

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

In the Matter of the Appeal of: ) OTA Case No. 230112463  
W. DOUGLAS AND )  
R. DOUGLAS (DECEASED) )  
\_\_\_\_\_ )

**OPINION**

Representing the Parties:

For Appellants: Stephanie Walden, Enrolled Agent  
For Respondent: Camille Dixon, Attorney  
For Office of Tax Appeals: Tom Hudson, Attorney

C. AKIN, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, R. Douglas (deceased) and W. Douglas (together, appellants) appeal an action by respondent Franchise Tax Board (FTB) proposing additional tax of \$5,606, an accuracy-related penalty of \$1,121.20, plus applicable interest for the 2011 tax year.

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

**ISSUES**

1. Whether appellants have shown error in the proposed assessment, which is based on a final federal determination.
2. Whether appellants are entitled to abatement of the accuracy-related penalty.
3. Whether appellants have established a legal basis to abate interest.

**FACTUAL FINDINGS**

1. Appellants jointly filed a timely 2011 California Resident Income Tax Return reporting negative California adjusted gross income, no taxable income, and zero total tax.
2. Subsequently, the IRS audited appellants' federal income tax return and made various adjustments including adjustments to appellant's Schedule C, Profit or Loss From

Business. The IRS also allowed itemized deductions in place of the standard deduction as reported on appellants' federal return.

3. According to appellants' federal account transcript, the date of the final federal determination was December 7, 2015. Per the transcript, the IRS imposed additional tax and a 20 percent accuracy-related penalty based on a federal substantial understatement of income.
4. Appellants did not notify FTB of the final federal determination, but FTB received notice of the changes by means of the FEDSTAR IRS Data Sheet dated October 26, 2017.
5. Based on the IRS information, FTB issued a Notice of Proposed Assessment (NPA) on October 6, 2021, that applied the federal adjustments to appellants' 2011 California income tax return. Specifically, the NPA allowed an additional self-employment tax deduction of \$7,143 and made the following changes to appellants' Schedule C: disallowed returns and allowances of \$5,733, increased gross receipts by \$72,792, disallowed depreciation and Internal Revenue Code (IRC) section 179 expenses of \$47,900, and disallowed a cost of goods sold deduction of \$57,444. The NPA allowed appellants to take itemized deductions totaling \$45,454, in place of the standard deduction of \$7,538 as reported on appellants' California return. The NPA proposed additional tax of \$5,606, and an accuracy-related penalty of \$1,121.20, plus applicable interest.
6. Appellants protested the NPA.
7. FTB issued a Notice of Action affirming the NPA.
8. This timely appeal followed.

### DISCUSSION

Issue 1: Whether appellants have shown error in the proposed assessment, which is based on a final federal determination.

R&TC section 18622(a) provides that a taxpayer must either concede the accuracy of a final federal determination or state wherein it is erroneous. A deficiency assessment based on federal adjustments to income is presumptively correct and the taxpayer bears the burden of proving that the determination is erroneous. (*Appeal of Gorin*, 2020-OTA-018P.) In the absence of credible, competent, and relevant evidence showing that FTB's determination is incorrect, it

must be upheld. (*Appeal of Valenti*, 2021-OTA-093P.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof with respect to a deficiency assessment based on a federal action. (*Appeal of Gorin*, *supra*.)

In this appeal, FTB based its proposed assessment on a final federal determination after an IRS audit. Appellants have not shown any error in the proposed assessment or in the federal determination upon which it was based. Appellants state that they disagree with the federal determination and FTB's proposed assessment, but they do not mention any specific areas of disagreement and provide no relevant evidence. Because there is no evidentiary basis to overturn the proposed assessment, it must be upheld.

In their protest filed with FTB, appellants asserted that FTB's proposed assessment was untimely. Generally, FTB must issue a proposed assessment within four years of the date the taxpayers filed their California tax return. (R&TC, § 19057.) However, if the IRS makes a change or correction to any item required to be shown on a federal return, taxpayers must report the federal change to FTB within six months after the date it becomes final. (R&TC, § 18622(a).) If taxpayers or the IRS report the change or correction to FTB within six months after the final federal determination, FTB may issue a proposed assessment resulting from those adjustments within two years from the date of the notice. (R&TC, § 19059(a).) However, if taxpayers or the IRS report that change or correction after that six-month period, FTB may issue a proposed assessment resulting from those adjustments within four years from the date of notification. (R&TC, § 19060(b).) The specific statute of limitations set forth in R&TC section 19060 overrides the general statute of limitations set forth in R&TC section 19057. (*Appeal of Valenti*, *supra*.)

