

**OFFICE OF TAX APPEALS
STATE OF CALIFORNIA**

In the Matter of the Appeal of:) OTA Case No. 21057835
A. SOTO AND)
L. SOTO)
_____)

OPINION

Representing the Parties:

For Appellants: Thaddeus Allen, Representative

For Respondent: Eric R. Brown, Attorney

For Office of Tax Appeals: Andrew Jacobson, Attorney

T. LEUNG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, A. Soto and L. Soto (appellants) appeal an action by the Franchise Tax Board (respondent) proposing additional tax of \$72,310, a late filing penalty of \$18,077.50, and an accuracy-related penalty of \$14,462, plus interest, for the 2015 taxable year.

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

ISSUES

1. Have appellants shown that respondent’s imposition of additional tax, which is based on an IRS audit, is incorrect?
2. Should the late filing penalty be waived?
3. Are appellants liable for the accuracy-related penalty?

FACTUAL FINDINGS

1. Appellants filed their 2015 California Resident Income Tax Return (Form 540) late, on May 1, 2017.
2. Appellants’ 2015 federal income tax return was examined by the IRS, which resulted in adjustments that increased their taxable income from \$32,676 to \$788,818; the IRS

adjustments included the disallowance of various deductions, and the addition of items of unreported income. The IRS reported these adjustments to respondent. Appellants' 2015 federal transcript shows that the IRS adjustments were assessed, and that collection activities were ongoing in November 2021.

3. Based on the IRS adjustments, respondent made corresponding adjustments to appellants' 2015 Form 540, increasing their California taxable income from \$54,117 to \$793,330, an increase of \$739,213. Consequently, respondent imposed additional tax, a late filing penalty, and an accuracy-related penalty, plus interest.
4. Appellants protested the adjustments, which respondent denied.

DISCUSSION

Issue 1: Have appellants shown that respondent's imposition of additional tax, which is based on an IRS audit, is incorrect?

When the IRS makes changes to a taxpayer's federal tax return, the taxpayer must report those changes to respondent, and concede the accuracy of the federal changes or state why the changes are erroneous. (R&TC, § 18622(a).) A deficiency assessment based on a federal audit report is presumptively correct, and a taxpayer bears the burden of proving that the determination is erroneous. (*Appeal of Gorin*, 2020-OTA-018P.) Unsupported assertions by taxpayers are insufficient to satisfy their burden of proof with respect to a proposed assessment based on a federal action. (*Ibid.*)

Appellants argue that the proposed assessment is erroneous because it is based on a federal determination that is not final. Appellants assert that they submitted a 2015 amended federal return (Form 1040X) to the IRS on April 29, 2021, and an IRS Appeals Officer confirmed on May 18, 2021, that the Form 1040X was "pending processing." Appellants provided a copy of a 2015 Form 1040X, which was signed by the tax preparer on March 7, 2019. In addition, appellants apparently provided to respondent a letter dated February 8, 2022, from the IRS, purporting to show that the IRS was still examining their 2015 amended federal return.¹

Appellants' 2015 federal account transcript shows that appellants filed a 2015 Form 1040X with the IRS on November 23, 2020, that the Form 1040X was filed again with the IRS on April 30, 2021, and that the IRS thereafter pursued collection action against

¹ This letter is not in the record.

appellants. There is no evidence that the IRS accepted appellants' 2015 Form 1040X or that it subsequently made any adjustments to the federal determination on which respondent based its proposed assessment. However, appellants' 2015 federal account transcript shows that the IRS was engaged in collection activities against appellants at this time and was no longer examining appellants' 2015 federal return with regard to any substantive tax issues. In addition, respondent argues that the February 8, 2022 letter provides no language to support appellants' contention that the IRS was still reviewing their 2015 federal return. What is evident from the record is that, in spite of the various Forms 1040X filed by appellants and the IRS's 2022 letter, the IRS adjustments had become final, and respondent used those IRS adjustments to issue its proposed assessment, as required by law. Therefore, appellants have provided no persuasive arguments as to why respondent's proposed assessment is incorrect. Accordingly, appellants have failed to meet their burden of proving error in the proposed assessment, which is based on a federal determination. (*Appeal of Valenti*, 2021-OTA-093P.)

