



2. On April 17, 2018, respondent received information from the IRS indicating that the IRS adjusted appellant's federal adjusted gross income (AGI) by a total of \$78,616 for the 2011 tax year, as follows: decreased alimony deduction by \$1,388; increased dividend income by \$4,898; increased interest income by \$176; increased other income by \$19,145; decreased itemized miscellaneous deductions by \$53,319; allowed a capital gains loss of \$302 and a self-employed AGI deduction of \$8. Based on its adjustments, the IRS assessed additional tax and imposed an accuracy-related penalty on appellant.
3. Respondent followed the federal adjustments and issued appellant a Notice of Proposed Assessment (NPA) which proposed a corresponding increase of \$75,615 to appellant's California taxable income.<sup>1</sup> Respondent proposed to assess an additional tax of \$5,742, an accuracy-related penalty of \$1,148.40, and applicable interest on appellant.
4. Appellant timely protested the NPA.
5. Respondent sent appellant a letter that requested documentation in support of appellant's position within 30 days. Appellant did not respond.
6. Respondent subsequently issued appellant a Notice of Action that affirmed the NPA.
7. This timely appeal followed.

### DISCUSSION

Issue 1: Whether appellant has established error in respondent's proposed assessment, which is based on a federal determination.

R&TC section 18622(a) provides that a taxpayer shall either concede the accuracy of a federal determination or state where it is erroneous. It is well settled that a deficiency assessment based on a federal adjustment is presumptively correct and the taxpayer bears the burden of proving that respondent's determination is erroneous. (*Appeal of Dillahunty*, 2024-OTA-024P (*Dillahunty*)). Unsupported assertions are insufficient to satisfy a taxpayer's burden of proof with respect to an assessment based on a federal action. (*Ibid.*)

Income tax deductions are a matter of legislative grace, and the taxpayer bears the burden of establishing entitlement to the deductions claimed. (*Dillahunty, supra.*) To meet this burden,

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<sup>1</sup> Respondent allowed a self-employed AGI deduction of \$9, \$1 more than the amount the IRS allowed. The difference does not affect the outcome of this appeal.

a taxpayer must point to an applicable statute authorizing the deduction and show by credible evidence that the deduction claimed falls within the scope of the statute. (*Ibid.*)

Here, the IRS adjusted appellant's reported income and claimed deductions, which resulted in an additional \$78,616 in federal AGI. Respondent later made corresponding adjustments that were noted in its NPA. Appellant must show that either the IRS reduced or cancelled appellant's income, disallowed expenses and deductions, or, regardless of the federal action, appellant is entitled to the originally-listed income, expense and deduction amounts.

Appellant appears to argue that the additional tax proposed by respondent was already paid.<sup>2</sup> As evidence, appellant submits copies of federal and California income tax summaries for the 2011 tax year. However, as noted by respondent, the tax summaries simply restate the income, expenses, deductions, and other tax figures originally reported on appellant's 2011 federal and state returns, which were filed prior to the date of the IRS assessment. Therefore, the summaries do not show error in respondent's determination. Moreover, the record shows that appellant withheld California income tax for the 2011 tax year and made no other payments. Respondent refunded appellant the excess withholding in 2012, prior to the date that the IRS informed respondent that it had assessed appellant additional federal tax. Appellant provides no other explanation or evidence to demonstrate that respondent's proposed assessment is erroneous. Accordingly, appellant has not established error in the proposed assessment.

Issue 2: Whether appellant has established a basis to abate the accuracy-related penalty.

R&TC section 19164, which generally incorporates Internal Revenue Code (IRC) sections 6662 and 6664 into California law, provides for an accuracy-related penalty of 20 percent of the underpayment of tax that was required to be shown on the taxpayer's return. As relevant here, the penalty applies to the 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 tax return for the tax year, over the amount of tax that is shown on the return, reduced by any rebate. (IRC, § 6662(d)(1)(A)(i)-(ii). For individual taxpayers, there is a "substantial understatement of income tax" when the amount of the understatement exceeds the greater of 10 percent of the tax

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<sup>2</sup> Appellant previously claimed that the matter was resolved with the IRS, an argument appellant does not raise on appeal. The record does not show that the IRS cancelled or reduced its assessment. While the record shows that appellant paid the additional federal tax, it does not show that appellant paid the additional California tax.

required to be shown on the return, or \$5,000. (IRC, § 6662(d)(1)(A).) The penalty may also apply to the portion of the underpayment attributable to negligence or disregard of rules and regulations.<sup>3</sup> (IRC, § 6662(b)(1).)

