

**OFFICE OF TAX APPEALS
STATE OF CALIFORNIA**

In the Matter of the Appeal of:)
J. JAMES) OTA Case No. 22019553
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OPINION

Representing the Parties:

For Appellant: J. James
For Respondent: Camille Dixon, Attorney

E. LAM, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, J. James (appellant) appeals an action by respondent Franchise Tax Board (FTB) proposing, as relevant here, an accuracy-related penalty of \$3,921.60, and applicable interest¹ for the 2016 tax year. During the briefing period for this appeal, FTB concedes that it will reduce the proposed accuracy-related penalty to \$3,361.60 at the conclusion of this appeal.

Appellant waived the right to an oral hearing; therefore, the Office of Tax Appeals (OTA) decides this matter based on the written record.

ISSUES

1. Whether appellant demonstrated that the accuracy-related penalty should be abated.
2. Whether appellant established a legal basis to abate interest.

FACTUAL FINDINGS

1. Appellant timely filed his 2016 California Resident Income Tax Return (Form 540).
2. FTB received information indicating that the IRS audited appellant’s 2016 federal tax return. The IRS made various adjustments and imposed a 20 percent accuracy-related penalty on April 1, 2019. Appellant did not notify FTB of the federal adjustments.

¹ Appellant concedes the additional tax proposed by FTB, but not the applicable interest, which includes the interest on the additional tax, among other things.

Based on the federal adjustments, FTB made corresponding adjustments to appellant's 2016 California tax return.

3. On August 19, 2020, FTB issued appellant a Notice of Proposed Assessment (NPA). According to the NPA, FTB increased appellant's reported taxable income by \$166,349, which consisted of including \$160,100 of unreported pension or annuities income; disallowing \$67 of miscellaneous deduction; and disallowing \$6,182 of the itemized deduction as a result of the increase in adjusted gross income limitation. The NPA also applied a premature distribution tax of \$4,002 and determined a total tax of \$26,674. After applying the original tax of \$7,066 (i.e., the original tax payment remitted by appellant) and an additional withholding credit of \$2,800 (i.e., California withholding from the unreported pension or annuities income), the NPA proposed additional tax of \$16,808 (\$26,674 - \$7,066 - \$2,800), a 20 percent accuracy-related penalty of \$3,921, and applicable interest.
4. On October 16, 2020, FTB received appellant's protest letter dated October 14, 2020, in which appellant protested the NPA and asserted that he agreed to pay the \$16,808 additional tax, but is protesting the accuracy-related penalty and applicable interest, which includes interest on the additional tax.
5. On January 11, 2021, FTB received appellant's payment of \$16,808.
6. On June 28, 2021, FTB issued appellant a position letter stating, among other things, that FTB assessed the accuracy-related penalty as reported to FTB by the IRS. FTB also requested appellant to respond within 30 days from June 28, 2021, if he disagreed with FTB's position; otherwise, FTB would provide written notice affirming its action.
7. On October 7, 2021, FTB issued appellant a letter stating that appellant did not respond to FTB's June 28, 2021 position letter; therefore, FTB would affirm the NPA.
8. On December 27, 2021, FTB's Interest Abatement Team issued appellant a letter and determined that interest could not be waived.
9. Also on December 27, 2021, FTB issued appellant a Notice of Action (NOA), affirming the NPA. The NOA imposed interest for the following two periods: (i) \$3,168.61 of interest for the period April 15, 2017, to May 16, 2020; and (ii) \$1,123.13 of interest for the period September 3, 2020, to December 27, 2021.
10. This timely appeal followed.