The date of the final federal determination was December 7, 2015. According to the FEDSTAR IRS Data Sheet, the IRS notified FTB of the IRS audit adjustments on October 26, 2017. Since appellants and the IRS did not notify FTB of the IRS adjustments within six months of the final federal determination, pursuant to R&TC section 19060(b), FTB had until October 26, 2021, four years from the date of the IRS notification, to issue its proposed assessment. Because FTB issued the NPA to appellants on October 6, 2021, the proposed assessment was timely under the applicable statute of limitations.

Issue 2: Whether appellants are entitled to abatement of the accuracy-related penalty.

When FTB imposes a penalty, it is presumed to have been imposed correctly. (*Appeal of Steffier*, 2024-OTA-071P.) R&TC section 19164 generally incorporates the provisions of IRC section 6662, which provides for an accuracy-related penalty of 20 percent of the applicable underpayment of tax. (See also *Appeal of Steffier*, *supra*.)

As relevant here, the penalty applies to any portion of an 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 was shown on the return, reduced by any rebate. (IRC, § 6662(d)(2)(A)(i)-(ii).) For individual taxpayers, an “understatement” constitutes a “substantial understatement” if the amount of the understatement for the tax year exceeds the greater of \$5,000, or 10 percent of the tax required to be shown on the return. (IRC, § 6662(d)(1)(A)(i)-(ii).)

In this appeal, appellants were required to report total tax of \$5,606 on their 2011 return, but appellants reported zero tax, so the understatement of tax exceeded both \$5,000 and 10 percent of the tax required to be reported on the return ( $\$5,606 \times 10\% = \$560.60$ ), which means that there was a substantial understatement. Thus, FTB properly imposed the 20 percent accuracy-related penalty.

Even if an understatement is found to be substantial, the penalty may be waived to the extent the taxpayer can show reasonable cause for the underpayment and the taxpayer acted in good faith with respect to that underpayment.<sup>1</sup> (R&TC, § 19164(d); IRC, § 6664(c)(1).) In this appeal, appellants have not argued, and the evidence does not show, that any exception to this penalty might potentially apply. Therefore, the accuracy-related penalty cannot be abated.

Issue 3: Whether appellants have established a legal basis to abate interest.

Interest must be assessed from the date a tax payment is due through the date that it is paid. (R&TC, § 19101). The imposition of interest is mandatory; it is not a penalty but is compensation for appellants’ use of money after it should have been paid to the state. (*Appeal of Moy*, 2019-OTA-057P.) There is no reasonable cause exception to the imposition of interest.

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<sup>1</sup> While IRC section 6662(d) provides other exceptions or defenses to the accuracy-related penalty (such as substantial authority and adequate disclosure), appellants have not argued or provided evidence to show that these exceptions apply to this appeal.

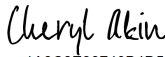
(*Ibid.*) To obtain interest relief, appellants must qualify under R&TC section 19104 (pertaining to an unreasonable error or delay by FTB in the performance of a ministerial or managerial act), section 19112 (pertaining to extreme financial hardship caused by significant disability or other catastrophic circumstance),<sup>2</sup> or section 21012 (pertaining to reasonable reliance on FTB’s written advice). Appellants do not allege, and the record does not show, that any of these waiver provisions might be applicable here. Therefore, there is no legal basis for interest abatement.

HOLDINGS

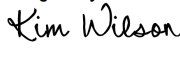
1. Appellants have not shown error in the proposed assessment, which is based on a final federal determination.
2. Appellants are not entitled to abatement of the accuracy-related penalty.
3. Appellants have not established a legal basis to abate interest.


DISPOSITION

FTB’s proposed assessment is sustained.

DocuSigned by:  
  
 Cheryl L. Akin  
 Administrative Law Judge

We concur:

Signed by:  
  
 Kim Wilson  
 Hearing Officer

DocuSigned by:  
  
 Teresa A. Stanley  
 Administrative Law Judge

Date Issued: 10/18/2024

<sup>2</sup> The Office of Tax Appeals does not have the legal authority to review or overturn FTB’s denial of a waiver of interest based on extreme financial hardship. (*Appeal of Moy, supra.*)