OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **N. SILVER**	) OTA Case No. 20116895)))))

OPINION

Representing the Parties:

For Appellant: N. Silver

For Respondent: Brian Werking, Tax Counsel III

For Office of Tax Appeals: Tom Hudson, Tax Counsel III

T. LEUNG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, N. Silver (appellant) appeals an action by Franchise Tax Board (respondent) proposing to assess additional tax of $10,121.00, an accuracy-related penalty (ARP) of $2,024.20, and applicable interest for the 2015 taxable year.

Appellant waived his right to an oral hearing; thus, this matter will be decided based on the written record.

ISSUES

1. Whether appellant has shown any error in respondent's proposed assessment of additional tax for 2015, which was based on IRS audit adjustments.
2. Whether appellant has shown reasonable cause for the waiver of the ARP.

FACTUAL FINDINGS

1. Appellant's 2015 federal income tax return (Form 1040) was audited by the IRS and, as a result, appellant's federal taxable income was increased by $130,823 (mostly due to disallowed deductions), additional federal tax was assessed, and a federal ARP was imposed. Appellant did not report these federal changes to respondent. A stipulated

decision from the U.S. Tax Court indicates that appellant agreed to the additional federal tax of $45,850 and the federal ARP of $9,170.

2. Appellant's IRS Account Transcript, dated April 27, 2022, reflects the final federal assessment of the additional federal tax and the federal ARP. There is no indication that the IRS cancelled or reduced this assessment.
3. To the extent allowable by California law, respondent made comparable adjustments to appellant's 2015 California personal income tax return (Form 540) and issued a Notice of Proposed Assessment (NPA) that increased appellant's taxable income from $6,992.00 to $137,131.00, proposed additional tax of $10,121.00, and imposed the California ARP of $2,024.20.
4. Appellant protested, claiming that the IRS was reviewing the 2015 assessment without providing evidence thereof.[1]
5. Respondent affirmed the NPA with a Notice of Action that explained that appellant did not provide information regarding a pending IRS review of the federal determination for 2015.

DISCUSSION

Issue 1: Whether appellant has shown any error in the proposed assessment of additional tax for 2015, which was based on IRS audit adjustments.

When the IRS makes changes to a taxpayer's Form 1040, the taxpayer must report those changes to respondent and concede the accuracy of the federal changes or state why the changes are erroneous. (R&TC, § 18622(a).) A deficiency assessment based on a federal audit report is presumptively correct and a taxpayer bears the burden of proving that the determination is erroneous. (*Appeal of Gorin*, 2020-OTA-018P.) Unsupported assertions by taxpayers are insufficient to satisfy their burden of proof with respect to a proposed assessment based on a federal action. (*Ibid*.)

Here, respondent issued its NPA based on a final IRS determination and, thus, respondent's proposed assessment is presumptively correct. (*Appeal of Gorin*, *supra*.)

[1] Appellant submitted to respondent IRS Form 4549 (Report of Income Tax Examination Changes) for the 2017 taxable year. That federal audit report is not discussed in this Opinion because the 2017 taxable year is not included in this appeal and there is no obvious relevance to the 2015 taxable year. Furthermore, appellant has not argued that there is some connection between the two separate federal audits.

Appellant does not argue, and the evidence does not suggest, that respondent erred in its adjustments to appellant's 2015 Form 540. Instead, appellant explains that he was disputing the figures provided by the IRS, and that the IRS was reviewing the calculations.

However, appellant has not demonstrated error in the IRS audit adjustments. Therefore, appellant has not shown that respondent's NPA is incorrect. Appellant has not even explained the nature of his disagreement with the IRS or why he might be entitled to the disallowed deductions. There is no documentation or evidence concerning the deductions that were disallowed by the IRS. Hence, there is no evidentiary basis that would allow this panel to overturn respondent's NPA.[2]

Issue 2: Whether appellant has shown reasonable cause for the waiver of the ARP.

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.)

[2] Appellant submitted a Client Services Agreement with Optima Tax Relief, LLC, dated June 24, 2020. Appellant stated that they are representing him with the IRS concerning "the re-calculations of the 2015 tax year." The 12-page Client Services Agreement makes no reference to the 2015 taxable year or any other taxable year.

In this appeal, appellant has not mentioned the ARP and has not argued that the penalty should be waived. The understated tax of $10,121 exceeds both $5,000 and 10 percent of the tax required to be shown on the return, so it is a "substantial understatement of income tax" as that term is used in the law. (IRC, § 6662(b)(2).) The record does not reflect any potential grounds for removing the ARP and it appears that the penalty was correctly calculated (i.e., $2,024.20 is 20 percent of $10,121.00). Therefore, the penalty cannot be waived.

HOLDINGS

1. Appellant has not shown any error in respondent's proposed assessment of additional tax for 2015, which was based on IRS audit adjustments.
2. Appellant has not shown reasonable cause for waiver of the ARP.

DISPOSITION

Respondent's action is sustained.

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Tommy Leung
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Tommy Leung
Administrative Law Judge

We concur:

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Asaf Kletter
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Asaf Kletter
Administrative Law Judge

DocuSigned by:
3CADA62FB4864CB...
Andrew J. Kwee
Administrative Law Judge

Date Issued: 6/12/2023