Here, the IRS imposed an accuracy-related penalty on appellant, and respondent imposed a corresponding accuracy-related penalty based on the federal determination. The federal penalty was imposed under transaction code 240, which is noted as an accuracy-related penalty attributed to penalty code 680 on appellant's Federal Individual Master File and IRS Account Transcript. During the 2011 tax year, the IRS applied penalty code 680 in instances of substantial understatement and negligence, among other grounds.<sup>4</sup>

Appellant's California return contained a substantial understatement of tax. Appellant reported tax of \$4,930 on the original return but was required to report tax of \$10,672.<sup>5</sup> Appellant's understatement of \$5,742 is substantial because it exceeds \$5,000, which is greater than 10 percent of the tax required to be shown on the return, \$1,067.20 (\$10,672 x 10 percent). Respondent thus correctly imposed the accuracy-related penalty. Moreover, when respondent's proposed assessment is based on a federal determination that imposed the accuracy-related penalty based on negligence, respondent's imposition of the penalty based on negligence is presumed correct. (*Dillahunt*, *supra*.) Therefore, respondent properly imposed the accuracy-related penalty under either basis.

The accuracy-related penalty may be reduced or abated with respect to any portion of an underpayment if it is shown that there was reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion. (IRC, § 6664(c)(1).) The accuracy-related penalty may also be reduced or abated to the extent a taxpayer shows that: (1) there is substantial authority for the taxpayer's reporting position, or (2) any item for which the relevant facts affecting the item's tax treatment was adequately disclosed in appellant's

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<sup>3</sup> Negligence is defined to include any failure to make a reasonable attempt to comply with the provisions of the code. (IRC, §6662(c).) Disregard is defined to include careless, reckless, or intentional disregard. (*Ibid*.)

<sup>4</sup> Penalty codes 786 through 792 were all previously housed under penalty code 680. Those codes cover the following descriptions: negligence or disregard of the rules and regulations, substantial understatement, substantial valuation misstatement, substantial overstatement of pension liabilities, substantial estate or gift tax valuation understatement, noneconomic substance transaction, and increase in penalty in case of gross valuation misstatement. Currently, penalty code 680 is used when the IRS imposes the penalty for a substantial understatement and negligence is a secondary consideration. (See Internal Revenue Manual § 20.1.5.4.2(8).)

<sup>5</sup> Respondent later assessed an additional tax of \$5,742 in its Notice of Action. Therefore, the amount of tax required to be shown on the return was \$10,672 (\$4,930 + \$5,742).

return (or in a statement attached to the return) and there is a reasonable basis for appellant's tax treatment of the item. (IRC, § 6662(d)(2)(B).) 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.)

Here, appellant provides no arguments or evidence to establish any potentially applicable defenses to the imposition of the accuracy-related penalty, and the record does not reflect any potentially applicable grounds for abating the penalty. Accordingly, the accuracy-related penalty cannot be abated.

Issue 3: Whether appellant has established a basis to abate interest.

The imposition of interest is mandatory and cannot be waived based on reasonable cause. (R&TC, § 19101(a); *Appeal of Moy*, 2019-OTA-057P.) To obtain relief from interest, the taxpayer must qualify under the waiver provisions of R&TC section 19104 (pertaining to unreasonable error or delay by respondent in the performance of a ministerial or managerial act), section 19112 (pertaining to extreme financial hardship caused by significant disability or other catastrophic circumstance), or section 21012 (pertaining to reasonable reliance on the written advice of respondent).<sup>6</sup> (*Appeal of Moy, supra.*) Appellant does not allege, and the record does not reflect, that any of the above waiver provisions are applicable here. Therefore, appellant has not established a basis to abate interest.

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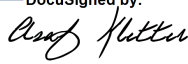
<sup>6</sup> OTA does not have jurisdiction to review respondent's interest abatement determination under R&TC section 19112. (*Appeal of Moy, supra.*)

HOLDINGS

1. Appellant has not established error in respondent’s proposed assessment, which is based on a federal determination.
2. Appellant has not established a basis to abate the accuracy-related penalty.
3. Appellant has not established a basis to abate interest.

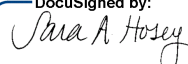
DISPOSITION

Respondent’s action is sustained.

DocuSigned by:  
  
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 Asaf Kletter  
 Administrative Law Judge

We concur:

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 Kenneth Gast  
 Administrative Law Judge

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 Sara A. Hosey  
 Administrative Law Judge

Date Issued: 11/14/2024