OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	OTA Case No. 21027212
W. MILLER	

OPINION

Representing the Parties:

For Appellant: W. Miller

For Respondent: Anne Mazur, Specialist

S. HOSEY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, W. Miller (appellant) appeals an action by respondent Franchise Tax Board (FTB) proposing additional tax of $4,785, a late filing penalty of $336.25, an accuracy-related penalty of $957, and applicable interest for the 2014 tax year.[1]

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

ISSUES

1. Whether appellant has established error in FTB's proposed assessment for the 2014 tax year, or the federal action on which it is based.
2. Whether appellant has established reasonable cause to abate the late filing penalty.
3. Whether appellant has established a basis to abate interest.
4. Whether the accuracy-related penalty should be abated.[2]

[1] FTB makes concessions on appeal to allow an additional $8,500 deduction that was allowed by the IRS. This reduces the proposed additional tax amount remaining at issue to $3,991. FTB indicates this reduces the late filing penalty to $137.75. Interest will also be recalculated based on these reduced amounts. Furthermore, FTB concedes to cancel the accuracy-related penalty based on a lack of negligence or substantial understatement.

[2] As this penalty has been conceded by FTB on appeal, it will not be discussed in detail below. The concession will be noted in the Holdings and Disposition.

FACTUAL FINDINGS

1. Appellant filed an untimely 2014 California resident income tax return on July 8, 2016, reporting a total tax of $355.
2. FTB received information from the IRS regarding its examination of appellant's 2014 tax return, showing the IRS increased appellant's taxable income, relating to Schedule C business expenses and Schedule A itemized deductions. The IRS assessed additional tax and late filing and accuracy-related penalties.
3. Appellant did not report the federal changes to FTB. FTB reviewed appellant's 2014 account and followed the adjustments made in the federal report. FTB issued a Notice of Proposed Assessment (NPA) increasing appellant's taxable income, including the adjustments in the following categories: car and truck expenses, business expenses, legal and professional expenses, miscellaneous deductions and medical deductions. FTB proposed additional tax of $4,785, a late filing penalty of $336.25, and an accuracy-related penalty of $957.
4. Appellant protested the NPA, stating he disagreed with the IRS determination, but did not have the financial ability to challenge it in court. Appellant provided documentation, including federal audit workpapers and an amended California tax return, in an effort to show he was entitled to some of the deductions disallowed by the IRS. FTB did not accept the amended return.
5. FTB issued a Notice of Action, affirming its assessment because appellant's account transcript showed no indication that the IRS revised or cancelled its assessment.
6. This timely appeal followed.
7. After a review of the appeal and finding an additional federal adjustment, FTB reduced the assessment of tax, recomputed the late filing penalty, and cancelled the accuracy related penalty that was on the original NPA.

DISCUSSION

Issue 1: Whether appellant has established error in FTB's proposed assessment for the 2014 tax year, or the federal action on which it is based.

A taxpayer shall concede the accuracy of a final federal determination to a taxpayer's income or state where the determination is erroneous. (R&TC, § 18622(a).) It is well settled that a deficiency assessment based on a federal adjustment to income is presumed to be correct and a taxpayer bears the burden of proving FTB's determination is erroneous. (*Appeal of Valenti*, 2021-OTA-093P.) Except as otherwise provided by law, the burden of proof requires proof by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(b).) A preponderance of the evidence means the taxpayer must establish by documentation or other evidence the circumstances it asserts are more likely than not to be correct. (*Appeal of Estate of Gillespie*, 2018-OTA-052P, at fn. 6.)

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); *Appeal of Black*, 2023-OTA-023P.) Likewise, a taxpayer can establish FTB's proposed assessment based on a final federal determination is incorrect. (*Appeal of Black, supra*.) However, in the absence of credible, competent, and relevant evidence showing FTB's determination is incorrect, it must be upheld. (*Appeal of Valenti, supra*.)

FTB received information from the IRS that it assessed additional tax and penalties relating to adjustments to appellant's Schedule A itemized deductions and Schedule C business expenses. Based on this federal determination, FTB proposed to assess additional taxes, plus interest. Because there is no evidence to indicate the federal determination was adjusted or cancelled, FTB's proposed assessment is presumed correct and appellant bears the burden of showing it is erroneous.

Income tax deductions are a matter of legislative grace, and a taxpayer who claims a deduction has the burden of proving by competent evidence that he or she is entitled to that deduction. (*New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435, 440; *Appeal of Dandridge*, 2019-OTA-458P.) To sustain the burden of proof, a taxpayer must be able to point to an applicable deduction statute and show that he or she comes within its terms. (*New Colonial Ice Co. v. Helvering, supra*.) Unsupported assertions cannot satisfy a taxpayer's burden of proof.

