

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:)
P. MRDJEN AND)
J. MRDJEN)
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OTA Case No. 230613564

OPINION

Representing the Parties:

For Appellants: P. Mrdjen and J. Mrdjen

For Respondent: Christopher T. Tuttle, Attorney

A. KLETTER, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, P. Mrdjen and J. Mrdjen (appellants) appeal actions by respondent Franchise Tax Board (FTB) proposing to assess additional tax of \$10,046, an accuracy-related penalty (ARP) of \$2,009.20, and applicable interest for the 2010 tax year; additional tax of \$10,529, an ARP of \$2,105.80, a late-filing penalty of \$2,632.25, and applicable interest for the 2011 tax year; and additional tax of \$2,203, an ARP of \$440.60, and applicable interest for 2017 tax years.¹

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

ISSUES²

1. Whether the ARPs were properly imposed for the 2010 and 2011 tax years.
2. Whether appellants are entitled to interest abatement.

¹ Appellants concede the additional tax for all tax years at issue. FTB agrees to abate the late-filing penalty of \$2,632.25 for the 2011 tax year and the ARP of \$440.60 for the 2017 tax year. Thus, the ARPs of \$2,009.20 and \$2,105.80, for the 2010 and 2011 tax years, respectively, and interest remain at issue in this appeal.

² Appellants affirmatively raise a timeliness argument as a defense only to FTB’s imposition of penalties and interest for all tax years at issue; therefore, this Opinion will address the statute of limitations in considering whether the ARPs were properly imposed, and whether appellants are entitled to interest abatement due to their assertion that FTB’s proposed assessments were unreasonably delayed.

FACTUAL FINDINGS

2010 Tax Year

1. Appellants timely filed their joint 2010 California Resident Income Tax Return (return) reporting zero total tax.
2. FTB received information from the IRS on October 24, 2017, indicating that it had audited appellants' 2010 federal income tax return and increased appellants' federal income.³ The IRS assessed additional federal tax of \$47,348 (rounded) based on its adjustments and imposed a federal ARP. Appellants did not report the federal changes to FTB.
3. To the extent allowable by California law, FTB made comparable adjustments to appellants' 2010 return and issued appellants a Notice of Proposed Assessment (NPA) on October 22, 2021, that proposed to assess additional tax of \$10,046 plus interest.
4. FTB also proposed a California ARP of \$2,009.20 for the 2010 tax year.

2011 Tax Year

5. On January 4, 2013, appellants untimely filed their joint 2011 return reporting zero total tax.
6. FTB received information from the IRS on October 24, 2017, indicating that it had audited appellants' 2011 federal income tax return and increased appellants' federal income.⁴ The IRS assessed additional federal tax of \$47,145 based on its adjustments and imposed a federal ARP. Appellants did not report the federal changes to FTB.
7. To the extent allowable by California law, FTB made comparable adjustments to appellants' 2011 return and issued appellants an NPA on October 22, 2021, that proposed to assess additional tax of \$10,529 plus interest.
8. FTB also proposed a California ARP of \$2,105.80 for the 2011 tax year and a late-filing penalty of \$2,632.25.⁵

³ Appellants provide no specific argument against the federal and California adjustments for the tax years at issue; therefore, this Opinion does not discuss them in detail here. The IRS made its final federal determinations for the 2010 tax year in December 2015; however, the IRS did not notify FTB until October 2017.

⁴ The IRS made its final federal determinations for the 2011 tax year in December 2015; however, the IRS did not notify FTB until October 2017.

⁵ As noted above, FTB agrees to abate the late-filing penalty on appeal.

2017 Tax Year

9. Appellants timely filed their joint 2017 return.
10. FTB received information from the IRS on January 5, 2021, indicating that it had audited appellants' 2011 federal income tax return and increased appellants' federal income.⁶ The IRS assessed additional federal tax of \$19,521 based on the federal adjustments and imposed a federal ARP. Appellants did not report the federal changes to FTB.
11. To the extent allowable by California law, FTB made comparable adjustments to appellants' 2017 return and issued appellants an NPA on December 29, 2021, that proposed to assess additional tax of \$2,203 plus interest.
12. FTB also proposed a California ARP of \$440.60 for the 2017 tax year.⁷

Protest and Appeal of the 2010, 2011, and 2017 tax years

13. Appellants protested the three NPAs for the 2010, 2011 and 2017 tax years. In October 2022, FTB issued position letters to appellants explaining that it would affirm each of the NPAs. In the position letters, FTB explained the IRS adjustments, that information received from the IRS did not show that the federal assessments had been reduced or cancelled, and how FTB calculated appellants' California tax liabilities.
14. Next, appellants requested penalty and interest abatement for the 2010, 2011 and 2017 tax years.
15. On May 25, 2023, FTB issued Notices of Action affirming the NPAs, and on that same day, FTB issued letters denying appellants' interest abatement requests.
16. Appellants timely appealed. On appeal, FTB provides appellants' federal account transcripts for the 2010 and 2011 tax years, which show that the IRS imposed the federal ARPs due to a substantial understatement, and that the penalties have not been revised or abated as of June 20, 2023.

