

**OFFICE OF TAX APPEALS
STATE OF CALIFORNIA**

In the Matter of the Appeal of:)
K. SANDERS-MCCREE AND) OTA Case No. 220610503
C. MCCREE)
_____)

OPINION

Representing the Parties:

For Appellants: K. Sanders-McCree
For Respondent: Ariana Macedo, Attorney
Bradley J. Coutinho, Attorney

O. Akopchikyan, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, K. Sanders-McCree and C. McCree (appellants) appeal an action by respondent Franchise Tax Board (FTB) proposing additional tax of \$4,971, a late filing penalty of \$1,057, and applicable interest for the 2017 tax year.

Office of Tax Appeals (OTA) Administrative Law Judges Veronica I. Long, Tommy Leung, and Ovsep Akopchikyan held an electronic oral hearing for this matter on January 18, 2024. At the conclusion of the hearing, OTA kept the record open and asked the parties for additional information. OTA closed the record after additional briefing and submitted this appeal for an opinion.

ISSUES

1. Whether appellants have shown error in FTB’s proposed assessment.
2. Whether appellants have established reasonable cause to abate the late filing penalty.

FACTUAL FINDINGS

1. Appellants did not file a timely 2017 California income tax return.
2. FTB issued a Demand for Tax Return on April 23, 2019 (Demand), after learning that appellants filed a 2017 income tax return with the IRS using a California address.

3. Appellants did not respond to the Demand and FTB issued a Notice of Proposed Assessment (NPA), proposing to assess \$4,971 of tax, late filing and demand penalties, and interest based on \$136,404 of estimated adjusted gross income (AGI).
4. In response, appellants filed their 2017 California income tax return, asserting it was an amended return, and reporting federal AGI of \$74,000, California AGI of \$72,650, and tax of \$1,677. FTB accepted the return as filed and waived the late filing and demand penalties.
5. FTB subsequently received information from the IRS indicating the federal AGI, \$137,754, did not match the AGI appellants reported on the late-filed California return. FTB issued a second NPA increasing taxable income by \$63,754 and proposing additional tax of \$4,971, a late-filing penalty of \$1,057, and interest.
6. Appellants protested the second NPA, arguing that the federal AGI that FTB used was incorrect, and that appellants filed an amended federal return deducting the \$63,754 from taxable income. FTB issued a Notice of Action affirming the NPA on the basis that the IRS had not processed or accepted the amended return, and that appellants did not substantiate the correct amount of taxable income. This timely appeal followed.

DISCUSSION

Issue 1: Whether appellants have shown error in FTB's proposed assessment.

When FTB assesses tax based on an estimate of income, FTB has the initial burden to show that its assessment is reasonable and rational. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509, 514.) An assessment based on unreported income is presumed correct when the taxing agency introduces a minimal factual foundation to support the assessment. (*In re Olshan* (9th Cir. 2004) 356 F.3d 1078, 1084; *Appeal of Bindley*, 2019-OTA-179P.) Once FTB has met its initial burden, the assessment is presumed correct, and the taxpayer has the burden of proving error in the assessment. (*Todd v. McColgan, supra*; *Appeal of Bindley, supra*.)

In this case, FTB used appellants' federal AGI, as reported by appellants on their 2017 federal tax return, to estimate income for California income tax purposes. Appellants are California residents and R&TC section 17041(a) provides that California residents are taxed on their entire taxable income, regardless of source. R&TC section 17072(a) provides that a starting point for determining AGI for California income tax purposes is Section 62 of the Internal

Revenue Code, which defines AGI. Therefore, FTB's proposed assessment is reasonable and rational and the burden is on appellants to prove error in the proposed assessment.

At the hearing in this appeal, appellants argued that the discrepancy between the federal AGI of \$137,754, as reported, and the correct federal AGI of \$74,000, as appellants assert, is due to incorrectly reporting a loss of \$63,754 (the difference between the two AGI amounts) from appellant K. Sanders-McCree's wholly owned S corporation called TCR Services, Inc. Specifically, appellants contend that the tax preparer who prepared their Schedule K-1 from TCR Services, Inc. incorrectly reported the \$63,754 as a gain, not a loss. Appellants contend that the tax preparer subsequently issued an amended Schedule K-1 reporting a loss of \$63,754.

After the hearing in this appeal, OTA kept the record open and asked the parties to submit TCR Services, Inc.'s federal and California income tax returns, account and return transcripts, wage and income transcripts, and any audit reports that may have been issued for the 2017 tax year. Appellants did not respond to OTA's request for additional briefing. FTB responded and stated that TCR Services, Inc., did not file a 2017 California income tax return and provided TCR Services, Inc.'s federal account transcript and appellants' wage and income transcripts for 2017. None of the documents submitted by FTB substantiate appellants' claim that a loss of \$63,754 flowed through to them from TCR Services, Inc.; the nature of the loss; or that the loss could be deducted in the current tax year.

Accordingly, appellants have not met their burden of establishing error in FTB's proposed assessment.

Issue 2: Whether appellants have 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 GEF Operating, Inc.*, 2020-OTA-057P.)

Appellants contend that they filed their 2017 California income tax return on time and that they filed an amended return in response to FTB’s Demand for a tax return. However, the record does not contain any documentary evidence of the original filing, such as proof of mailing, email confirmation, or an affidavit from a tax professional. Accordingly, appellants have not established a basis to abate the late filing penalty.

HOLDINGS

1. Appellants have not shown error in FTB’s proposed assessment.
2. Appellants have not established reasonable cause to abate the late filing penalty.

DISPOSITION

FTB’s action is sustained.

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Ovsep Akopchikyan

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Ovsep Akopchikyan
Administrative Law Judge

We concur:

DocuSigned by:

Tommy Leung

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Tommy Leung
Administrative Law Judge

DocuSigned by:

Veronica I. Long

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Veronica I. Long
Administrative Law Judge

Date Issued: 3/18/2024