OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	OTA Case No. 18011164[1]
W. FOOTE AND	
E. FOOTE	

OPINION

Representing the Parties:

For Appellants: W. Foote

For Respondent: Natasha S. Page, Attorney

For the Office of Tax Appeals: Andrew Jacobson, Attorney

H. LE, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, W. Foote and E. Foote (appellants) appeal an action by the Franchise Tax Board (respondent) proposing an assessment of additional tax of $39,052.00, and an amnesty penalty of $31,261.19 for the 1993 tax year, and an assessment of additional tax of $29,226.00, and an amnesty penalty of $20,467.57 for the 1994 tax year. Appellants also appeal respondent's actions denying their request for abatement of interest for the 1992, 1993, and 1994 tax years. [2]

[1] The Board of Equalization (BOE) accepted this appeal on May 1, 2015. On July 20, 2015, the BOE deferred the appeal at the request of respondent, pending the outcome of appellants' appeal to the United States Court of Appeals for the Ninth Circuit (Ninth Circuit) from the decision of the United States Tax Court concerning the imposition of interest by the IRS for the 1992, 1993, and 1994 tax years. When the deferral period expired and no party requested an extension, the BOE returned the matter to active proceedings on February 10, 2016. On August 8, 2016, at the request of appellants, the BOE again deferred appellants' appeal pending the outcome of appellants' appeal to the Ninth Circuit. When the second deferral period expired and no party requested an extension, BOE returned the case to active status on September 15, 2017. On January 1, 2018, the Office of Tax Appeals (OTA) acquired jurisdiction over all unresolved franchise and income tax appeals filed with the BOE. (See Gov. Code, §§ 15671, 15672, 15674 & 15676–15679.5.)

[2] The appeal of the proposed assessment for 1993 and 1994 was consolidated with the appeal of respondent's denial of appellants' request for interest abatement for 1992, 1993, and 1994. Although appellants initially appealed the late filing penalties and interest, in their supplemental brief dated September 7, 2018, appellants state that they are no longer appealing the imposition of the late filing penalties for 1993 and 1994 nor respondent's denial of their request for the abatement of interest for 1992, 1993, and 1994. Since appellants no longer contest these issues on appeal, OTA does not further address them in this opinion.

Appellants waived the right to an oral hearing; therefore, the Office of Tax Appeals (OTA) decides this matter based on the written record.[3]

ISSUES

1. Whether appellants have demonstrated error in respondent's proposed assessment for the 1993 tax year, which is based on federal adjustments.
2. Whether appellants have demonstrated error in respondent's proposed assessment for the 1994 tax year, which is an income estimate due to appellants' failure to file a return.
3. Whether the OTA has jurisdiction to review the amnesty penalties and, if so, whether the amnesty penalties apply.

FACTUAL FINDINGS

The Federal Audit

1. Appellant-husband was a real estate developer who worked for his own companies and in partnership with outside entities. Appellant-husband worked for his operating corporation, Southwest Diversified, Inc. (SWD), a California S Corporation, which served as the general partner in limited partnerships that invested in real estate development. SWD issued appellant-husband a 1993 Form W-2 showing that he received wages of $266,109.61 and listing an employer's address in Santa Ana, California. Appellants also directly or indirectly owned shares in many S corporations and several general partnerships, which in turn held minority interests in limited partnerships that owned construction projects in California. Appellant-wife also operated an interior design business in California called Grand Design Interiors.
2. On December 16, 1993, appellants sold their residence in Newport Beach, California for $1,150,000, on which they realized a capital gain of $216,883. On December 6, 1993, appellants also sold raw land in Newport Beach, California for $1,600,000, on which they realized a gross profit of $608,021 and for which they received an installment payment of $550,000 during 1993.

[3] Appellants requested an oral hearing at the time they filed their appeal; however, after several deferrals at appellants' request, appellants ultimately failed to timely respond to the notice of oral hearing. Therefore, the matter was converted to non-appearance and is decided based on the written record. (See Cal. Code Regs., tit. 18, § 30404(a).)