⁶ The IRS made its final federal determinations for the 2017 tax year in December 2020; however, the IRS did not notify FTB until January 2021.

⁷ As noted above, FTB agrees to abate the ARP for the 2017 tax year on appeal.

DISCUSSION

Issue 1: Whether the ARPs were properly imposed for the 2010 and 2011 tax years.

R&TC section 19164, which incorporates the provisions of Internal Revenue Code (IRC) section 6662,⁸ provides for an ARP of 20 percent of the portion of an underpayment of the tax that was required to be shown on the taxpayer's return. (See also *Appeal of Daneshgar*, 2021-OTA-210P.) FTB's proposed assessment based upon a final federal determination is presumed to be correct. (*Ibid.*; see also *Appeal of Xie*, 2018-OTA-076P [FTB penalties are presumed to be imposed correctly].) As relevant here, the penalty applies to the portion of the underpayment attributable to any substantial understatement of income tax. (IRC, § 6662(b)(2).) For individual taxpayers, there is a "substantial understatement of income tax" when the amount of the understatement for a taxable year 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 record shows that the ARPs were properly imposed for the 2010 and 2011 tax years. The IRS's proposed assessments for the 2010 and 2011 tax years were based on respective understated federal tax of \$47,347 and \$47,145, which were substantial understatements of tax for federal tax purposes. (IRC, § 6662(b)(2).) For California purposes, appellants reported zero California tax on their 2010 and 2011 returns, but FTB's NPAs determined that the tax for the 2010 and 2011 tax years was understated by \$10,046 and \$10,529, respectively. The California understatements for the 2010 and 2011 tax year were also substantial understatements of tax.⁹ (R&TC, § 19164(a)(1)(A); IRC, § 6662(b)(2).) FTB's assessments were based on the IRS's imposition of ARPs for the 2010 and 2011 tax years for substantial understatements of tax and are presumed to be correct. (See *Appeal of Daneshgar*, *supra*.) FTB correctly calculated the ARPs as \$2,009.20 and \$2,105.80, which equal 20 percent of \$10,046 and \$10,529, respectively.

⁸ See R&TC section 19164 as in effect for the 2010 and 2011 tax years. For those tax years, R&TC section 17024.5(a)(1)(O) provides that for Personal Income Tax Law purposes, California conforms to the IRC as effective on January 1, 2009. Thus, references to the IRC contained in this Opinion are to the IRC as effective on January 1, 2009.

⁹ An understatement is a "substantial understatement" if it exceeds the greater of \$5,000 or 10 percent of the tax required to be shown on the return. (IRC, § 6662(d)(1)(A).) Here, the understatements of tax exceeded \$5,000. The understatements also exceeded 10 percent of the tax required to be shown on the return; as appellants reported zero total tax on their returns for these years, 100 percent of the proposed additional tax was understated.

There are various exceptions to the imposition of the ARP. The ARP shall be reduced by the portion of the understatement attributable to the tax treatment of any item if there was substantial authority for that treatment, or the relevant facts affecting the item's tax treatment are adequately disclosed and there is a reasonable basis for the tax treatment of such item. (IRC, § 6662(d)(2)(B)(i)-ii.) Additionally, the ARP will not be imposed to the extent that a taxpayer has shown that a portion of the underpayment was due to reasonable cause and the taxpayer acted in good faith with respect to that portion of the underpayment. (R&TC, § 19164(d)(1); IRC, § 6664(c)(1); Treas. Reg. §§ 1.6664-1(b)(2), 1.6664-4(a).) The taxpayer bears the burden of proving any defenses to the imposition of the ARP. (*Recovery Group, Inc. v. Commissioner*, T.C. Memo. 2010-76.) The taxpayer may rebut the presumption that a penalty was properly imposed by providing credible and competent evidence supporting abatement of the penalty for reasonable cause. (*Appeal of Xie, supra.*)

Appellants have not asserted any facts or legal authority to establish any of the potentially applicable defenses. Rather, appellants assert that FTB assessed interest and penalties after a delay caused by FTB's negligence. In response, FTB explained that there are statutes of limitation for FTB to assess deficiency notices based on final federal determinations, discussed in more detail following. Appellants responded, asserting that FTB had four years to inform appellants of the interest and penalties due, and that since that period had passed by many years, appellant should not be assessed for penalties. OTA treats appellants arguments as contention that FTB is barred by the statute of limitations from assessing the ARPs for the 2010 and 2011 tax years.¹⁰

