OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **A. BHATTAL AND** **B. BHATTAL**	OTA Case No. 21129313

OPINION

Representing the Parties:

For Appellants: Ryan Alexander, CPA

For Respondent: Brian Werking, Tax Counsel III

K. LONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, A. Bhattal and B. Bhattal (appellants) appeal an action by respondent Franchise Tax Board (FTB) proposing additional tax of $629,390, an accuracy-related penalty of $125,878, and applicable interest, for the 2016 tax year.

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

ISSUES

1. Whether appellants have established that the accuracy-related penalty should be abated.
2. Whether interest should be abated for the 2016 tax year.

FACTUAL FINDINGS

1. Appellants timely filed a joint California income tax return for 2016 reporting a tax liability of $25,193. After applying payments of $41,731, appellants claimed a refund of $3,022.[1]
2. Appellants owned 100 percent of Bakersfield Investments Land LLC (Bakersfield Investments). Bakersfield Investments filed a timely 2016 California income tax return

[1] Appellants requested that a portion of the overpaid tax be applied to their 2017 estimated tax payments.

reporting an Internal Revenue Code (IRC) section 1031 safe-harbor exchange of a "truck stop facility" (sold on March 30, 2016) for a "hotel" (received on September 21, 2016).

3. FTB audited Bakersfield Investments' return. During the audit, FTB found that Bakersfield Investments' claimed IRC section 1031 exchange was an attempted non safe-harbor reverse like-kind exchange. Based on this finding, FTB disallowed the claimed IRC section 1031 exchange. The gain from the disallowed IRC section 1031 exchange flowed through to appellants' taxable income.
4. On January 27, 2021, FTB issued a Notice of Proposed Assessment (NPA) to appellants as a result of the audit of Bakersfield Investments, as well as made adjustments to appellants' claimed capital losses and itemized deductions. FTB increased appellants' taxable income by $4,879,043, which resulted in additional proposed tax of $629,390.[2] FTB also imposed an accuracy-related penalty of $125,878. Appellants timely protested the NPA.
5. On December 10, 2021, FTB issued a Notice of Action affirming the NPA.
6. Appellants filed this timely appeal disputing the accuracy-related penalty and interest.

DISCUSSION

Issue 1: Whether appellants have established that the accuracy-related penalty should be abated.

California conforms to IRC section 6662, which imposes an accuracy-related penalty of 20 percent of the applicable underpayment. (R&TC, § 19164(a)(1)(A)-(B).) As relevant here, the penalty applies to the portion of the underpayment attributable to any "substantial understatement of income tax." (IRC, § 6662(b)(2).) For individuals, a substantial understatement of income tax is defined as an understatement that exceeds the greater of 10 percent of the tax required to be shown on the return for the taxable year, or $5,000. (IRC, § 6662(d)(1)(A)(i)-(ii).) An "understatement" is defined as the excess of the amount of tax required to be shown on the return for the tax year over the amount of the tax imposed which is shown on the return, reduced by any rebate. (IRC, § 6662(d)(2)(A)(i)-(ii).)

[2] Appellants do not dispute the increase to their taxable income or the proposed assessment of additional tax. The only issue in this case is whether the accuracy-related penalty should be abated.

The accuracy-related penalty based on a substantial understatement may be reduced or abated if the taxpayers can show: (1) there is substantial authority for their reporting position;[3] (2) their position was adequately disclosed in the tax return (or a statement attached to the return)[4] and there is a reasonable basis for treatment of the item; or (3) that they acted in good faith and had reasonable cause for the understatement.[5]

On appeal, there is no dispute that appellants failed to report $629,390 in tax, which exceeds 10 percent of the tax required to be shown on the return. Therefore, the Office of Tax Appeals (OTA) finds that the accuracy-related penalty was properly imposed based on appellants' substantial understatement. However, appellants assert that they are entitled to penalty abatement based on (1) adequate disclosure of the transaction, and (2) reliance on a tax professional.

The accuracy-related penalty shall be reduced by the portion of the understatement attributable to a tax treatment of any item if the relevant facts affecting the item's tax treatment are adequately disclosed and there is or was a reasonable basis for the tax treatment of such item. (IRC, § 6662(d)(2)(B)(ii); Treas. Reg. § 1.6662-3(c)(1).) Disclosure is adequate for purposes of the penalty for disregarding rules or regulations if made in accordance with the provisions of Treasury Regulation section 1.6662-4(f)(1), (3), (4) and (5), which permit disclosure on a properly completed and filed federal Form 8275 or 8275-R, or a qualified amended return as appropriate.[6] (Treasury Regulation § 1.6662-3(c)(2).) In addition, the statutory or regulatory

[3] Appellants have not made any argument that there was substantial authority for their reporting position. As such, whether there was substantial authority is not at issue and will not be discussed further.

[4] To qualify as an adequate disclosure, Treasury Regulations generally require that the taxpayer disclose the details of his or her position on either a Federal Form 8275, a Form8275-R, or a qualified amended return. (Treas. Reg. § 1.6662-4(f).)