3. Appellants filed a 1993 U.S. Individual Income Tax Return (Form 1040). On their Schedule D and attached statements, appellants reported capital gains of $3,671,007, which includes the following long-term capital gains and losses: (1) a gain of $2,402,926 from SWD; (2) a gain of $600,191 from Footlan V, Inc.; (3) a gain of $482,809 from Footlan IV, Inc.; (4) a gain of $1,733 from Footlan VI, Inc.; and (5) a loss of $23,000 for Owadara II, Inc. On their Schedule E, appellants reported a loss of $1,101 from the rental of two condominium properties located in Costa Mesa, California. On a supplemental statement attached to their Schedule E, appellants reported Schedule E passive income and loss adjustments for the following entities: (1) FSW Associates Ltd.; (2) William IV, Inc.-Nevada; (3) GD Design Centers; (4) Grand Design Interiors; (5) Owadara II, Inc.; (6) Footlan II, Inc.; (7) Footlan III, Inc.; (8) Footlan IV, Inc.; (9) Footlan V, Inc.; (10) Footlan VI, Inc.; (11) Footlan VII, Inc.; (12) Denver Cascade Associates; and (13) SWD.
4. The IRS subsequently audited appellants' federal returns for numerous tax years including 1993 and 1994.
5. On November 10, 1999, the IRS issued an IRS Form 886-A, Explanation of Items, which explained the IRS's position that for 1993, appellants reported capital gains of $3,671,007 on their Schedule D but instead received capital gains of $30,126,100, and for 1994, they reported capital gains of $22,235, but received capital gains of $5,319,567. In making these adjustments, the IRS auditor reported that appellants had received a series of distributions from a number of business entities that they had failed to report on their federal returns.
6. Also on November 10, 1999, the IRS issued a second IRS Form 886-A, which indicated that appellants' reported Schedule E losses for 1993 should be increased from the $3,954,654 as reported on their return to $4,216,336, and an allowed loss should be increased to $261,682. For 1994, the IRS asserted that appellants reported a Schedule E loss of $447,173, while appellants had Schedule E income of $485,970, an increase of $933,143.
7. Between March 21, 2006, and July 13, 2006, the IRS issued three statutory notices of deficiency for tax years 1992 through 2000.

The Federal Appeals Concerning Understated Items of Income

8. Appellants appealed the IRS determinations to the United States Tax Court.

9. On December 21, 2009, appellants entered into a Stipulation of Partially Settled Issues with the IRS. As relevant to the current appeal, appellants and the IRS agreed to the following stipulations: (1) appellants conceded that they had unreported dividend income of $64 for 1994; (2) with respect to the unreported capital gain income adjustment in the amount of $9,235,685 for 1993, the IRS conceded $6,720,235, and appellants conceded $57,650, while the remaining amount remained under negotiation; (3) with respect to the Schedule E-P/S & S-Corp income in the amount of $465,590 for 1994, the IRS conceded $335,686, while the remaining amount remained under negotiation; (4) appellants conceded that they were not entitled to a Schedule E-P/S & S-Corp loss of $2,038,232 for 1993; (5) appellants conceded that they had unreported royalty income of $98 for 1994; (6) unreported royalty income of $112 for 1993 was under negotiation; (7) unreported non-employee compensation of $19,952 for 1993 remained under negotiation; (8) unreported income from settlement of $12,500 during 1993 remained under negotiation; and (9) exclusion of the Internal Revenue Code (IRC) section 104 settlement recovery of $181,250 for 1994 remained under negotiation.

10. Appellants and the IRS submitted stipulations that the Tax Court entered as a Decision dated February 3, 2011. As relevant here, the Tax Court Decision dated February 3, 2011, states the following: (1) for 1993, appellants owed additional tax of $197,913.00 and an addition to tax of $49,783.26 pursuant to IRC section 6651(a)(1); and (2) for 1994, appellants owed additional tax of $69,115.00 and addition to tax of $10,136.00 pursuant to IRC section 6651(a)(1).

