

**OFFICE OF TAX APPEALS
STATE OF CALIFORNIA**

In the Matter of the Appeal of:
E. HERNANDEZ

) OTA Case No. 21037391
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OPINION

Representing the Parties:

For Appellant: E. Hernandez

For Respondent: Topher Tuttle, Tax Counsel III

L. KATAGIHARA, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, E. Hernandez (appellant) appeals an action by respondent Franchise Tax Board (FTB) proposing additional tax of \$5,096.00, an accuracy-related penalty of \$1,019.20, and applicable interest for the 2014 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 established error in FTB’s proposed assessment of additional tax, which is based upon a final federal determination.
2. Whether appellant has established that the accuracy-related penalty should be abated.
3. Whether appellant has established a basis upon which interest can be abated.

FACTUAL FINDINGS

1. Appellant and his spouse timely filed a joint 2014 California income tax return, reporting zero tax.¹

¹ Appellant’s spouse is not a party to this appeal.

2. On December 24, 2018, the IRS notified appellant that it increased appellant's 2014 federal adjusted gross income (AGI) to account for \$103,678 of unreported income that passed through an S corporation to appellant.
3. The IRS informed FTB of its adjustments on February 15, 2019. Consequently, FTB made corresponding adjustments to appellant's California AGI and issued a Notice of Proposed Assessment (NPA) to appellant dated March 12, 2020, that proposed additional tax of \$5,096.00, and an accuracy-related penalty of \$1,019.20, plus applicable interest.
4. Appellant protested the NPA and requested additional time to review the IRS's assessment. On July 21, 2020, FTB granted appellant's request and placed appellant's case on hold for approximately five months, until December 31, 2020.
5. Appellant did not provide FTB written substantiation that the IRS reduced or canceled its assessment by December 31, 2020. Consequently, FTB issued a Notice of Action affirming the NPA on February 4, 2021.
6. This timely appeal followed.

DISCUSSION

Issue 1: Whether appellant has established error in FTB's proposed assessment of additional tax, which is based upon a final federal determination.

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. (*Appeal of Valenti*, 2021-OTA-093P.) In the absence of credible, competent, and relevant evidence showing that FTB's determination is incorrect, it must be upheld. (*Ibid.*)

Here, FTB received information from the IRS indicating that it revised appellant's federal AGI for the 2014 tax year to include unreported income that passed through an S corporation to appellant. FTB followed the IRS's adjustments and made conforming changes to appellant's California AGI. These changes resulted in FTB's proposed deficiency assessment against appellant. Therefore, FTB's proposed assessment is based on a federal adjustment and is presumed to be correct. (*Appeal of Valenti, supra.*) Consequently, the burden is upon appellant to prove that FTB's proposed assessment is erroneous. (*Ibid.*)

On appeal, appellant asserts that he believes that his former CPA made an error on appellant's 2014 tax returns.² Appellant also indicates that due to various medical issues and financial obligations, he has been unable to resolve the errors. In support of his contention, appellant provided a document indicating that he underwent surgery sometime prior to July 2, 2019, and intended to have another surgery sometime after July 2, 2019. However, the document neither specifies the dates of the surgeries nor confirms that the second surgery indeed occurred. Moreover, appellant has not provided evidence that these surgeries or his other medical or financial issues rendered him incapable of addressing the alleged errors during the entire duration of December 24, 2018 (when the IRS notified appellant of its adjustment), to the present. Appellant has had since the end of 2018 or early 2019 to remedy the alleged errors in his 2014 tax returns or to substantively address the IRS's adjustments and/or FTB's proposed assessment but has not done so. As such, appellant has not established that the IRS's adjustments were incorrect, or that FTB erred in following those adjustments.