(*Appeal of Vardell*, 2020-OTA-190P.)

A taxpayer may deduct unreimbursed employee expenses as ordinary and necessary business expenses under R&TC section 17201, which incorporates by reference Internal Revenue Code (IRC) section 162. IRC section 162(a) authorizes a deduction for "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business . . . ." (See also *Haldeman v. Franchise Tax Board* (1983) 141 Cal.App.3d 373, 376.) The expenses must be ordinary and necessary business expenditures directly related to the taxpayer's trade or business. (IRC, § 162(a); Treas. Reg. § 1.162-1(a); *Appeal of La Rosa Capital Resource, Inc.*, 2020-OTA-220P.)

IRC section 274(d),[3] prohibits an IRC section 162(a) deduction for the following types of expenses unless they are substantiated by adequate records or by sufficient evidence corroborating the taxpayer's own statement: (1) any travel expense, including meals and lodging away from home; (2) any item with respect to an activity in the nature of entertainment, amusement, or recreation; (3) an expense for gifts; or (4) the use of "listed property," as defined in IRC section 280F(d)(4), which includes passenger automobiles. (See *Roberts v. Commissioner*, T.C. Memo. 2012-197.) To qualify for a deduction, the taxpayer must meet heightened requirements to substantiate a claimed expense with adequate records or sufficient evidence to corroborate the taxpayer's own statement as to: (1) the amount of the expense or other item; (2) the time and place of the travel, entertainment, amusement, recreation, or use of the property, or the date and description of the gift; (3) the business purpose of the expense or other item; and (4) the business relationship to the taxpayer of the persons entertained or receiving the gift. (IRC, § 274(d).) "Generally, expenses subject to the strict substantiation requirements of [IRC] section 274(d) must be disallowed in full unless the taxpayer satisfies every element of those requirements." (*Fleming v. Commissioner*, T.C. Memo. 2010-60.) Federal regulations provide that taxpayers have maintained "adequate records" if they keep a contemporaneous log or diary, combined with supporting documents, which substantiate the required elements of the expense, such as the amount, the date, and the business purpose of the item. (Treas. Reg. § 1.274-5T(c)(2)(i).) If "adequate records" are not provided under this provision, the taxpayer must establish each element of the expense by his or her own statement

[3] R&TC section 17201 incorporates IRC section 274 into California law. For the 2014 tax year, California adopted IRC section 274 as in effect on January 1, 2009. (R&TC, § 17024.5(a)(1).) All references to the IRC in this Opinion refer to that version.

containing specific detail as to each element, and "other corroborative evidence sufficient to establish such element." (Treas. Reg. § 1.274-5T(c)(3).)

In this appeal, appellant claimed $14,774 in Schedule C utility expenses, of which $7,387 (i.e., 50 percent) was disallowed. Appellant claims that he should be allowed additional expenses, as he is required to telework for his work with the military and that he runs an architectural practice out of his home. However, appellant has not provided any documentation to support his claim for utility expenses, in any amount, but more specifically for any amount over the $7,387 allowed by the IRS.

Appellant claimed $14,819 in legal and professional services, of which $14,406 was initially disallowed. The IRS then later revised its position and allowed an additional $8,500. The NPA did not originally allow this amount, but on appeal FTB concedes that it will allow it. Appellant provided documentation to illustrate what the attorneys' fees were regarding, but has not provided itemized invoices or other evidence to show that any additional amount over the allowed $8,500 should be deducted.

Appellant claimed $12,514 in car expenses, of which $6,257 (i.e., 50 percent) was disallowed. Vehicle mileage deductions are subject to the heightened substantiation requirements of IRC section 274. Appellant argues that he should be allowed additional car expenses, but has not provided sufficient documentation to support his claim for an amount over the $6,257 allowed by the IRS.

Appellant claimed $31,660 in travel and entertainment employee business expenses, all of which was disallowed. As discussed above, IRC section 274(d) requires that taxpayers satisfy the heightened requirements to substantiate various expenses, including travel, meal, and entertainment expenses, with "adequate records" showing the amount of the expense, the time and place of the expense, the business purpose for the expense, and the business relationship to the taxpayer of the person receiving the benefit. (See also Treas. Reg. § 1.274-5T(b)(2).) Appellant argues that the amount he claimed includes fees related to his travel to information forums as a presenter in relation to his work. However, appellant has not met the heightened requirements to substantiate these expenses, such as travel logs.

Therefore, appellant has not met his burden to show error in FTB's proposed assessment for the 2014 tax year, or the federal action on which it is based.