11. The IRS issued an IRS Form 5278, *Statement - Income Tax Changes*.[4] The IRS Form 5278 shows that the IRS increased appellants' reported 1993 taxable income from $44,811 to $1,014,025, an increase of $969,214, based on the following adjustments: (1) increased capital gains income of $636,550; (2) increased non-employee compensation of $19,952; (3) increased income of $12,500 from settlement; (4) interest

[4] The copy provided by appellants appears to be only a one-page excerpt from this document and there is no date on the document.

income of $58; (5) disallowed itemized deductions of $344,853; and (6) additional royalty income of $112.

12. The IRS Form 5278 shows that the IRS increased appellants' reported 1994 taxable income from a loss of $49,113 to taxable income of $296,974, an increase of $346,087, based on the following adjustments: (1) disallowed IRC section 104 exclusion of $90,625; (2) disallowed Schedule E deductions of $64,952; (3) increased interest income of $7,061; (4) an increased dividend income of $64; (5) increased royalty income of $98; (6) disallowed claimed exemptions of $2,156; and (7) disallowed itemized deductions of $181,131.

1993 Proposed Assessment

13. On December 11, 1995, appellants late filed a 1993 California Nonresident or Part-Year Resident Income Tax Return (Form 540NR), on which they reported that appellants left California on October 19, 1993.[5] As relevant here, on the Schedule CA (540NR), appellants reported California amounts as follows: (1) wages, salaries, tips, etc. of $266,109; (2) a capital gains income of $3,080,411; and (3) rents, royalties, partnerships, estates, trusts, etc. of -$3,980,257.

14. After the IRS first informed respondent of the 1993 federal adjustments, respondent issued appellants a Notice of Proposed Assessment (NPA) dated July 5, 2012, which made the following adjustments to appellants' 1993 return: (1) increased capital gains income of $898,344.00; (2) increased non-employee compensation of $19,952.00; (3) increased income of $12,500.00 for settlement; (4) increased interest income of $58.00; (5) disallowed itemized deductions of $53,535.00; and (6) additional Schedule E expense exclusions of $261,682.00. As a result, the NPA revised appellants' reported 1993 taxable income from $160,441.00 to $883,148.00, an increase of $722,707.00. Applying a California apportionment factor of 0.4417, the NPA proposed additional tax of $39,052.00, a late filing penalty of $9,763.00, an amnesty penalty of $31,261.19, and applicable interest.

[5] The date that appellants left California is not in dispute.

15. Appellants timely protested the 1993 NPA. Respondent issued a Notice of Action (NOA) dated February 20, 2015, that affirmed the 1993 NPA. This timely appeal of the NOA for the 1993 tax year followed.

1994 Proposed Assessment

16. Appellants did not file a 1994 California return.
17. A number of entities that were 100 percent owned by appellants filed California returns for 1994. On 1994 California S Corporation Franchise or Income Tax Returns (Forms 100S), Footlan II, Inc., Footlan III, Inc., Footlan VI, Inc. and Owadara II, Inc. each reported the minimum tax due of $800. A Form 100S for Grand Design Interiors reported an ordinary loss of $122,250 and a minimum tax due of $800.
18. After the IRS informed respondent of the 1994 federal adjustments, respondent issued appellants an NPA dated October 10, 2012, for the 1994 tax year. The NPA estimated appellants' 1994 taxable income as follows: (1) estimated unreported income of $236,695.00; (2) disallowed IRC section 104 exclusion of $90,625.00; (3) an additional Schedule E income of $64,952.00; (4) unreported interest income of $7,061.00; (5) unreported dividend income of $64.00; (6) unreported royalty income of $98.00; and (7) subtracted itemized deductions of $93,630.00. The NPA proposed additional tax of $29,226.00, a late filing penalty of $7,306.50, an amnesty penalty of $20,467.57, and applicable interest.
19. Appellants timely protested the 1994 NPA. Respondent issued an NOA dated February 20, 2015, that affirmed the 1994 NPA. This timely appeal of the NOA for 1994 tax year followed.

