

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:

M. STEIN AND
G. STEIN

) OTA Case No. 22029636
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OPINION

Representing the Parties:

For Appellants:

M. Stein and G. Stein

For Respondent:

Andrea Watkins, Tax Counsel

A. KLETTER, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, M. Stein and G. Stein (appellants) appeal an action by respondent Franchise Tax Board (FTB) proposing additional tax of \$1,644, plus interest, for the 2017 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 shown error in FTB’s proposed assessment of additional tax, which is based upon a final federal determination.
2. Whether appellants are entitled to interest abatement.

FACTUAL FINDINGS

1. Appellants timely filed their joint 2017 California Resident Income Tax Return (return). Appellants reported \$292,137 in wages from two attached Forms W-2. FTB accepted appellants’ 2017 California return as filed.
2. FTB subsequently received information from the IRS indicating that it had audited and determined that appellants failed to include \$17,165 in wages from United Services

Automobile Association (USAA) reported on a third Form W-2 (USAA W-2).¹ The IRS further determined that appellant G. Stein failed to include her distributive share of partnership income reported on a limited liability company (LLC) Schedule K-1 (LLC Schedule K-1) as follows: \$505 in partnership real estate income and \$9 in interest income. The LLC Schedule K-1 also reported appellant G. Stein's \$1,349 share of the LLC's ordinary business loss (distributive share of loss).

3. The IRS increased appellants' federal adjusted gross income (AGI) by \$17,679 (\$17,165 wages + \$505 partnership real estate income + \$9 interest income). The IRS credited federal withholding reported on the USAA W-2. However, the IRS did not adjust appellants' federal AGI for appellant G. Stein's distributive share of loss.² On February 17, 2020, the IRS's determination became a final federal determination for the 2017 tax year.
4. FTB timely issued a Notice of Proposed Assessment (NPA) proposing to follow the IRS adjustments and increase appellants' California AGI by \$17,679 to reflect the unreported income.³ The NPA did not credit any state withholding for the USAA W-2, nor did it adjust appellants' state AGI for appellant G. Stein's distributive share of loss. The NPA proposed additional tax due of \$1,644, plus interest.
5. On April 16, 2021, appellants filed a protest. FTB acknowledged the protest and affirmed its position in letters dated November 18, 2021 and February 14, 2022. The November 18, 2021 letter explained that FTB's adjustment was based on the final federal determination and requested information showing that the IRS income adjustment was reduced or cancelled.
6. Appellants responded by letter dated December 23, 2021, and provided copies of the following: (1) a February 25, 2019 IRS notice (original IRS notice) proposing to increase appellants' federal AGI by \$77,679, comprised of the \$17,679 adjustment and a \$60,000

¹ A copy of the USAA W-2 is not in the record.

² The IRS income records record appellant G. Stein's distributive share of loss, but appellants' federal AGI is not reduced by the amount of the loss.

³ For personal income tax purposes, California generally conforms to Internal Revenue Code section 62, defining federal AGI, except as otherwise provided. (R&TC, § 17072(a).) A taxpayer must generally report the same federal AGI from the federal return on his or her California return, subject to California-specific addition and subtraction modifications. Appellants reported modifications to their income on Schedule CA of their 2017 California return, accounting for the difference between their federal AGI and state AGI.

adjustment attributable to nonemployee compensation paid by USAA (NEC income adjustment); (2) appellants' response, including two pages from a settlement agreement between USAA and appellant G. Stein (settlement agreement); and (3) a July 1, 2019 revised IRS Notice proposing to increase appellants' federal AGI by \$17,769 (i.e., excluding the NEC income adjustment). FTB subsequently issued a Notice of Action (NOA) affirming the NPA.⁴

7. Appellants timely appealed.
8. On appeal, the Office of Tax Appeals (OTA) requested information and documentation concerning: (1) appellant G. Stein's distributive share of loss; and (2) the state withholding, if any, reported on the USAA W-2. FTB provided an excerpted copy of appellant G. Stein's Federal Wage & Income Transcript, its California wages and withholding record for appellant G. Stein, and a November 10, 2022 letter from the Employment Development Department (EDD) confirming that no state wage withholding was reported to EDD.

DISCUSSION

Issue 1: Whether appellants have demonstrated error in FTB's proposed assessment of tax, which is based upon a final federal determination.

When the IRS makes a final federal determination, a taxpayer must concede the accuracy of the federal changes to a taxpayer's income or state where the changes are erroneous. (R&TC, § 18622(a).) 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-093P.) The applicable burden of proof standard is by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(c).) To meet this evidentiary standard, a party must establish by documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (*Concrete Pipe and Products of Cal., Inc. v. Construction Laborers Pension Trust for So. Cal.* (1993) 508 U.S. 602, 622.) In the absence of credible, competent, and relevant evidence showing that FTB's determination is incorrect, it must be upheld. (*Appeal of*

⁴ The NOA erroneously states that appellants did not respond to the November 18, 2021 letter. As noted above, FTB provided an additional response affirming the NOA on February 14, 2022.

Valenti, supra.) Taxpayers' failure to introduce evidence that is within their control gives rise to the presumption that the evidence, if provided, would be unfavorable to the taxpayers' position. (*Appeal of Bindley*, 2019-OTA-179P.)

Appellants contend that the IRS drastically revised its income adjustment on which FTB's proposed assessment is based. Appellants provide copies of the original IRS notice, their response, and the revised IRS notice, to show that the IRS significantly reduced its income adjustment. Appellants also allege that the IRS erred in ignoring appellant G. Stein's distributive share of loss.