11. FTB submits appellant's 2016 IRS Account Transcript, dated February 24, 2022, and 2016 federal Individual Master File (IMF), dated March 23, 2022, both of which show no subsequent reduction or cancellation of appellant's 2016 tax year's federal determination. The 2016 IMF has an entry for transaction code 240 (which relates to the assessment of an accuracy-related penalty) along with penalty reference number (PRN) 680.²
12. On appeal, FTB concedes that it will reduce the accuracy-related penalty to \$3,361.60 ([$\$26,674$ total tax – $\$7,066$ original total tax - $\$2,800$ additional withholding] -x- 20 percent) at the conclusion of this appeal.³

DISCUSSION

Issue 1: Whether appellant demonstrated that the accuracy-related penalty should be abated.

R&TC section 19164 generally incorporates the provisions of Internal Revenue Code (IRC) section 6662, which provides for an accuracy-related penalty of 20 percent of the applicable underpayment of tax. As relevant here, the accuracy-related penalty applies to the portion of the underpayment attributable to: (1) negligence or disregard of rules and regulations, or (2) any substantial understatement of income tax. (IRC, § 6662(b)(1) & (2).)

The proposed assessment is based on a federal determination, which imposed the accuracy-related penalty based on both substantial understatement and negligence as a secondary consideration. For an individual, 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 \$5,000.⁴ (R&TC, § 19164; IRC, § 6662(d)(1)(A).)

Here, appellant does not dispute that there was a substantial understatement on the return, that the understatement was correctly calculated, or that FTB properly assessed the penalty based upon the information then available to it. Additionally, according to available evidence in the

² PRN 680 pertains to the assessment of the penalty for *both* substantial understatement *and* negligence as a secondary consideration. (See https://www.irs.gov/irm/part20/irm_20-001-005#idm1401692946735520.)

³ FTB previously calculated the accuracy-related penalty to be \$3,921 ([$\$26,674$ total tax – $\$7,066$ original total tax] x 20 percent), but it did not take into consideration the additional withholding of \$2,800.

⁴ The “amount of the tax required to be shown on the return” is synonymous with “the amount of income tax imposed” as defined in Treasury Regulation section 1.6664-2(b). (Treas. Reg. § 1.6662-4(b)(3).) Treasury Regulation section 1.6664-2(b) essentially provides that this is the amount of tax imposed on the taxpayer, determined without regard to, among other items, credits relating to tax withheld on wages and payments of tax or estimated tax by the taxpayer.

record, appellant's California understatement of income tax of \$16,808 exceeds the greater of two thresholds: (i) 10 percent of the tax required to be shown on the return, equating to \$2,667.40 (10 percent x \$26,674 of total tax); or (ii) \$5,000. (IRC, § 6662(d)(1)(A).) Therefore, OTA finds that FTB properly imposed the accuracy-related penalty based on substantial understatement of income tax.

The accuracy-related penalty may be reduced or abated to the extent a taxpayer shows that: (1) there is substantial authority for appellants' reporting position, (2) the position was adequately disclosed in the tax return (or a statement attached to the return) and there is a reasonable basis for treatment of the item, or (3) that they acted in good faith and had reasonable cause for the understatement. (IRC, §§ 6662(d)(2)(B), 6664(c)(1); R&TC, § 19164(d); Cal. Code Regs., tit. 18, § 19164(a); see *Appeals of Lovinck Investments N.V., et al.*, 2021-OTA-294P.) As relevant to this appeal, a determination of whether a taxpayer acted with reasonable cause and in good faith is made on a case-by-case basis and depends on the pertinent facts and circumstances, including the taxpayer's efforts to assess the proper tax liability, the taxpayer's knowledge and experience, and the extent to which the taxpayer relied on the advice of a tax professional. (Treas. Reg. § 1.6664-4(b)(1).)