The OTA Appeal

20. With its opening brief, respondent provided, among other exhibits, a LexisNexis Comprehensive Business Report for SWD. The report showed that appellant-husband was a member, director and president of SWD, and this entity did not terminate its SOS filing with California until 1996. In addition, SWD held deeds to four real properties in California. These deeds were recorded in 1991 and 1993.
21. During appeal, OTA requested additional briefing from the parties.

22. In response, appellants filed a supplemental brief and provided copies of several documents including the IRS Form 5278 and the version of the Tax Court Decision dated February 3, 2011, entered by the Tax Court. Respondent submitted a supplemental brief and provided copies of appellants' 1993 and 1994 IRS Individual Master Files (IMFs).

DISCUSSION

Issue 1: Whether appellants have demonstrated error in respondent's proposed assessment for the 1993 tax year, which is based on federal adjustments.

R&TC section 18622(a) provides, in pertinent part, that a taxpayer must either concede the accuracy of a federal determination or state wherein it is erroneous. It is well settled that a deficiency assessment based on a federal audit report is presumptively correct and the taxpayer bears the burden of proving that the determination is erroneous. (*Appeal of Gorin*, 2020-OTA-018P.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof with respect to an assessment based on a federal action. (*Ibid*.) A taxpayer's failure to introduce evidence that is within his or her control gives rise to the presumption that the evidence, if provided, would be unfavorable to the taxpayer's position. (*Appeal of Bindley*, 2019-OTA-179P.)

As relevant to this appeal, the IRS audited appellants' federal returns and issued notices of deficiency. Then, appellants petitioned the United States Tax Court for redetermination. Appellants and the IRS ultimately submitted stipulated decisions that redetermined appellants' tax liability and penalties, and the United States Tax Court entered the decisions accordingly in February 2011.[6] Subsequently, the IRS provided respondent with federal audit information showing adjustments had been made to appellants' federal returns for the 1993 and 1994 tax years.

Respondent issued a 1993 NPA that adjusted appellants' 1993 return by increasing capital gains by $898,344, increasing non-employee compensation by $19,952, increasing income of $12,500 from settlement, including interest income of $58, disallowing itemized deductions of $53,535, and decreasing income based on a Schedule E expense deduction of

[6] Interest, however, was not resolved. Ultimately, the United States Tax Court entered a decision for the IRS and held that the IRS's denial of appellants' claim for abatement of interest was not an abuse of discretion. Subsequently, appellants appealed the interest abatement denial to the Ninth Circuit Court of Appeals. The Ninth Circuit Court of Appeals affirmed the United States Tax Court's finding that the IRS did not abuse its discretion in denying appellants' request for abatement of interest.

$261,682. The 1993 NPA mirrors the IRS Form 5278 with respect to the non-employee compensation of $19,952, the increased income of $12,500 from settlement, and the interest income of $58.

As to capital gains, the IRS Form 5278 increased gains by $636,550, rather than $898,344, as shown on the 1993 NPA, which appears to produce a disparity between the two assessments. However, OTA notes that the IRS Form 5278 does not include additional Schedule E expense deductions of $261,682, while it does include additional royalty income of $112 that is not reflected on the 1993 NPA. When the Schedule E adjustment of $261,682 and the additional royalty income of $112 are subtracted from respondent's capital gains increase of $898,344, it equals $636,550, which is the same amount as the IRS's capital gains adjustment of $636,550 ($898,344 – $261,682 – $112 = $636,550). Moreover, the IRS Form 886-A, which resulted from the IRS audit, shows increased allowed Schedule E expenses of $261,682. Therefore, despite some differences in labeling between the 1993 NPA and the IRS Form 5278, OTA finds that the federal and California capital gains adjustments match when other items are taken into account.