Issue 2: Whether appellant has established reasonable cause to abate the late filing penalty.

California imposes a penalty for the failure to file a return on or before the due date, unless it is shown that the failure is due to reasonable cause and not due to willful neglect. (R&TC, § 19131.) When FTB imposes a penalty, the law presumes that the penalty was imposed correctly, and the burden of proof is on the taxpayer to establish otherwise. (*Appeal of Xie*, 2018-OTA-076P.) To overcome the presumption of correctness attached to the penalty, a taxpayer must provide credible and competent evidence supporting a claim of reasonable cause; otherwise, the penalty cannot be abated. (*Ibid*.) To establish reasonable cause, a taxpayer must show that the failure to file a timely return occurred despite the exercise of ordinary business care and prudence, or that cause existed as would prompt an ordinarily intelligent and prudent businessperson to have so acted under similar circumstances. (*Appeal of Belcher*, 2021-OTA-284P.)

Illness and other personal difficulties may be considered reasonable cause if a taxpayer presents credible and competent proof that the taxpayer was continuously prevented from filing a tax return. (*Appeal of Head and Feliciano*, 2020-OTA-127P.) However, if the difficulties simply caused a taxpayer to sacrifice the timeliness of one aspect of the taxpayer's affairs to pursue other aspects, the taxpayer must bear the consequences of that choice. (*Ibid*.) The taxpayer's selective inability to perform tax obligations, while participating in regular business activities, does not establish reasonable cause. (*Ibid*; *Watts v. Commissioner* (1999) T.C. Memo. 1999-416.)

Appellant's 2014 tax return was due on April 15, 2015. Appellant filed the return on July 8, 2016, approximately 15 months late. Appellant states that his professional duties as an infrastructure designer for the United States military prevented him from timely filing his tax return. However, appellant has not provided evidence to support that his professional work obligations continuously prevented him from filing his tax return. Nevertheless, the inability to file a return in a timely fashion because of the press of business affairs or work pressures is not reasonable cause. Additionally, appellant claims he suffers from non-diagnosed post-traumatic stress disorder. However, appellant has not provided credible and competent proof that he was continuously prevented from filing a return due to his illness, such as documentation from doctors' offices or hospitals documenting any illness. Therefore, appellant has not established

reasonable cause for failing to timely file his 2014 tax return and the late filing penalty will not be abated.

Issue 3: Whether appellant has established a basis to abate interest.

Tax is due on the original due date of the return without regard to any filing extension. (R&TC, § 19001.) If a taxpayer does not pay the tax by the original due date of the tax return, or if FTB assesses additional tax, the law provides for charging interest on the balance due. (R&TC, § 19101.) Imposition of interest is mandatory; it is not a penalty, but it is compensation for a taxpayer's use of money after it should have been paid to the state. (*Appeal of Moy*, 2019-OTA-057P.) There is no reasonable cause exception to the imposition of interest. (*Ibid*.) To obtain relief from interest, a taxpayer must qualify under the waiver provisions of R&TC sections 19104, 19112, or 21012.[4] (*Ibid*.) In this case, appellant only provides reasonable cause type arguments for the abatement of interest. Appellant has not shown that he qualifies for waiver or abatement of interest under the provisions of R&TC sections 19104, 19112 or 21012.

[4] Under R&TC section 19104, FTB is authorized to abate or refund interest if there has been an unreasonable error or delay in the performance of ministerial or managerial act by an employee of FTB. R&TC section 21012 may apply where there has been reliance on written advice requested of FTB. Appellant does not allege any unreasonable error or delay by FTB or that he relied upon written advice from FTB. Finally, OTA does not have jurisdiction over R&TC section 19112 relating to extreme financial hardship. (*Appeal of Moy*, *supra*.)

HOLDINGS

1. Appellant has not established error in FTB's proposed assessment for the 2014 tax year, or the federal action on which it is based, beyond the amount conceded by FTB.
2. Appellant has not established reasonable cause to abate the late filing penalty.
3. Appellant has not established a basis to abate interest.
4. The accuracy-related penalty is abated based on FTB's concession on appeal.

DISPOSITION

FTB's action is adjusted, as conceded on appeal, to reduce the proposed assessment of additional tax to $3,991, recalculate the late filing penalty to $137.75, abate the accuracy-related penalty, and recalculate interest accordingly. FTB's action is otherwise sustained.

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Sara A Hosey
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Sara A. Hosey
Administrative Law Judge

We concur:

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John O Johnson
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John O. Johnson
Administrative Law Judge

DocuSigned by:
Tommy Leung
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Tommy Leung
Administrative Law Judge

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