copy of appellants’ federal account transcript to show that the IRS income adjustments were reduced or cancelled.
6. Appellants did not respond, and FTB issued a Notice of Action affirming the NPA.
7. This timely appeal followed.
8. On appeal, following an SCP conference, OTA gave the parties 30 days to submit any additional evidence.⁵ Appellants did not submit any additional evidence in response.

¹ For the 2017 tax year, 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. IRC section 72(t)(1) defines a “qualified retirement plan” as one described in IRC sections 401, 403, and 408. (IRC, § 4974(c).) For loan distributions, IRC § 72(p)(4) defines a “qualified employer plan” more narrowly.

² Copies of the federal Forms 1099-R are not in the record.

³ IRC section 72(t)(1) 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, if, among other things, the taxpayer received the distribution before the age of 59½. (IRC, § 72(t)(2)(A)(i).) However, there are exceptions to the tax as marked by exception codes. (See, e.g., IRC, § 72(t)(2)(A)(v), (vii).) This tax is in addition to income tax otherwise assessed on the early withdrawal income. (IRC, § 72(p).) R&TC section 17085(c)(1), which conforms to IRC section 72, modifies the early distribution tax to 2.5 percent of the early withdrawal income.

⁴ FTB also allowed a \$193 withholding credit which is not at issue here.

⁵ FTB submitted a copy of appellants’ 2017 California wages and withholding details to support the withholding credit allowance.

DISCUSSION

R&TC section 18622(a) requires a taxpayer to concede the accuracy of federal changes to a taxpayer's income or state where the changes are erroneous. It is well settled that a deficiency assessment based on a federal adjustment to income is presumed to be correct and a taxpayer bears the burden of proving that FTB's determination is erroneous. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Valenti*, 2021-OTA-039P.) In the absence of credible, competent, and relevant evidence showing that FTB's determination is incorrect, it must be upheld. (*Appeal of Valenti, supra.*)

Gross income shall mean all income from whatever source derived, including interest, dividends, and annuity and pension income, unless the items of income are specifically excluded by law. (Internal Revenue Code (IRC), § 61(a); R&TC, § 17071; Treas. Reg. § 1.61-1(a).) Pursuant to R&TC section 17085(c)(1), which adopts IRC section 72, with modifications,⁶ if a taxpayer receives an early distribution from a qualified retirement plan, the early withdrawal income is subject to the early distribution tax. However, an exception may apply. Loans from qualified employer plans are permitted and not taxable distributions if they comply with the loan rules with respect to amount, duration, and repayment terms. (IRC, § 72(p)(2).) A qualifying loan is required be repaid within five years, except for home loans to a acquire a principal residence. (*Ibid.*) If a loan from a qualified employer plan fails to satisfy the rules and regulations, then it is deemed a taxable distribution. (IRC, § 72(p)(1).)

Appellants' 2017 IRS wage and income transcript, dated July 21, 2022, indicates that two taxable distributions of \$9,695 and \$4,739 were made from appellant A. Martin's qualified retirement plan to her. The \$9,695 early distribution was taxable but marked with an early distribution exception code. The \$4,739 transfer was reported as a loan. However, the record contains no evidence that the loan was repaid during the statutorily mandated period.

On appeal, appellants continue their protest on the grounds that their sole annuity and pension income for the 2017 tax year was a nontaxable rollover from another pension or annuity plan. However, this rollover is not in dispute.

On appeal, appellants provide an IRS tax return transcript dated November 9, 2021, which matches appellants' 2017 federal tax return filed with the IRS. However, the IRS tax

⁶ See footnote 3, *supra* [R&TC section 17085(c)(1) reduces the early distribution tax to 2.5 percent from the 10 percent rate imposed under the IRC].

return transcript reflects only the information shown on the original return. FTB submitted an IRS Wage and Income transcript dated November 21, 2022, which includes the unreported early withdrawal income as per the subsequent final federal determination.

On appeal, appellants requested another opportunity to respond because they never received the FTB's April 15, 2021 position letter.⁷ However, appellants did not respond to OTA's additional briefing request that they submit additional evidence supporting that the early withdrawal income was nontaxable. Thus, OTA cannot discern whether appellants complied with the rules under IRC section 72(p) such that the transfer should not be treated as a taxable distribution and should not be subject to the early distribution tax. Further, appellants provide no evidence to show that the IRS has cancelled or revised its assessment.

Therefore, appellants failed to show error in FTB's treatment of the early withdrawal income as taxable distributions, or in FTB's proposed assessment of additional tax.

HOLDING

Appellants have not shown error in FTB's proposed assessment of additional tax, which is based upon a final federal determination.

DISPOSITION

FTB's action is sustained.

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Asaf Kletter
Administrative Law Judge

Date Issued: 3/22/2023

⁷ OTA notes that appellants received the NPA and NOA that were sent to the same address, which appears to be appellants' last-known address. The "last-known address" shall be the address that appears on the taxpayer's last return filed with FTB, unless the taxpayer has provided to FTB clear and concise written or electronic notification of a different address, or FTB has an address that it has reason to believe is the most current address for the taxpayer. (R&TC, § 18416(c).) It is well-established that notices sent by FTB to a taxpayer's last-known address are sufficient, even if not received by the taxpayer. (R&TC, § 18416; *Appeal of Goodwin* (97-SBE-003) 1997 WL 258474.)