As to itemized deductions, respondent disallowed these deductions by $53,535, which is considerably less than the disallowed itemized deductions of $344,853 shown on the IRS Form 5278. The lower amount of itemized deductions likely represents differences between federal and California law. Nevertheless, the fact that respondent disallowed fewer itemized deductions is to appellants' advantage. Therefore, OTA finds that respondent properly based its 1993 NPA on a federal determination. Respondent's deficiency assessment is presumptively correct, and the taxpayer bears the burden of proving that the determination is erroneous. (*Appeal of Gorin*, *supra*.)

Appellants contend that the IRS's 1993 capital gain adjustment should be $296,550, which is $340,000 less than the $636,550 amount listed on the IRS Form 5278. Appellants argue that although there is no calculation in any stipulation or correspondence, the correct capital gain adjustment can be inferred because the tax deficiency as listed in the United States Tax Court decision dated February 3, 2011, is less than the amount listed on the IRS Form 5278. During OTA appeal, respondent conceded this amount by stating ". . . [respondent] will make an adjustment to the revised capital gain by $340,000 to conform the [NPA] to reflect a federal tax

reduction of $68,000." Other than respondent's concession, OTA finds that no other adjustments to capital gains are warranted based on the evidence in the record.

California Source Income

California residents are taxed on their entire taxable income (regardless of source), while nonresidents are only taxed on income from California sources. (R&TC, §§ 17041(a), (b), & (i), 17951.) Part-year residents are taxed on their income (regardless of source) earned while residents of this state, as well as all income derived from California sources while nonresidents. (R&TC, § 17041(b) & (i).)

R&TC section 17951, as in effect during 1993 and 1994, provided that, for purposes of computing the taxable income of a nonresident, gross income included only that which is derived from sources within California. (See also Cal. Code Regs., tit. 18, § 17951-1(a).) R&TC section 17954, in turn, provides that gross income from sources within and without California shall be allocated and apportioned under rules and regulations prescribed by respondent. California Code of Regulations, title 18, (Regulation) section 17951-4, which implements and interprets R&TC section 17954, deals with nonresident sourcing provisions when income is derived from a business, trade, or profession. (See also Cal. Code Regs., tit. 18, § 17951-2.) Income of a nonresident from sources within California includes rents from real or tangible personal property in California, gains realized from the sale or transfer of such property regardless of where the sale or transfer is consummated, and any other type of income derived from the ownership, control or management of real and tangible personal property located in California regardless of whether a trade, business or profession is carried on within California. (Cal. Code Regs., tit. 18, § 17951-3.) If a nonresident's business, trade or profession is conducted wholly within California, then the entire net income therefrom is derived from sources within this state. (Cal. Code Regs., tit. 18, § 17951-4(a).)

On the other hand, if a nonresident's business, trade or profession is conducted partly in California and partly in another state, but the part within California is unconnected with the part outside of it to such an extent that the respective activities do not constitute parts of a unitary business, trade, or profession, then only the net income from activities within California are sourced to California. (Cal. Code Regs., tit. 18, § 17951-4(b).) Business income is apportioned pursuant to R&TC section 25120 et seq. Except for certain exceptions not relevant to the current appeal, R&TC section 25128 provides that, for taxable years beginning before January 1, 2013,

all business income should be apportioned to California by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus twice the sales factor, and the denominator of which is four.[7]

With regard to the gross income of a nonresident of California who is a member of a partnership, the member's distributive share of the taxable income of the partnership is California source income to the extent that the partner's distributive share is derived from sources within California. (Cal. Code Regs., tit. 18, § 17951-1(b).) If a nonresident is a partner in a partnership which carries on a unitary business, trade or profession within and without this state, the source of the partner's distributive share of partnership income derived from sources within this state shall be apportioned at the partnership level in accordance with the apportionment rules of the R&TC section 25120 et seq. (Cal. Code Regs., tit. 18, § 17951-4(d)(1).) If the partnership and the business activity of the partner are part of one unitary business, then the rules of Regulation section 25137-1(f) apply, and the apportionment of the partnership business income is carried out at the partner level for the unitary partner or partners.