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

Except as otherwise provided, California incorporates Internal Revenue Code (IRC) sections 6662 and 6664, relating to the imposition of accuracy-related penalties on underpayments. (R&TC, § 19164(a)(1)(A) & (d)(1); *Appeal of Silver*, 2022-OTA-408P.) As relevant here, the accuracy-related penalty applies to the portion of the underpayment of tax attributable to any substantial understatement of income tax. (IRC, § 6662(b)(2).) An "understatement" of tax is defined as the excess of the amount of tax required to be shown on the tax return for the taxable year, less the amount of tax imposed which is shown on the return, reduced by any rebate. (IRC, § 6662(d)(2)(A)(i)-(ii).) For individual taxpayers, an "understatement" constitutes a "substantial understatement" if the amount of the understatement exceeds the greater of \$5,000 or 10 percent of the tax required to be shown on the return. (IRC, § 6662(d)(1)(A)(i)-(ii).)

In determining whether there is a substantial understatement, the taxpayer may reduce that portion of the understatement attributable to: (1) the tax treatment of any item for which there is or was substantial authority for such treatment; or (2) any item for which the relevant facts affecting the item's tax treatment were adequately disclosed in the tax return (or in a

² Appellant has not specified whether the alleged error was on his federal or California tax return, or both.

statement attached to the return), and for which there is a reasonable basis for the tax treatment of such item. (IRC, § 6662(d)(2)(B)(i)-(ii).) In addition, “[n]o penalty shall be imposed under [IRC] section 6662 . . . with respect to any portion of an underpayment if it is shown that there was a reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion.” (IRC, § 6664(c)(1); R&TC, § 19164(d)(1).)

Here, the accuracy-related penalty was properly imposed for the 2014 tax year because the additional tax proposed (i.e., \$5,096) exceeded \$5,000, which is greater than 10 percent of the tax required to be shown on the return (i.e., \$509.60), resulting in a substantial understatement of tax under IRC section 6662(d)(1)(A).³ Appellant has not provided any basis to reduce any portion of the understatement. Specifically, appellant has neither argued nor provided any evidence showing that: (1) appellant had substantial authority for not reporting the pass-through income; (2) appellant adequately disclosed in his tax return the relevant facts affecting the tax treatment of the pass-through income; or (3) reasonable cause exists for abating the accuracy-related penalty. As such, appellant has not established that he is entitled to an abatement of the accuracy-related penalty.

Issue 3: Whether appellant has established a basis upon which interest can be abated.

Imposing interest on a tax deficiency is mandatory. (R&TC, § 19101(a).) Interest is also charged on penalties. (R&TC, § 19101(c)(2).) Interest is not a penalty but is compensation for the taxpayer’s use of money after it should have been paid to the state, and it can only be abated in certain limited situations when authorized by law. (*Appeal of Moy*, 2019-OTA-057P.) There is no reasonable cause exception to the imposition of interest. (*Ibid.*)

To obtain interest abatement, appellant must qualify under either R&TC section 19104 or R&TC section 21012.⁴ First, R&TC section 19104 does not apply here because appellant does not allege, and the evidence does not show, that the interest at issue is attributable, in whole or in part, to any unreasonable error or delay by an officer or employee of FTB when performing a ministerial or managerial act. Second, R&TC section 21012 does not apply because appellant does not allege, and the evidence does not show, FTB provided appellant with any requested

³ Appellant was required to show \$5,096 of tax on his 2014 tax return, but he reported zero tax.

⁴ Pursuant to R&TC section 19112, FTB also has discretion to waive interest, but the Office of Tax Appeals does not have jurisdiction to review FTB’s exercise of such discretion. (See *Appeal of Moy*, *supra*.)

written advice. Accordingly, appellant has not established that he is entitled to interest abatement.

HOLDINGS

1. Appellant has not established error in FTB’s proposed assessment of additional tax, which is based upon a final federal determination.
2. Appellant has not established that the accuracy-related penalty should be abated.
3. Appellant has not established a basis upon which interest can be abated.

DISPOSITION


FTB’s action is sustained.

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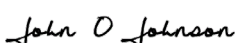
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 Lauren Katagihara
 Administrative Law Judge

We concur:

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 Suzanne B. Brown
 Administrative Law Judge

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 John O. Johnson
 Administrative Law Judge

Date Issued: 5/18/2023