Issue 2: Should the late filing penalty be waived?

A late filing penalty is imposed when a taxpayer fails to file a tax return on or before the due date, unless the taxpayer establishes that the late filing was due to reasonable cause and not willful neglect. For every month that the return is late, the penalty is 5 percent of the tax due, up to a maximum of 25 percent. (R&TC, § 19131(a).) 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 intelligent and prudent businessman to have acted in such a way under similar circumstances. (*Appeal of GEF Operating, Inc.*, 2020-OTA-057P.) Unsupported assertions are not enough to satisfy a taxpayer's burden of proof. (*Ibid.*)

Here, respondent properly imposed the late filing penalty because appellants filed their 2015 Form 540 on May 1, 2017, more than a year after the original due date of April 15, 2016. Moreover, appellants do not dispute that the penalty was properly calculated. Appellants have not provided any reasonable cause argument as to why their 2015 Form 540 was filed late. Therefore, appellants have failed to show reasonable cause for filing their 2015 Form 540 late; thus, there is no basis for waiving the late filing penalty.

Issue 3: Are appellants liable for the accuracy-related penalty?

R&TC section 19164 generally incorporates the provisions of IRC section 6662 and 6664 and imposes an accuracy-related penalty of 20 percent on any portion of the underpayment attributable to a 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 return for the tax year, over the amount of tax imposed that is shown on the return, reduced by any rebate. (IRC, § 6662(d)(2)(A).) For individuals, a substantial understatement of income tax is defined as an understatement that exceeds the greater of 10 percent of the tax required to be shown on the return or \$5,000. (IRC, § 6662(d)(1)(A).)

The taxpayer bears the burden of proving any defenses to the imposition of the accuracy-related penalty. (*Recovery Group, Inc. v. Commissioner*, T.C. Memo. 2010-76, affd. (1st Cir. 2011) 652 F.3d 122.) In determining whether there is a substantial understatement, the amount of the understatement shall be reduced by any portion of the understatement that is attributable to: (1) the tax treatment of any item by the taxpayer if there is or was substantial authority for such treatment; or (2) any item if the relevant facts affecting the item's tax treatment were adequately disclosed in the return (or in a statement attached to the return) and there is a reasonable basis for the tax treatment of the item by the taxpayer. (IRC, § 6662(d)(2)(B); see also Treas. Reg. § 1.6662-4(d)-(f).) The accuracy-related penalty also does not apply to any portion of an 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. (IRC, § 6664(c)(1).)

Here, the IRS and respondent each imposed the accuracy-related penalty for the 2015 taxable year based on a substantial understatement of tax. Appellants' understatement of California income tax of \$72,310 is substantial because it exceeds \$7,301, which is 10 percent of the tax required to be shown on the return, \$73,018, and is greater than \$5,000. Thus, respondent properly imposed an accuracy-related penalty because there was a substantial understatement of tax.


Appellants neither dispute the computation of the accuracy-related penalty nor argue (or assert any facts establishing) any defenses to the imposition of the accuracy-related penalty, and there is no such evidence in the appeal record. Accordingly, appellants have failed to show that the accuracy-related penalty should be waived.

HOLDINGS

1. Appellants have not shown that respondent’s imposition of additional tax, which was based on an IRS audit, was incorrect.
2. The late filing penalty cannot be waived.
3. Appellants are liable for the accuracy-related penalty.

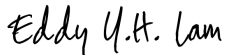
DISPOSITION

Respondent’s action is sustained.


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 Tommy Leung
 Administrative Law Judge

We concur:

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 Eddy Y.H. Lam
 Administrative Law Judge

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 Teresa A. Stanley
 Administrative Law Judge

Date Issued: 2/1/2024