It is undisputed that appellants were California residents until October 19, 1993. To the extent that appellants received taxable income prior to October 19, 1993, that income would be taxable because appellants were residents of California. Appellants are also taxed on all income derived from California sources while they were nonresidents starting on October 19, 1993. Although appellants contend that "[a]t no time in 1993 did the Taxpayers have California sourced income," they have failed to prove their contention.

As previously discussed, the 1993 NPA revised appellants' reported taxable income from $160,441 to $883,148, an increase of $722,707. The increase of $722,707 is based on respondent's increase of appellants' 1993 capital gains income by $898,344, non-employee compensation by $19,952, the income from settlement by $12,500 and interest income by $58, while disallowing itemized deductions of $53,535 and increasing Schedule E expense deductions of $261,682. In OTA's additional briefing letter, OTA requested that appellants address whether any of these items of income were derived from non-California sources, but appellants could not

[7] For a discussion of the double-weighted sales factor enacted by the Legislature in 1993, see *The Gillette Co. v. Franchise Tax Bd.* (2015) 62 Cal.4th 468, 475-76.

recall the nature of the income and failed to provide evidence in response. Appellants contend that their documents concerning the 1993 tax year have been destroyed.[8]

Despite appellants' contention, appellants' own reporting on their 1993 federal and California return shows that they had substantial California source income. Appellants reported California wages of $266,109 and a California gain of $3,671,007. Appellants' IRS Form 2119 filed with their 1993 federal return shows that they sold their Newport Beach home for $1,150,000 and realized a gain of $216,883, while the Form 3805E, attached to their 1993 California return, showed that they sold a parcel of raw land in Newport Beach for $1,600,000, of which they received an installment payment of $550,000 during 1993. On their federal Schedule E, appellants reported that they had a loss of -$1,102 from the rental of two condominium properties located in Costa Mesa, California. Appellants' federal and state returns show that they had substantial California source income in California during 1993.

Accordingly, OTA finds that appellants have failed to show that any of the adjusted items shown on the 1993 NPA were non-California source income. [9]

Issue 2: Whether appellants have demonstrated error in respondent's proposed assessment for the 1994 tax year, which is an income estimate due to appellants' failure to file a return.

R&TC section 19087(a) provides that if any taxpayer fails to file a return, respondent at any time "may require a return . . . under penalties of perjury or may make an estimate of the net income, from any available information, and may propose to assess the amount of tax, interest and penalties due." When respondent makes a proposed assessment of additional tax based on an estimate of income, respondent's initial burden is to show why its proposed assessment is

[8] Appellants assert that they lived in a small apartment and that four years ago they shredded all but their most current records.

[9] On respondent's 1993 and 1994 NPAs, it used an apportionment factor of 0.4417 and 1.000, respectively. This apportionment factor is known as the "California Method" under R&TC section 17041(b). (See *Appeal of Williams*, 2023-OTA-041P.) Aside from appellants' general assertions that they have no California sourced income in the 1993 and 1994 tax years, appellants made no specific arguments and cited no authorities addressing respondent's calculation under the "California Method." During the OTA appeal, OTA sent an additional briefing letter and asked respondent to explain respondent's California Method calculations. Respondent's additional brief explained that for the 1993 tax year the apportionment factor should have been 1.000 instead of 0.4417 based on appellants' federal AGI and California AGI but that respondent may not seek to amend its NPA. For the 1994 tax year, respondent used an apportionment factor of 1.000 because appellants did not provide enough data to calculate a different apportionment factor. Appellants were given the opportunity to respond to respondent's additional brief, but appellants did not do so. As such, appellants have not met their burden of proving that respondent's calculation under the "California Method" is erroneous.

reasonable and rational. (*Appeal of Bindley*, *supra*.) An assessment based on unreported income is presumed correct when the taxing agency introduces a minimal factual foundation to support the assessment. (*Ibid*.) Once respondent has met its initial burden, the proposed assessment of additional tax is presumed correct, and the taxpayer has the burden of proving it to be wrong. (*Ibid*.) Here, respondent has introduced a minimal factual foundation to show: (1) that appellants had income in 1994 based on federal information; and (2) that income is sourced to California.

