

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 221212011
S. ESPINOZA)
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OPINION

Representing the Parties:

For Appellant: S. Espinoza

For Respondent: Brian Werking, Attorney

T. STANLEY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, S. Espinoza (appellant) appeals an action by respondent Franchise Tax Board (FTB) proposing additional tax of \$28,105.00, an accuracy-related penalty of \$5,621.00, a late-filing penalty of \$7,026.25, and applicable interest for the 2016 taxable year.

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

ISSUES

1. Has appellant shown error in FTB’s proposed assessment of additional tax which is based on a final federal determination?
2. Has appellant established reasonable cause to abate the accuracy-related penalty?
3. Has appellant established reasonable cause to abate the late-filing penalty?

FACTUAL FINDINGS

1. On May 18, 2018, appellant late-filed a 2016 California Resident Income Tax Return reporting zero total tax.
2. Subsequently, FTB received information that the IRS had adjusted appellant’s federal tax liability. As relevant here, the IRS disallowed the following expenses claimed on appellant’s Schedule C (Profit or Loss From Business): office expenses of \$11,939; legal

and professional expenses of \$13,569; and wage expenses of \$318,458. Based on the adjustments, the IRS increased appellant's self-employment tax deduction by \$10,589 and reduced exemptions by \$4,698.

3. FTB made corresponding adjustments to appellant's California tax liability and issued a Notice of Proposed Assessment (NPA), proposing to assess \$28,105.00 in additional tax, an accuracy-related penalty of \$5,621.00, and a late-filing penalty of \$7,026.25, plus applicable interest.
4. Appellant protested the NPA, which FTB denied in a Notice of Action.
5. This timely appeal followed.

DISCUSSION

Issue 1: Has appellant shown error in FTB's proposed assessment of additional tax which is based on a final federal determination?

R&TC section 18622(a) provides that a taxpayer shall either concede the accuracy of a final federal determination or state wherein it is erroneous. It is well settled that a deficiency assessment based on federal adjustments to income is presumptively correct and that a taxpayer bears the burden of proving that the determination is erroneous. (*Appeal of Gorin*, 2020-OTA-018P.) In the absence of credible evidence showing that FTB's determination is incorrect, it must be upheld. (*Appeal of Valenti*, 2021-OTA-093P.) Unsupported assertions are insufficient to satisfy a taxpayer's burden of proof with respect to an assessment based on a federal action. (*Appeal of Gorin, supra.*)

Appellant does not allege error in either the IRS determination or in FTB's proposed assessment. Rather, appellant argues that the IRS accepted an offer in compromise that appellant submitted to the IRS but not to FTB. Appellant claims that since California law is the same as federal law for the issues involved (as FTB states in its correspondence to appellant), FTB should follow the IRS's cancellation of appellant's tax liability.

However, FTB is a separate agency unaffiliated with the IRS. The offer in compromise programs offered by the two agencies have different requirements. FTB asserts that appellant must use its separate procedures to apply for FTB's offer in compromise program. FTB attaches

FTB 4905 PIT Booklet, Offer in Compromise for Individuals, to explain to appellant FTB's application procedures.¹

OTA's function in the appeals process is to determine the correct amount of tax, and OTA does not have authority to make discretionary adjustments to the amount of tax assessed based on a taxpayer's ability to pay. (*Appeal of Robinson*, 2018-OTA-059P.) Because appellant has not offered any information supporting either that the IRS modified its own assessment or that FTB's proposed assessment based on the IRS adjustments is incorrect, OTA finds no error in FTB's proposed assessment.

Issue 2: Has appellant established reasonable cause to abate the accuracy-related penalty?

Except as otherwise provided, California incorporates Internal Revenue Code (IRC) section 6662, relating to the imposition of the accuracy-related penalty on underpayments. (R&TC, § 19164(a)(1)(A); *Appeal of Daneshgar*, 2021-OTA-210P.) 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, over the amount of tax that 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 for the taxable year 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).)² In general, no penalty shall be imposed with respect to any portion of any underpayment if it is shown that there was reasonable cause for such portion and the taxpayer acted in good faith with respect to such portion. (R&TC, § 6664(c)(1).)³ An accuracy-related penalty may also be imposed when a taxpayer is negligent or fails to make a reasonable attempt to comply with the statutes and regulations. (IRC, § 6662(b)(1) & (c).)

¹ As noted in FTB's brief, the agency will not process an application for an offer in compromise while this appeal is pending. When this appeal becomes final, appellant may apply to FTB directly if he wishes to request either an offer in compromise or an installment payment plan. (See <https://www.ftb.ca.gov/pay/if-you-cant-pay>.)

² In determining whether there is a substantial understatement, the taxpayer may reduce the understatement by the portion 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 statement attached to the return, and for which there is a reasonable basis for the tax treatment of such item by the taxpayer. (IRC, § 6662(d)(2)(B)(i)-(ii).)

³ California conforms per R&TC section 19164(d)(1).

OTA's record reflects that the IRS imposed the accuracy-related penalty for both substantial understatement and negligence. Appellant's underpayment exceeds both thresholds under IRC section 6662(d)(1)(A)(i-ii) as appellant reported zero total tax while the proposed assessment exceeds both \$5,000 and 10 percent of the tax required to be shown on the return. Appellant makes no specific arguments with respect to the accuracy-related penalty. Appellant does not dispute FTB's proposed assessment and does not claim he had reasonable cause for the understatement and a good faith belief that he reported his tax correctly on the original California tax return. (See IRC, § 6664(c)(1).) Appellant makes the same assertions, i.e., that he believes FTB's proposed assessment should be modified based upon the IRS's acceptance of appellant's offer in compromise. As such, appellant has not established a basis to abate the accuracy-related penalty.

Issue 3: Has appellant established reasonable cause to abate the late-filing penalty?

California imposes a penalty for failing to file a return on or before the due date, unless the taxpayer shows that the failure is due to reasonable cause and not due to willful neglect. (R&TC, § 19131.) When FTB imposes a penalty, it is presumed to have been imposed correctly. (*Appeal of Xie*, 2018-OTA-076P.) A taxpayer may rebut this presumption by providing credible and competent evidence supporting abatement of the penalty for reasonable cause. (*Ibid.*) To establish reasonable cause, the taxpayer must show that the failure to file a timely return occurred despite the exercise of ordinary business care and prudence, or that such cause existed as would prompt an ordinarily prudent businessperson to have so acted under similar circumstances. (*Appeal of Head and Feliciano*, 2020-OTA-127P.)

Appellant makes no specific arguments with respect to the late-filing penalty. Appellant makes the same assertions, i.e., that he believes FTB's proposed assessment should be modified based upon the IRS's acceptance of appellant's offer in compromise. As such, appellant has not established that he acted as a reasonably prudent businessperson and has, therefore, not established reasonable cause to abate the late-filing penalty.

HOLDINGS

1. Appellant has not shown error in FTB’s proposed assessment of additional tax.
2. Appellant has not established reasonable cause to abate the accuracy-related penalty.
3. Appellant has not established reasonable cause to abate the late-filing penalty.

DISPOSITION

FTB’s action is sustained.

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 Teresa A. Stanley
 Administrative Law Judge

We concur:

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 Asaf Kletter
 Administrative Law Judge

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 Veronica I. Long
 Administrative Law Judge

Date Issued: 10/4/2023