Here, appellant contends that the omitted income was from an early withdrawal from his pension account due to financial hardship. Appellant asserts that he used an accountant, he had paid the tax on the early withdrawal in good faith, and any error was due to an oversight with no intent to defraud. Appellant also contends that the impact of COVID-19 hindered the resolution of his tax matters. In essence, appellant contends that he acted in good faith and that these circumstances are reasonable cause for the understatement. However, appellant has not demonstrated that his omission of pension income, leading to the substantial understatement of tax, occurred despite exercising ordinary business care and prudence. In fact, evidence in the record does not establish that appellant took any steps or efforts to properly assess the tax liability from the early withdrawal of his pension account on Form 540. (See Treas. Reg. § 1.6664-4(b)(1).) Additionally, there is no evidence of any communication from appellant's accountant outlining the analysis or conclusion that the \$2,800 of California tax withholding was sufficient to avoid the imposition of the accuracy-related penalty. (See Treas. Reg. § 1.6664-4(c)(2).) Furthermore, appellant does not present any additional facts or legal authority to

establish other potentially applicable defenses. Accordingly, OTA concludes that appellant has failed to establish that the penalty should be abated.

Issue 2: Whether appellant established a legal basis to abate interest.

When a taxpayer fails to pay any amount of tax by the due date, the law requires FTB to impose interest, which accrues from the due date until the date the tax is paid. (R&TC, § 19101(a).) Interest is also imposed on penalties. (R&TC, § 19101(c)(2).) In relevant parts, interest imposed with respect to any addition to tax pertaining to R&TC section 19164 (relating to imposition of the accuracy-related penalty) accrues on the due date of the tax return, including any extensions, and ends on the date of payment. (R&TC, § 19101(c)(2)(B).) Interest is not a penalty but is compensation for the taxpayer's use of money that should have been paid to the state. (*Appeal of Balch*, 2018-OTA-159P.) Imposition of interest is mandatory, and it can only be abated in certain limited situations when authorized by law. (R&TC, § 19101(a); *Appeal of Balch*, *supra*.) There is no reasonable cause exception to the imposition of interest. (*Appeal of Moy*, 2019-OTA-057P.)

As relevant to this appeal,⁵ FTB may abate interest related to a proposed deficiency to the extent the interest is attributable in whole or in part to: (1) an unreasonable error or delay; (2) by an officer or employee of FTB acting in his or her official capacity; (3) in performing a ministerial or managerial act; and (4) which occurred after FTB contacted the taxpayer in writing regarding the proposed deficiency, provided no significant aspect of that error or delay can be attributable to the taxpayer. (R&TC, § 19104(a)(1), (b)(1); *Appeal of Gorin*, 2020-OTA-018P.)

However, OTA's jurisdiction in an interest abatement case is limited. OTA only reviews FTB's failure to abate interest for abuse of discretion. (R&TC, § 19104(b)(2)(B).) To show an abuse of discretion, a taxpayer must establish that, in refusing to abate interest, FTB exercised its discretion arbitrarily, capriciously, or without sound basis in fact or law. (*Appeal of Gorin*, *supra*.) Interest abatement provisions are not intended to be routinely used to avoid the payment of interest; thus, abatement should be ordered only where failure to abate interest would be widely perceived as grossly unfair. (*Ibid.*)

⁵ Generally, to obtain relief from interest, a taxpayer must qualify under one of the following three R&TC sections: 19104, 19112, or 21012. (*Appeal of Moy*, *supra*.) However, OTA has no jurisdiction to determine whether a taxpayer is entitled to abatement of interest under R&TC section 19112. (*Ibid.*) Also, R&TC section 21012 is not relevant here because evidence in the record does not demonstrate that FTB provided appellant with any written advice. Therefore, only R&TC section 19104 is at issue.

Here, FTB imposed interest on two periods. For the first period, FTB imposed interest in the amount of \$3,168.61 from April 15, 2017, to May 16, 2020 (First Period). As stated above, R&TC section 19104(b)(1) provides that an error or delay can only be considered for purposes of interest abatement *after* FTB contacted appellant in writing with respect to the deficiency. Therefore, no interest may be abated for periods prior to FTB contacting appellant in writing with respect to that deficiency or payment. (See R&TC, § 19104(b)(1).) Here, FTB first contacted and issued appellant an NPA on August 19, 2020. However, appellant is disputing the interest assessed during the First Period on appeal, which predates August 19, 2020. The law is clear that no portion of the interest imposed for the First Period is eligible for abatement because there is no evidence in the record showing that FTB contacted appellant in writing prior to the First Period. As such, OTA finds that FTB did not abuse its discretion in failing to abate interest for the First Period, and interest abatement is not applicable.