Appellants failed to file a 1994 California return. As a result, respondent estimated appellants' income based on federal information. Respondent issued an NPA that calculated previously unreported income of $236,695 and allowed additional itemized deductions of $93,630, while tracking the federal adjustments in denying an IRS section 104 exclusion of $90,625 and finding additional Schedule E income of $64,952, interest income of $7,061, dividend income of $64 and royalty income of $98. Based on these adjustments, the 1994 NPA revised taxable income to be $305,865. The 1994 NPA is consistent with the adjustments made on the IRS Form 5278, the Stipulation of Partially Settled Issues dated December 21, 2009, and appellants' IRS IMF transcripts. Therefore, OTA finds that respondent properly estimated appellants' income based on federal information.

Appellants argue that the 1994 NPA does not conform to the Stipulation of Partially Settled Issues dated December 21, 2009, but appellants have failed to advance any specific arguments and offered no persuasive evidence. Indeed, the Stipulation of Partially Settled Issues dated December 21, 2009, shows that appellants conceded that they had unreported dividend income of $64 and unreported royalty income of $98 for 1994, which match the amounts on the 1994 NPA. Thus, OTA finds appellants' argument to be unpersuasive.

California Source Income

Respondent also provided a minimal factual foundation to show that its estimate of appellants' income has a California source in 1994. Appellant-husband is a real estate developer who worked for his own companies and in partnership with outside entities. One of those entities is SWD. Appellant-husband was a member, director and president of SWD, and this entity did not terminate its SOS filing with California until 1996. In addition, SWD held deeds to four real properties in California. These deeds were recorded in 1991 and 1993. Furthermore, the United States Tax Court noted that appellant-wife operated interior design businesses in

Nevada and California. Accordingly, OTA finds that respondent has met its initial burden to introduce a minimal factual foundation to support the assessment. Thus, respondent's deficiency assessment is presumptively correct, and the taxpayer bears the burden of proving that the determination is erroneous. (*Appeal of Bindley*, *supra*.)

In our additional briefing letter, OTA requested that appellants address the source of all underreported items of income listed on the 1994 NPA, but appellants failed to provide any evidence. Appellants were also asked to provide information concerning the domicile of their corporations during 1993 and 1994. In response, appellants argue that none of their entities operated in California during 1994, because all of their California entities had failed in 1993 and 1994. However, appellants provide no evidence in support of this contention, such as articles of incorporation, partnership or LLC agreements, registration certificates showing domicile in Nevada or other states, cancelled checks, accounting records, or any other documents showing either the domicile of their entities or the sources of their income. Indeed, appellants contend that they have no records from 1994.

Despite this absence of evidence, appellants ask OTA to believe that virtually all of their many businesses ceased to operate before 1994. The Tax Court found that appellant-husband had ownership interests directly or indirectly in over 20 entities. (*Foote v. Commissioner*, T.C. Memo. 2015-187.) On a supplemental statement attached to their Schedule E, appellants reported Schedule E passive income and loss adjustments for the following entities: (1) FSW Associates Ltd.; (2) William IV, Inc.-Nevada; (3) GD Design Centers; (4) Grand Design Interiors; (5) Owadara II, Inc.; (6) Footlan II, Inc.; (7) Footlan III, Inc.; (8) Footlan IV, Inc.; (9) Footlan V, Inc.; (10) Footlan VI, Inc.; (11) Footlan VII, Inc.; (12) Denver Cascade Associates; and (13) SWD. Appellants concede that, except for Denver Cascade Associates and another entity located in Utah, these corporations were domiciled in California prior to their asserted failure.

