

**OFFICE OF TAX APPEALS**  
**STATE OF CALIFORNIA**

In the Matter of the Appeal of: )  
**F. VENEGAS** ) OTA Case No. 220810986  
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**OPINION**

Representing the Parties:

For Appellant: F. Venegas

For Respondent: Joel Smith, Attorney

V. LONG Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, F. Venegas (appellant) appeals an action by respondent Franchise Tax Board (FTB) proposing additional tax of \$2,784, a late-filing penalty of \$696, and applicable interest for the 2019 tax year.

Appellant elected to have this appeal determined pursuant to the procedures of the Small Case Program. Those procedures require the assignment of a single administrative law judge. (Cal. Code Regs., tit. 18, § 30209.05.) Office of Tax Appeals (OTA) Administrative Law Judge Veronica I. Long held an oral hearing for this matter electronically on September 20, 2023. At the conclusion of the hearing, Judge Long requested additional briefing. Upon the receipt of additional briefing, the record was closed and this matter was submitted for an opinion.

**ISSUES**

1. Whether appellant has established error in FTB’s proposed assessment of tax, which is based on information FTB received from its Integrated Non-Filer Compliance (INC) Program.
2. Whether appellant has demonstrated that FTB improperly imposed the late-filing penalty.

FACTUAL FINDINGS

1. Appellant did not file a California income tax return for the 2019 tax year.
2. Through its INC Program, FTB received a 2019 Form 1098 issued by PennyMac Loan Services indicating that appellant paid mortgage interest of \$12,349 during 2019 on a property located in California. The mortgage interest information indicated to FTB that appellant may have a 2019 California filing requirement, but he had not filed a return.
3. FTB issued appellant a Request for Tax Return (Request) requesting that appellant file a 2019 California return, provide evidence that he already filed a 2019 California return, or complete a questionnaire form showing that he had no filing requirement for 2019.<sup>1</sup>
4. After appellant did not respond to the Request, FTB issued appellant a Notice of Proposed Assessment (NPA). The NPA stated that FTB had not received appellant's 2019 California return or information establishing that appellant did not have a filing requirement. Based on statistical information obtained from an analysis of returns filed by California residents, the NPA estimated appellant's gross income for the 2019 tax year to be \$74,094, which is six times the mortgage interest he paid for the year or (\$12,349 x 6). The NPA proposed tax of \$2,784, a late-filing penalty of \$696, and applicable interest.<sup>2</sup>
5. Appellant protested the NPA asserting that he was unemployed in 2019 and that his family's sole income for the year was his wife's social security disability benefits. Appellant also stated that his wife received treatment for cancer during 2019.
6. In response to appellant's protest, FTB requested that appellant produce copies of credit card and/or bank account statements for January, June, and December and documentation of non-taxable income benefits, such as an SSA-1099 statement of benefits.
7. After appellant did not respond, FTB issued a Notice of Action affirming its NPA.

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<sup>1</sup> A California resident who was a single individual under the age of 65 years old, with no dependents, has a California filing requirement for the 2019 tax year if the individual's California gross income exceeds \$18,241 or the individual's California adjusted gross income (AGI) exceeds \$14,593. For married taxpayers filing jointly, the minimum California gross income filing threshold dependents was \$36,485, or California AGI of \$29,190. (See <https://www.ftb.ca.gov/forms/2019/2019-540-booklet.html#Do-I-Have-to-File>.)

<sup>2</sup> The NPA stated that the proposed assessment was based on the standard deduction and exemption credits on a single individual with no dependents, which may not include all estimated tax payments and withholding credits that appellant is entitled to claim and FTB would revise any difference in filing status, additional deductions, exemptions, or credits when appellant files his required return.

8. This timely appeal followed.
9. On appeal, FTB provided a copy of appellant's IRS wage and income transcript for 2019, which included the Form 1098 mortgage interest statement but did not show any income.
10. At the hearing, appellant and his wife testified under oath that during 2019:
  - appellant's wife had cancer;
  - appellant and his wife had two minor children;<sup>3</sup>
  - appellant was unemployed and cared for his wife during her illness;
  - appellant's wife and minor children received social security disability benefits and food assistance;
  - appellant and his wife rented out a room in their residential house for \$800 per month including utilities;
  - appellant and his wife received financial support from their family;
  - appellant's mortgage payments were made with proceeds from social security disability payments, family support, and rental income.

#### DISCUSSION

Issue 1: Whether appellant has established error in FTB's proposed assessment of tax, which is based on information FTB received from its INC Program.

R&TC section 17041(a) provides, in pertinent part, that tax shall be imposed on the entire taxable income of every resident of California. R&TC section 17071 incorporates Internal Revenue Code (IRC) section 61, which defines "gross income" as including all income from whatever source derived. R&TC section 18501 requires every individual subject to the Personal Income Tax Law to make and file a return with FTB "stating specifically the items of the individual's gross income from all sources and the deductions and credits allowable," if an individual has gross income or adjusted gross income exceeding certain filing thresholds. (R&TC, § 18501(a)(1)-(4).) R&TC section 19087(a) provides that if any taxpayer fails to file a return, FTB, at any time, "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."

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<sup>3</sup> Appellant's wife testified that they allowed their children to be claimed as dependents by another family member. For this reason, OTA will not include appellant's children as dependents.