For the second period, FTB imposed interest in the amount of \$1,123.13 from September 3, 2020, to December 27, 2021 (Second Period). Here, appellant filed a protest with FTB by letter dated October 14, 2020, which FTB received on October 16, 2020. It was not until June 28, 2021, that FTB responded to appellant's protest requesting more information. This was later followed by a letter sent by FTB on October 7, 2021, indicating that it had not received appellant's reply to the June 28, 2021 position letter. Finally, it was not until December 27, 2021, that FTB issued an NOA affirming its previous decision from the NPA.

However, the mere passage of time does not establish error or delay in performing a ministerial or managerial act. (*Appeal of Gorin, supra*; see, e.g., *Ibrahim v. Commissioner*, T.C. Memo. 2011-215.)⁶ In fact, R&TC section 19104(b)(1) requires that no significant aspect of the error or delay be attributable to the taxpayer involved. Here, the interest that accrued during the Second Period was due to a protest initiated by appellant by letter dated October 14, 2020; therefore, OTA finds that FTB did not abuse their discretion in not abating interest.

Appellant also asserts that interest from the Second Period should be abated because the state office closures resulting from the COVID-19 pandemic prevented him from reaching a resolution on this tax issue. However, appellant provides no evidence, and the record does not

⁶ R&TC does not define what is meant by an "unreasonable error or delay." However, California's interest abatement provision under R&TC section 19104(a)(1) for unreasonable error or delay applies the same standard and uses substantially identical language as IRC section 6404(e), which is the comparable federal statute authorizing interest abatement for unreasonable error or delay. Therefore, it is appropriate to look to federal authority for guidance. (*Douglas v. State* (1948) 48 Cal.App.2d 835, 838; *Appeal of Kishner* (99-SBE-007) 1999 WL 1080250.)

indicate, that FTB committed any unreasonable error or delay in performing a ministerial or managerial act due to the alleged office closures. For example, there was no evidence to suggest that FTB's mere passage of time in responding to appellant's protest was unreasonable, or that the COVID-19 office closures themselves would indicate that FTB employees assigned to review appellant's matter were not actively working under reasonable workload constraints. (See *Appeal of Gorin, supra.*) Furthermore, appellant did not show that the tax liability would have been paid earlier, but for an unreasonable error or delay by FTB. (See *Hull v. Commissioner*, T.C. Memo. 2014-36.) Therefore, OTA finds that FTB's denial of appellant's request for abatement of interest for the Second Period was not an abuse of discretion. Consequently, OTA denies the request for relief of interest.


However, FTB concedes that it will reduce the accuracy-related penalty to \$3,361.60 at the conclusion of this appeal. Therefore, applicable interest, if any, with respect to any addition to tax imposed by R&TC section 19164, must also be adjusted accordingly to account for the reduced accuracy-related penalty amount.

HOLDINGS

1. Appellant has not demonstrated that the accuracy-related penalty should be abated.
2. Appellant has not established a legal basis to abate interest.


DISPOSITION

FTB’s action is modified, in accordance with FTB’s concession on appeal, to reduce the 20 percent accuracy-related penalty to \$3,361.60, and applicable interest, if any, with respect to the addition to tax imposed by R&TC section 19164 for the 2016 tax year. Otherwise, FTB’s action is sustained.

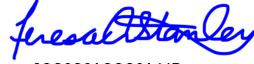
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 Eddy Y.H. Lam
 Administrative Law Judge

We concur:

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 Administrative Law Judge

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 Teresa A. Stanley
 Administrative Law Judge

Date Issued: 6/18/2024