In addition, Footlan II, Inc., Footlan III, Inc., Footlan VI, Inc. and Owadara II, Inc. all filed 1994 California S Corporation returns, reported minimal net income and reported minimum franchise tax due of $800, which shows that, contrary to appellants' contentions, these entities continued to exist in 1994 when the returns were filed. Moreover, OTA's record does not have a 1994 return for SWD, which accounted for the largest share of appellants' capital gains during 1993 and which, according to a LexisNexis Comprehensive Business Report provided by

respondent, continued to be the subject of creditors' liens during later tax years. Finally, the IRS found that during 1994, appellants had additional unreported Schedule E income of $64,952, which shows that appellants must have continued to receive substantial income from their own businesses, the vast majority of which were located in California during 1993. Without any evidence to the contrary, OTA cannot accept that appellants would have lost or divested themselves of all their California source income when appellants concede that the corporations mainly acted as general partners for California limited partnerships that were developing California real property.[10]

Therefore, OTA finds that appellants did not meet their burden of proving that respondent's determination is erroneous.

Issue 3: Whether the OTA has jurisdiction to review the amnesty penalties and, if so, whether the amnesty penalties apply.

In 2004, the California Legislature enacted the income tax amnesty program for taxpayers subject to the Personal Income Tax Law and the Corporation Tax Law. (R&TC, §§ 19730-19738.) Eligible taxpayers could participate by filing an amnesty application and paying their outstanding liabilities of tax and interest, or by entering into an installment plan, during the period from February 1, 2005, through March 31, 2005, inclusive. (R&TC, §§ 19730 & 19731.) The amnesty program applies to tax liabilities for tax years beginning before January 1, 2003. (R&TC, § 19731.) If an eligible taxpayer paid in full the unpaid tax obligations and met all the other requirements of the amnesty program, respondent waived all unpaid penalties and fees imposed, and no criminal action would be brought against the taxpayer for years subject to the amnesty program. (R&TC, § 19732.)

However, if a taxpayer underpaid his or her taxes during a period prior to January 1, 2003, and failed to participate in the amnesty program, R&TC section 19777.5 imposed an amnesty penalty. Pursuant to R&TC section 19777.5(a)(1), a 50 percent interest-based amnesty penalty ("amnesty penalty") applied to a taxpayer's past due liabilities if the

[10] Appellants also generally argue that it is unconstitutional for respondent to require them to file a 1994 California return, without pointing to a particular statute or elaborating on its constitutionality argument. OTA believes appellants are arguing that the language that respondent "may require a return or an amended return under penalties of perjury" under R&TC section 19087(a) is unconstitutional. However, Regulation section 30104(a) provides that the OTA does not have jurisdiction to consider whether a California statute is invalid or unenforceable under the United States or California Constitutions, unless a federal or California appellate court has already made such a determination.

liabilities were eligible for the 2005 amnesty program but the taxpayer did not participate in that program. The penalty is equal to 50 percent of the interest that accrued on the balance due from the original due date of the tax to March 31, 2005. Under R&TC section 19777.5(d) & (e), once an amnesty penalty is assessed as a final liability and has been paid, a taxpayer may file a refund claim only on the limited grounds that the amount paid to satisfy the penalty "was not properly computed by the Franchise Tax Board."

Here, appellants have not paid the amnesty penalties for 1993 and 1994, and they have not filed a timely refund claim asserting that the amnesty penalties were not properly computed. Thus, there is no action by respondent on a refund claim for OTA to review. Accordingly, OTA has no statutory basis to review the amnesty penalties.

HOLDINGS

1. Appellants have not demonstrated error in respondent's proposed assessment for the 1993 tax year. On appeal, respondent agreed to reduced capital gains by $340,000.
2. Appellants have not demonstrated error in respondent's proposed assessment for the 1994 tax year.
3. OTA has no jurisdiction to review the amnesty penalties.

DISPOSITION

Respondent's action for the 1993 tax year is modified as conceded by respondent on appeal to reduce capital gains by $340,000. Respondent's actions are otherwise sustained.

DocuSigned by:
Huy "Mike" Le
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Huy "Mike" Le
Administrative Law Judge

We concur:

DocuSigned by:
John O Johnson
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John O. Johnson
Administrative Law Judge

DocuSigned by:
Ovsep Akopchikyan
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Ovsep Akopchikyan
Administrative Law Judge

Date Issued: 10/6/2023