When FTB makes a tax assessment based on an estimate of income, FTB's initial burden is to show that its proposed assessment is reasonable and rational. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509, 514; *Appeal of Bindley*, 2019-OTA-179P (*Bindley*)). Federal courts have held that the taxing agency need only introduce some evidence linking the taxpayer with income-producing activity. (See *Rapp v. Commissioner* (9th Cir. 1985) 774 F.2d 932, 935.) A proposed assessment based on unreported income is presumed correct when the taxing agency introduces a minimal factual foundation to support the assessment. (*Bindley, supra*; see also *Andrews v. Commissioner*, T.C. Memo. 1998-316 [information including interest payments by the taxpayer and statistics can provide the "minimal factual predicate" for an assessment].)

Here, FTB estimated appellant's income for the 2019 tax year based on the mortgage interest that appellant paid, which was reported to FTB by a third party on a 2019 Form 1098. FTB estimated appellant's California income based on a six-to-one ratio of income to mortgage interest paid based on FTB's study of tax returns filed by California residents. FTB has conducted at least two studies establishing a statistical relationship between the income shown on taxpayers' tax returns and the mortgage interest paid by taxpayers. The premise of the studies is that a non-filer who can pay mortgage interest payments may have sufficient income to generate a filing requirement. The mortgage interest paid by appellant and reported on the 2019 Form 1098 qualifies as "some evidence linking [appellant] with income-producing activity" and as a minimal factual foundation to support the proposed assessment. (See *Rapp v. Commissioner, supra*, 774 F.2d at p. 935.) OTA finds that FTB's use of third-party information to estimate appellant's income using the six-to-one ratio of income to mortgage interest paid is reasonable and rational. OTA finds that FTB has met its initial burden by showing that its proposed assessment is reasonable and rational.

Once FTB has met its initial burden, the proposed assessment of tax is presumed correct, and the taxpayer has the burden of providing it to be wrong. (*Todd v. McColgan, supra*, 89 Cal.App.2d at p. 514; *Bindley, supra*.) Appellant and his wife provided sworn testimony that appellant did not work in 2019 while he provided care to his wife who had been diagnosed with cancer. Appellant and his wife also testified that their sole income was from social security disability payments, family support, and rental income. Appellant and his wife testified that they paid their mortgage using these funds. OTA finds appellant and his wife's testimony to be highly credible.

Social security benefits are excluded from California taxable income. (R&TC, § 17087(a).) The amount of rental income reportedly received by appellant and his wife in 2019 totaled approximately \$9,600.<sup>4</sup> While rental income is taxable in California under IRC section 61(a)(5), this amount does not exceed the threshold for appellant to have a filing requirement in California.<sup>5</sup>

The applicable standard of proof is by a preponderance of the evidence. (Cal. Code Regs., tit. 18 § 30219(b).) A preponderance of the evidence means a taxpayer must establish by documentation or other evidence that the circumstances the taxpayer asserts are more likely than not to be correct. (*Appeal of Estate of Gillespie* 2018-OTA-052P.) The direct evidence of one witness who is entitled to full credit is sufficient for proof of any fact, except where additional evidence is required by statute. (Evid. Code § 411.)<sup>6</sup>

OTA finds appellant and his wife's testimony credible, and sufficient to meet appellant's burden of proof that it is more likely than not that appellant did not have sufficient income to meet the California filing requirement for 2019. However, appellant is cautioned that his failure to provide documentation, such as copies of bank statements, credit card statements, and documentation of nontaxable income benefits, to FTB and OTA made this a difficult and close determination.

Issue 2: Whether appellant has demonstrated that FTB improperly imposed the late-filing penalty.

A late filing penalty will be imposed when a taxpayer fails to file a tax return on or before its due date, unless the taxpayer establishes that the late filing was due to reasonable cause and was not due to willful neglect. (R&TC, § 19131(a).) When FTB imposes a late filing penalty, the law presumes that the penalty was imposed correctly. (*Appeal of Xie*, 2018-OTA-076P.)

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<sup>4</sup> Appellant and his wife testified that they rented out a room in their home for \$800 a month, which results in an annual rent of \$9,600 (\$800 x 12 months).

<sup>5</sup> \$9,600 does not exceed the minimum threshold of gross income for a single filer of \$18,241, let alone the filing threshold for married filing jointly of \$36,485.

<sup>6</sup> OTA may use the California rules of evidence when evaluating the weight to give evidence presented in a proceeding. (Cal. Code Regs., tit. 18 § 30214(f)(4).)

As discussed above, appellant has met his burden of proving that he did not have a filing requirement for 2019. Accordingly, FTB did not properly impose the late-filing penalty. Appellant is therefore not liable for the late-filing penalty.

HOLDINGS

1. Appellant has established error in FTB’s proposed assessment of tax, which is based on information FTB received from its INC Program.
2. Appellant has demonstrated that FTB improperly imposed the late-filing penalty.

DISPOSITION

FTB’s proposed assessment of additional tax of \$2,784, a late-filing penalty of \$696, and applicable interest for the 2019 tax year is reversed.

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Veronica I. Long  
Administrative Law Judge

Date Issued: 2/28/2024