

**OFFICE OF TAX APPEALS
STATE OF CALIFORNIA**

In the Matter of the Appeal of:

**K. SMITH AND
B. SMITH**

) OTA Case No. 220610535
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OPINION

Representing the Parties:

For Appellants: George Ortiz, Representative¹

For Respondent: Camille Dixon, Attorney

S. BROWN, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, K. Smith and B. Smith (appellants) appeal an action by respondent Franchise Tax Board (FTB) proposing additional tax of \$6,642, an accuracy-related penalty of \$1,328.40, and applicable interest for the 2017 tax year.

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

ISSUES

1. Whether appellants have shown error in FTB’s proposed assessment of additional tax, which is based on federal adjustments.
2. Whether appellants have shown that the accuracy-related penalty should be abated.
3. Whether appellants have shown that interest should be abated.

FACTUAL FINDINGS

1. Appellants timely filed their joint California resident income tax return for the 2017 tax year, reporting California adjusted gross income and itemized deductions, and total tax of \$792.

¹ Although appellants identified George Ortiz as their representative, appellants filed their own briefing, and Mr. Ortiz did not provide any briefing, evidence, or other submission in this appeal.

2. Subsequently, FTB received information that the IRS examined appellants' federal return for the 2017 tax year and made adjustments by disallowing appellants' itemized deductions and instead allowing the standard deduction. These adjustments increased appellants' federal taxable income by \$87,971; as a result, the IRS assessed additional federal tax of \$18,498 and imposed an accuracy-related penalty of \$3,699.60. Appellants did not report the federal adjustments to FTB.
3. Based on the information it received from the IRS, FTB made corresponding adjustments to appellants' 2017 California tax return, and issued appellants a Notice of Proposed Assessment (NPA) dated January 21, 2021. The NPA indicated that appellants were required to report total tax of \$7,434 on their California income tax return, and thus proposed additional tax of \$6,642² and an accuracy-related penalty of \$1,328.40, plus applicable interest.
4. Appellants protested the NPA. On April 25, 2022, FTB affirmed the NPA in a Notice of Action.
5. This timely appeal to the Office of Tax Appeals (OTA) followed.

DISCUSSION

Issue 1: Whether appellants have shown error in FTB's proposed assessment of additional tax, which is based on federal adjustments.

When the IRS changes or corrects a taxpayer's federal tax return, the taxpayer must either concede the accuracy of those changes or state how the changes are erroneous. (R&TC, § 18622(a).) FTB's determination based on a federal adjustment to income is presumed correct and the taxpayer bears the burden of proving FTB's determination is erroneous. (*Appeal of Valenti*, 2021-OTA-093P.) FTB's determination must be upheld in the absence of credible, competent, and relevant evidence showing that its determination is incorrect. (*Appeal of Chen and Chi*, 2020-OTA-021P.) Income tax deductions are a matter of legislative grace, and a taxpayer who claims a deduction has the burden of proving by credible evidence that he or she is entitled to that deduction. (*Appeal of Dandridge*, 2019-OTA-458P.) Unsupported assertions are insufficient to satisfy a taxpayer's burden of proof. (*Appeal of Bracamonte*, 2021-OTA-156P.)

² 7,434 - 792 = 6,642

Appellants contend that the IRS did not allow them to show the receipts and deductions needed to prove that their taxes were calculated correctly. Appellants indicate that they signed a power of attorney and their representative would respond to “get this all straightened out.”

Here, FTB proposed to assess additional tax based on the federal adjustments. Appellants have not provided any evidence or substantive argument to support their position that they are entitled to the disputed deductions; appellants did not provide any response to FTB’s brief and did not respond to OTA’s request for additional briefing on this topic.³ Accordingly, appellants have not met their burden of proof to establish error in FTB’s proposed assessment.

Issue 2: Whether appellants have shown that the accuracy-related penalty should be abated.

R&TC section 19164 generally incorporates the provisions of Internal Revenue Code (IRC) section 6662 and imposes an accuracy-related penalty of 20 percent of an applicable underpayment. As relevant here, the penalty applies to any portion of an underpayment attributable to negligence or disregard of rules and regulations, or any “substantial understatement of income tax.” (IRC, § 6662(b)(1) & (2).) 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. (R&TC, § 19164; IRC, § 6662(d)(1)(A).)

Here, the IRS imposed an accuracy-related penalty based on substantial understatement of income tax.⁴ As shown on the NPA, appellants were required to report total tax of \$7,434 on their California income tax return.⁵ Ten percent of this amount is \$743. Appellants reported total tax of \$792 on their 2017 tax return, for a difference of \$6,642. Because appellants’ understatement exceeds \$5,000 (the greater of the two amounts in IRC section 6662(d)(1)(A)), it constitutes a substantial understatement of California income tax. Consequently, OTA finds that FTB properly imposed the penalty.

³ In a letter dated March 16, 2023, OTA requested that appellants submit any documentation to show error in either FTB’s proposed assessment for the 2017 tax year or the federal (IRS) assessment on which it is based. Appellants did not respond to this request.

⁴ Appellants’ federal Individual Master File transcript shows penalty reference number 787, which pertains to assessment of the accuracy-related penalty due to understatement. (See https://www.irs.gov/irm/part20/irm_20-001-005#idm1401692946735520.)

⁵ The accuracy-related penalty for a substantial understatement only applies to the portion of the underpayment of tax that is attributable to the substantial understatement of tax. Here, the penalty amount is 20 percent of the understatement ($6,642.00 \times 0.20 = 1,328.40$).

The accuracy-related penalty may be reduced or abated to the extent a taxpayer shows that: (1) there is substantial authority for the taxpayer's reporting position; (2) the position was adequately disclosed in the tax return (or a statement attached to the return) and there is a reasonable basis for treatment of the item; or (3) the taxpayer acted in good faith and had reasonable cause for the understatement. (IRC, §§ 6662(d)(2)(B), 6664(c)(1); *Appeals of Lovinck Investments N.V., et al.*, 2021-OTA-294P.) Appellants have not raised any specific arguments concerning the accuracy-related penalty, nor have they otherwise satisfied their burden of proving error in FTB's imposition of the accuracy-related penalty. Therefore, appellants have failed to establish that the penalty should be abated.

Issue 3: Whether appellants have shown that interest should be abated.

If any amount of the tax is not paid by the due date, interest is required to be imposed from the due date until the date the taxes are paid. (R&TC, § 19101(a).) Interest is not a penalty, but is compensation for the taxpayer's use of money that should have been paid to the state. (*Appeal of Balch*, 2018-OTA-159P.) Imposition of interest is mandatory, and interest can only be abated in certain limited situations when authorized by law. (R&TC, § 19101(a); *Appeal of Balch, supra.*) There is no reasonable cause exception to imposition of interest. (*Appeal of Moy*, 2019-OTA-057P.) Appellants do not allege, and the record does not reflect, any grounds for abatement of interest here. Accordingly, interest cannot be abated.

HOLDINGS

1. Appellants have not demonstrated error with the proposed assessment of additional tax, which is based upon federal adjustments.
2. The accuracy-related penalty is not abated.
3. Appellants are not entitled to interest abatement.

DISPOSITION

FTB’s action is sustained in full.

DocuSigned by:
Suzanne B. Brown
47E45ABE89E34D0
Suzanne B. Brown
Administrative Law Judge

We concur:

DocuSigned by:
Josh Aldrich
48745BB806914B4
Josh Aldrich
Administrative Law Judge

DocuSigned by:
Cheryl L. Akin
1A8C8E38740B4D5
Cheryl L. Akin
Administrative Law Judge

Date Issued: 11/3/2023