In general, FTB must issue a proposed assessment within four years of the date the taxpayer files his or her California return. (R&TC, § 19057(a).) However, if the IRS makes a change or correction to "any item required to be shown on a federal tax return, including any gross income, deduction, penalty, credit, or tax for any year," the taxpayer must report the federal change to FTB within six months after the date it becomes final. (R&TC, § 18622(a).) If there are adjustments to a taxpayer's federal account and the taxpayer or the IRS notifies FTB within six months of the date that the federal changes become final, then FTB may issue a proposed assessment within two years of the date of notification, or within the general four-year

¹⁰ Concerning interest, OTA treats appellants' arguments as a contention that FTB unreasonably delayed its issuance of the NPAs to appellants for the tax years at issue, and addresses that argument in Issue 2, below.

statute of limitations period, whichever expires later. (R&TC, § 19059(a).) If the taxpayer or the IRS notifies FTB of the federal change or correction after the six-month period required by R&TC section 18622, then FTB may issue a proposed assessment within four years of the date of notification. (R&TC, § 19060(b).)

Here, for the 2010 and 2011 tax years, the IRS notified FTB on October 24, 2017, after the six-month period required in R&TC section 18622; therefore, FTB was required to issue NPAs within four years from the date of notification. (R&TC, § 19060(b).) FTB issued appellants the NPAs on October 22, 2021, within four years. For the 2017 tax year, the IRS notified FTB on January 5, 2021, within six months of the final federal determination date; therefore, FTB was required to issue an NPA within the later of two years from the date of notification, or the general four-year statute of limitations period. (R&TC, § 19059(a).) FTB issued appellants the NPA on December 29, 2021, within two years.¹¹ Thus, FTB timely issued appellants the NPAs for the tax years at issue within the applicable statutes of limitation.

As described above, appellants have not established error in FTB's imposition of the ARPs, that an exception to the ARPs applies, or that FTB's NPAs which imposed the ARPs were untimely. Accordingly, the penalty may not be abated.

Issue 2: Whether appellants are entitled to interest abatement.

Interest must be assessed from the date a tax payment is due through the date that it is paid. (R&TC, § 19101(a).) Imposing interest is mandatory; it is not a penalty, but it is compensation for the taxpayers' use of money after it should have been paid to the state. (*Appeal of Moy*, 2019-OTA-057P.) Generally, to obtain relief from interest, taxpayers must qualify under R&TC section 19104 or 21012.¹² R&TC section 21012 does not apply because FTB did not provide appellants with any requested written advice. Pursuant to 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 a ministerial or managerial act by an employee of FTB.

¹¹ Appellants timely filed their joint 2017 return on May 2, 2018. The 2017 NPA, which was issued on December 29, 2021, was also timely under the general four-year statute of limitations. (See R&TC, § 19057(a).)

¹² Under R&TC section 19112, FTB may waive interest for any period for which FTB determines that an individual or fiduciary is unable to pay interest due to extreme financial hardship. OTA does not have authority to review FTB's denial of a request to waive interest under R&TC section 19112. (*Appeal of Moy, supra.*)

Here, appellants contend that FTB unreasonably delayed its issuance of the NPAs to appellants to October 22, 2021, for the 2010 and 2011 tax years, and to December 29, 2021, for the 2017 tax year. However, R&TC section 19104(b)(1) requires that any error or delay occur after FTB contacts appellants in writing about the deficiency. The record indicates that each of FTB's respective NPAs was its first written contact to appellants concerning the tax years at issue, and appellants provide no evidence to the contrary. Thus, the interest accrued on appellants' respective tax year accounts prior to the 2021 issuance of the NPAs may not be abated. Further, for interest abatement, R&TC section 19104(b)(1) requires that no significant aspect of the error or delay be attributable to the taxpayer. Here, appellants did not report the federal changes to FTB as R&TC section 18622(a) requires. FTB became aware of the federal changes only in 2017 when the IRS reported its changes to FTB for the 2010 and 2011 tax years, and in 2021 for the 2017 tax year. FTB timely assessed tax based on the federal changes. Appellants failed to report the federal changes to FTB, causing significant delay, thus, no abatement is warranted.

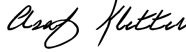
Based on the evidence in the record, none of the statutory provisions for abatement apply. Thus, appellants have not demonstrated any grounds for interest abatement.

HOLDINGS

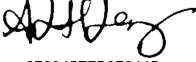
1. The ARPs were properly imposed for the 2010 and 2011 tax years.
2. Appellants are not entitled to interest abatement. However, interest should be modified to account for FTB’s agreement to abate the late-filing penalty for the 2011 tax year and the ARP for the 2017 tax year.


DISPOSITION

FTB’s actions are sustained, as modified to abate the late-filing penalty for the 2011 tax year, the ARP for the 2017 tax year, and applicable interest to account for the abatement of these penalties, consistent with FTB’s concessions on appeal.

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 Asaf Kletter
 Administrative Law Judge

We concur:

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 Andrea L.H. Long
 Administrative Law Judge

DocuSigned by:

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 Ovsep Akopchikyan
 Administrative Law Judge

Date Issued: 2/28/2024