FTB counters that appellants have not met their burden to show error in the final federal determination. FTB received information from the IRS that appellants' federal AGI was increased by \$17,679. On May 13, 2022, FTB obtained appellants' 2017 federal account transcript, which shows that appellants' federal AGI was the same increased amount reported to FTB by the IRS and was not adjusted or cancelled.

Concerning appellants' argument that the IRS drastically revised its income adjustment, appellants provide IRS notices that predate the final federal determination on February 17, 2020. Both IRS notices provided by appellants include the \$17,679 income adjustment; however, the revised IRS notice excludes the NEC income adjustment, which is not at issue. The final federal determination also excludes the NEC income adjustment and makes the \$17,679 income adjustment. Because both IRS notices predate the final federal determination, and show no reduction in the final income adjustment, the IRS notices are not credible or competent evidence that the final federal determination was modified or cancelled.

Appellants also argue that the IRS erroneously ignored appellant G. Stein's distributive share of loss. Appellants provided a copy of the LLC's partnership return, which includes the LLC Schedule K-1 reporting appellant G. Stein's \$1,349 distributive share of loss.⁵ The IRS did not adjust appellants' federal AGI for appellant G. Stein's distributive share of loss, but its records record her distributive share of loss in the same amount as reported on the LLC Schedule K-1. FTB bases its proposed assessment on the final federal determination and the 2017 federal account transcript showing appellants' federal AGI. Both documents record but fail to account for appellant G. Stein's distributive share of loss. Appellants have shown with credible evidence that appellant G. Stein's distributive share of loss was not reflected in the final federal

⁵ On appeal, appellants agreed with FTB that \$1,349 was appellant G. Stein's distributive share of loss.

determination, nor in appellants' revised federal AGI. Therefore, they have shown error in the federal determination. On appeal, FTB concedes that appellant G. Stein's distributive share of loss should be applied and revised the assessment to account for it.

OTA requested additional briefing from the parties concerning whether state withholding, if any, reported on the USAA W-2 should have been credited to appellants' state account. On appeal, appellants refer to one page of the settlement agreement, which provides in relevant part that USAA would pay appellant G. Stein \$15,000 for lost wages, "less applicable withholdings and deductions." However, the quoted terms are not defined on the two provided pages of the settlement agreement, and a full copy of the settlement agreement is not in the record. Further, appellants do not explain why the USAA W-2 wages are different than the amount set forth in the settlement agreement. Although the settlement agreement indicates that USAA and appellant G. Stein agreed to some withholdings and deductions, no information in the record indicates the amount withheld. OTA specifically asked for the USAA W-2, but appellants did not provide the requested copy of the USAA W-2 reporting state withholdings or any other evidence to establish the amount of state withholding. Taxpayers' failure to provide evidence within their control presumes that the evidence is unfavorable to the taxpayers' position. (*Appeal of Bindley, supra.*) OTA therefore presumes that the USAA W-2 is unfavorable to appellants' position.

On appeal, FTB provides a copy of its wages and withholding record for appellant G. Stein, which shows no record of wages or withholding reported by USAA to FTB. FTB also provided a letter from EDD confirming that no USAA state wages subject to withholding were reported for appellant G. Stein to EDD. OTA concludes based on the record that the preponderance of the evidence indicates that USAA made no state withholdings. Therefore, appellants have not met their burden to show that FTB erred in its determination that no state wage withholding should be credited for appellant G. Stein's USAA W-2 wages.

Issue 2: Whether appellants are entitled to interest abatement.

Imposing interest is mandatory, and FTB cannot abate interest except where authorized by law. (R&TC, § 19101(a); *Appeal of Balch*, 2018-OTA-159P.) Interest is not a penalty; it is compensation for the taxpayer's use of money, which should have been paid to the state. (*Appeal of Balch, supra.*) Interest accrues on a deficiency assessment regardless of the reason for the assessment. (*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 sections 19104 (pertaining to unreasonable error or delay by FTB in the performance of a ministerial or managerial act), 19112 (pertaining to extreme financial hardship caused by significant disability or other catastrophic circumstance), or 21012 (pertaining to reasonable reliance on FTB's written advice). (*Appeal of Balch, supra.*) The record does not reflect that section 19112 or 21012 are applicable to the facts of this case.

Here, appellants generally request interest relief. 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 FTB employee. However, R&TC section 19104(b)(1) requires that no significant aspect of the error or delay be attributable to the taxpayers involved. OTA reviews FTB's determination for abuse of discretion. (R&TC, § 19104(b)(2)(B).)⁶ Neither appellants nor FTB provide any facts or circumstances concerning whether R&TC section 19104 applies, such as the nature of any error or delay, whether any significant aspect of the alleged error or delay was attributable to appellants, whether FTB considered interest abatement, and if so, why FTB did not abate interest. Based on its review of the record, R&TC section 19104 is not applicable to the facts of this case. Therefore, FTB properly imposed interest and OTA has no basis to abate it.


⁶ To show an abuse of discretion, a taxpayer must establish that, in refusing to abate interest, FTB exercised its discretion arbitrarily, capriciously, or without sound basis in fact or law. (*Appeal of Gorin, supra.*)

HOLDINGS

1. Appellants have shown error in FTB’s proposed assessment of additional tax, which is based upon a final federal determination. As conceded on appeal, FTB’s proposed assessment is modified to account for appellant G. Stein’s distributive share of loss.
2. Appellants are not entitled to interest abatement.


DISPOSITION

FTB’s action is sustained, as modified, to account for appellant G. Stein’s distributive share of loss.

DocuSigned by:

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 Asaf Kletter
 Administrative Law Judge

We concur:

DocuSigned by:

 8A4294817A67463

 Andrew Wong
 Administrative Law Judge

DocuSigned by:

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 Huy “Mike” Le
 Administrative Law Judge

Date Issued: 4/10/2023