[5] A determination of whether a taxpayer acted with reasonable cause and in good faith is made on a case-by-case basis and depends on the pertinent facts and circumstances, including the taxpayer's efforts to assess the proper tax liability, the taxpayer's knowledge and experience, and the extent to which the taxpayer relied on the advice of a tax professional. (Treas. Reg. § 1.6664-4(b)(1).)

[6] Federal Form 8275 is a disclosure statement that allows a taxpayer or tax return preparer to disclose items or positions, except those taken contrary to a Treasury Regulation, that are not otherwise adequately disclosed on a tax return to avoid certain penalties. (See *Instructions for Form 8275,* https://www.irs.gov/instructions/i8275.) federal Form 8275-R is used by taxpayers and tax return preparers to disclose positions taken on a tax return that are contrary to Treasury Regulations. (See *Instructions for Form 8275-R,* https://www.irs.gov/pub/irs-pdf/i8275r.pdf#:~:text=Form%208275-R%20is%20used%20by%20taxpayers%20and%20tax,understatements%20due%20to%20positions%20taken%20contrary%20to%20regulations.)

provision or ruling in question must be adequately identified on the form. (*Ibid.*) The disclosure exception does not apply, however, when the taxpayer's position does not have a reasonable basis or where the taxpayer fails to substantiate items properly. (Treas. Reg. § 1.6662-3(c)(1).)

Here, Bakersfield Investments reported the exchange on federal Form 8824, Like-Kind Exchanges, with the description "Truck Stop Facility" and "Hotel," as though the exchange was a standard IRC section 1031 exchange. However, given the facts surrounding the exchange, and that in actuality, it was an attempted non safe-harbor reverse like-kind exchange, the transactions should have been reported on federal Form 8275, 8275-R, or qualified amended return disclosing the relevant facts surrounding the exchange. Having failed to do so, OTA finds that appellants did not adequately disclose the relevant facts affecting their tax treatment of the property. (See *Little v. Commr.*, (9th. Cir. 1997) 106 F.3d 1445, 1452-1453.) Moreover, appellants did not provide any additional information from which a reasonable basis for their position could be identified. Indeed, appellants have not provided OTA with neither argument nor evidence that they have a reasonable basis for their position that a like-kind exchange was made.

With respect to appellants' alleged reliance on a tax professional, appellants have not provided any evidence (emails, letters, etc.) demonstrating the specific advice they allegedly received and when the specific advice was allegedly provided. Therefore, OTA cannot determine, among other things, if the advice was actually received, the content of the advice, and whether appellants reasonably relied on any such advice. In the absence of corroborating evidence, OTA finds that appellants' unsupported assertions are insufficient to meet their burden of proof. Therefore, OTA finds no basis to abate the accuracy-related penalty.

Issue 2: Whether interest should be abated for the 2016 tax year.

The imposition of interest is mandatory. (R&TC, § 19101(a); *Appeal of Moy*, 2019-OTA-057P.) Interest is charged from the due date of the tax payment to the date the tax is paid. (R&TC, §19101(a).) Interest is not a penalty but is compensation for the taxpayer's use of money after it should have been paid to the state. (*Appeal of Moy*, *supra.*) There is no reasonable cause exception to the imposition of interest and interest can only be waived in certain limited situations when authorized by law. (*Ibid*.)

To obtain relief from interest, a taxpayer must qualify under R&TC section 19104 (unreasonable error or delay), 19112 (extreme financial hardship), or 21012 (reasonable reliance on FTB's written advice). (*Appeal of Moy*, *supra.*) OTA has no jurisdiction to determine

whether appellant is entitled to the abatement of interest under R&TC section 19112. (*Ibid.*) The relief of interest under R&TC section 21012 is not relevant here, because FTB did not provide appellant with any written advice. Under R&TC section 19104(a)(1), FTB may abate all of a part of any interest on a deficiency to the extent that interest is attributable in whole or in part to any unreasonable error or delay committed by FTB in the performance of a ministerial or managerial act. (R&TC, § 19104(a)(1).) OTA has jurisdiction to determine whether FTB's denial of interest abatement under R&TC section 19104 was an abuse of discretion. (R&TC, § 19104(b)(2)(B); *Appeal of Moy*, *supra.*)

On appeal, appellants assert that interest should be abated. However, appellants have not provided any basis upon which interest relief may be granted. Instead, appellants present the same arguments made with respect to the accuracy related penalty. As noted above, there is no reasonable cause exception to the imposition of interest. (*Appeal of Moy*, *supra*.) Therefore, interest should not be abated.

HOLDINGS

1. Appellants have not established that the accuracy-related penalty should be abated.
2. Interest should not be abated for the 2016 tax year.

DISPOSITION

FTB's action is sustained.

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Keith T. Long
Administrative Law Judge

We concur:

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Amanda Vassigh
Administrative Law Judge

DocuSigned by:
Lauren Katagihara
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Lauren Katagihara
Administrative Law Judge

Date Issued: 4/11/2023