

**OFFICE OF TAX APPEALS**  
**STATE OF CALIFORNIA**

In the Matter of the Appeal of:  
**E. YAN**

) OTA Case No. 22029730  
)  
)  
)  
)  
)

**OPINION**

Representing the Parties:

For Appellant: E. Yan

For Respondent: Maria Brosterhous, Tax Counsel IV

For Office of Tax Appeals: Michelle Huh, Tax Counsel

K. LONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, E. Yan (appellant) appeals an action by respondent Franchise Tax Board (FTB) proposing additional tax of \$1,374 and applicable interest for the 2016 tax year.

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

**ISSUE**

Whether appellant has shown error in FTB’s proposed assessment, which is based on a federal determination.

**FACTUAL FINDINGS**

1. During 2016, appellant received wage income from his solely owned S-corporation.
2. On August 17, 2017, appellant recharacterized a \$5,800 distribution taken in 2016 from a traditional individual retirement account (IRA) as a Roth IRA contribution.
3. Appellant timely filed a 2016 California Resident Income Tax Return (Form 540) within the extension period. After applying California income tax withholdings of \$6,860 and estimated tax payments of \$24,695, appellant claimed a refund of \$7,931, which FTB issued on October 5, 2017.

4. Subsequently, FTB received information that the IRS audited appellant's 2016 federal return and increased appellant's reported federal adjusted gross income (AGI) by \$13,340, to include unreported wage income of \$7,540 and unreported pension/annuity income of \$5,800.
5. Based on the information provided by the IRS, FTB made corresponding adjustments to appellant's 2016 California return. On August 19, 2020, FTB issued a Notice of Proposed Assessment (NPA), which increased appellant's taxable income by \$13,340, and proposed additional tax of \$1,374, plus applicable interest.
6. Appellant timely protested the NPA.
7. On June 29, 2021, FTB sent appellant a letter, requesting information that showed the IRS revised or cancelled the federal assessment.
8. Appellant provided FTB with correspondence from the IRS, which stated that the IRS would contact appellant within 60 days. Appellant requested that FTB place a hold on his account while the federal case was under review. Appellant stated that he would inform FTB once a federal determination was made.
9. On December 1, 2021, FTB requested additional documentation that appellant's case was still pending with the IRS or that the IRS changed its assessment. Appellant did not respond and on January 13, 2022, FTB issued a Notice of Action affirming the NPA.
10. This timely appeal followed.
11. On appeal, FTB concedes that appellant's distribution from a traditional IRA was timely recharacterized as a Roth IRA contribution and properly excluded from appellant's taxable income for 2016. As a result, FTB has agreed to revise the proposed additional tax from \$1,374 to \$777. Therefore, the only remaining issue in this appeal is the unreported taxable wages of \$7,540.

#### DISCUSSION

R&TC section 18622(a) requires a taxpayer to concede the accuracy of a final federal determination to a taxpayer's income or state where the final federal determination is erroneous. It is well settled that a proposed assessment based on a final federal determination is presumed to be correct, and a taxpayer bears the burden of proving that FTB's proposed assessment is erroneous. (*Appeal of Valenti*, 2021-OTA-093P.) In the absence of credible, competent, and relevant evidence showing FTB's determination is incorrect, it must be upheld. (*Appeal of*

*Black*, 2023-OTA-023P.) Unsupported assertions are not sufficient to satisfy appellant's burden of proof. (*Appeal of Gorin*, 2020-OTA-018P.)

Although FTB may base its proposed assessment on a final federal determination to the extent applicable under California law, it is not bound to do so and can conduct an independent investigation. (See Cal. Code Regs., tit. 18, § 19059(d); see also *Appeal of Der Wienerschnitzel International, Inc.* (79-SBE-063) 1979 WL 4104.) Likewise, appellant can establish FTB's proposed assessment based on a final federal determination is incorrect. (*Appeal of Black*, *supra*.)

Here, FTB received information from the IRS that appellant's federal AGI was increased to include unreported wage income of \$7,540. Based on this final federal determination, FTB proposed to assess additional tax, plus interest. Because there is no evidence to indicate that the final federal determination was adjusted or cancelled, FTB's corresponding adjustments are presumed correct. To meet his burden, appellant must prove that FTB's proposed assessment is erroneous.

On appeal, appellant contends that the proposed assessment is incorrect. Appellant asserts that the IRS is still reviewing his 2016 federal return. Appellant concedes that he should have reported additional wages on his federal return, consisting of a health savings account (HSA) contribution of \$3,350 and health insurance premiums of \$4,190. However, appellant argues that if these items were included on his federal return, then the health insurance premiums would be deductible. Appellant argues that if he had reported these in his wages and made the proper deduction, then the federal AGI would be unchanged from the amounts reported on appellant's 2016 federal and California returns.

#### Health Insurance Premiums

Internal Revenue Code (IRC) section 162(l)(1) and (5) provides that a self-employed individual or an individual shareholder of an S-corporation who owns more than two percent of its outstanding stock (also known as a two percent shareholder) may deduct health insurance premiums as ordinary and necessary expenses paid or incurred during a taxable year while carrying on a trade or business. California generally conforms to IRC section 162. (See R&TC, § 17201(a).)

Income tax deductions are a matter of legislative grace, and a taxpayer has the burden of proving that he or she is entitled to that deduction. (*Appeal of Silver*, 2022-OTA-408P.) To

support a deduction, the taxpayer must establish by credible evidence, other than mere assertions, that the deduction claimed falls within the scope of a statute authorizing the deduction. (*Appeal of Dandridge*, 2019-OTA-458P.)

Here, appellant has not provided any evidence that he paid health insurance premiums during the 2016 tax year and as a result has not shown that he is entitled to a deduction for health insurance premiums paid during the 2016 tax year. Thus, appellant does not satisfy his burden of proving that he is entitled to claim a health insurance deduction as a shareholder of his S-corporation for the 2016 tax year.

### HSA Contribution

HSA contributions made by an S-corporation for a two percent shareholder-employee in consideration for services rendered are treated as guaranteed payments under IRC section 707(c) and the HSA contributions are deductible by the S-corporation under IRC section 162, but the HSA contributions are included in the two percent shareholder-employee's gross income.<sup>1</sup> (IRS Notice 2005-8, Q&A 3, 2005-4 I.R.B. 368.) In addition, the two percent shareholder-employee is not entitled to exclude the contributions from gross income under IRC section 106(d). (*Ibid.*)

Alternatively, if the two percent shareholder-employee is an eligible individual under IRC section 223(c)(1),<sup>2</sup> the two percent shareholder-employee is entitled to deduct the amount of the contributions made to the two percent shareholder-employee's HSA during the tax year as an adjustment to gross income on his or her federal income tax return. (*Ibid.*; see also IRC, § 223(a).) However, California does not conform to IRC section 223, which means that HSA contributions must be included in a taxpayer's California taxable income. (R&TC, § 17215.4.)

Because California does not allow a taxpayer to deduct HSA contributions from taxable income, FTB properly adjusted appellant's taxable income to include the claimed HSA contribution of \$3,350. FTB's determination to include a claimed HSA contribution in

---

<sup>1</sup> Under IRC section 1372, for purposes of applying the provisions of Subtitle A that relate to fringe benefits, an S corporation is treated as a partnership, and any 2-percent shareholder of the S corporation is treated as a partner of such partnership. (See IRS Notice 2005-08.)

<sup>2</sup> Under IRC section 223(c)(1), an eligible individual is any individual covered under a high deductible health plan as of the first day of any month and is not, while covered under a high deductible health plan, covered under any health plan which is not a high deductible health plan and which provides coverage for any benefit which is covered under the high deductible health plan.

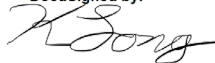
appellant’s taxable income is independent of any federal determination because California does not conform to federal law in regard to the deductibility of HSA contributions.

HOLDING

Appellant has not shown error in FTB’s revised proposed assessment of additional tax of \$777 related to appellant’s taxable wage income of \$7,540.

DISPOSITION


Consistent with its concession on appeal, FTB’s action is modified to reduce the proposed additional tax to \$777, plus applicable interest. FTB’s action in proposing additional tax related to appellant’s taxable wage income, plus associated interest, is otherwise sustained.

DocuSigned by:  
  
DC88A60D8C3E442...

---

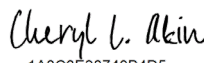
Keith T. Long  
Administrative Law Judge

We concur:

DocuSigned by:  
  
88F35E2A835348D...

---

Ovsep Akopchikyan  
Administrative Law Judge

DocuSigned by:  
  
1A8C8E38740B4D5...

---

Cheryl L. Akin  
Administrative Law Judge

Date Issued: 7/6/2023