

**OFFICE OF TAX APPEALS
STATE OF CALIFORNIA**

In the Matter of the Appeal of:) OTA Case No. 221011572
S. LEE)
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OPINION

Representing the Parties:

For Appellant: Gary Slavett, Attorney

For Respondent: Christopher T. Tuttle, Attorney

For Office of Tax Appeals: Oliver Pfof, Attorney

V. LONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, S. Lee (appellant) appeals an action by respondent Franchise Tax Board (FTB) proposing additional tax of \$15,444, a late-filing penalty of \$3,861, and applicable interest for the 2019 tax year.

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

ISSUE

Whether appellant has shown error in FTB’s proposed assessment of tax.

FACTUAL FINDINGS

1. FTB obtained information from the IRS that appellant paid mortgage interest of \$39,372 during the 2019 tax year, as reported on IRS Form 1098—Mortgage Interest Statement issued by Zions Bancorporation.
2. When FTB obtained the mortgage interest statement, it did not have a record of receiving from appellant a tax return for the 2019 tax year. Subsequently, FTB issued a Request for Tax Return requesting appellant to respond and state whether she had already filed a

- return, needed to file a return, or if she was unsure whether she had a filing requirement for 2019.
3. FTB did not receive a response to its request and issued a Notice of Proposed Assessment (NPA) estimating that appellant received gross income of \$236,232 during the 2019 tax year based on the amount of mortgage interest appellant paid during that tax year. FTB explained it arrived at its estimate by multiplying the amount of the mortgage interest appellant paid by six—a ratio based on an analysis of tax returns filed by California residents.¹ After allowing for a mortgage interest deduction,² FTB calculated appellant's taxable income to be \$196,860 and proposed tax of \$15,444, a late-filing penalty of \$3,861, and applicable interest.
 4. Appellant timely protested the NPA, and FTB subsequently issued a Notice of Action affirming the NPA in its entirety.
 5. Appellant timely filed this appeal.³
 6. On appeal, appellant provides a 2019 California Resident Income Tax Return (Return), signed by appellant and dated May 30, 2023. On the Return, appellant reports a flow-through loss from Aspire Holding LLC of \$90,938 and \$0 in California taxable income. Appellant also provides a 2019 U.S. Individual Income Tax Return signed by appellant and dated May 30, 2023. Lastly, appellant provides a federal S corporation tax return (Form 1120-S) for a business entity named Mad Atom LLC, which is not signed and not dated on the signature line. On an attached Schedule L—Current Assets, the Form 1120-S reports an end of tax year “[I]oan to Aspire” totaling \$2,390,455.
 7. As of August 10, 2023, the IRS does not have a record of receiving appellant's 2019 federal income tax return.

¹ On appeal, FTB submitted a document titled “1098 Mortgage Interest Trends” which summarizes several FTB studies showing that a six-to-one ratio between income and mortgage interest is reasonable. For example, the 2019 study considered 17,109,053 income tax returns with mortgage interest greater than \$1,999 and less than \$100,000 from 2013 to 2016; the income to mortgage interest ratio in that study was \$14.14 to \$1.00.

² FTB allowed a single itemized deduction of \$39,372—the amount of mortgage interest paid—from adjusted gross income in determining appellant's taxable income.

³ Appellant only disputes the proposed assessment of tax and not the late-filing penalty. Therefore, the penalty will not be discussed further.

DISCUSSION

R&TC section 18501 requires every individual subject to the Personal Income Tax Law to make and file a return with FTB “stating specifically the items of the individual’s gross income from all sources and the deductions and credits allowable,” in excess of certain filing thresholds. (R&TC, § 18501(a)(1)-(4).) R&TC section 19087(a) provides that if any taxpayer fails to file a return, FTB at any time “may make an estimate of the net income, from any available information, and may proposed to assess the amount of tax, interest, and penalties due.”

When FTB proposes an assessment based on an estimate of income, FTB’s initial burden is to show why its proposed assessment is reasonable and rational. (*Appeal of Bindley*, 2019-OTA-179P.) An assessment based on unreported income is presumed correct when the taxing agency introduces a minimal factual foundation to support the assessment. (*Ibid.*) If FTB meets its initial burden, the proposed assessment of tax is presumed correct, and the taxpayer has the burden of proving it to be erroneous. (*Ibid.*)

The applicable burden of proof is by a preponderance of the evidence, meaning the party must establish by documentation or other evidence the circumstances it asserts are more likely than not to be correct. (Cal. Code Regs., tit. 18, § 30219(b); *Appeal of Belcher*, 2021-OTA-284P.) Unsupported assertions are insufficient to satisfy a taxpayer’s burden of proof. (*Appeal of Bindley, supra.*) Similarly, uncorroborated assertions that the figures appearing in a tax return are true is insufficient to satisfy a taxpayer’s burden of proof. (See *Appeal of Lew* (78-SBE-073) 1978 WL 3876.)

FTB estimated appellant’s gross income to be \$236,232 based on the Form 1098 issued by Zions Bancorporation which reported appellant paid \$39,372 of mortgage interest during the 2019 tax year. The Office of Tax Appeals (OTA) finds that it was reasonable and rational for FTB to infer that appellant realized sufficient income during the 2019 tax year to make those mortgage interest payments. Likewise, OTA finds FTB’s estimate is reasonable and rational because it is based on an analysis of millions of tax returns filed by California residents. FTB’s study shows the average gross income to mortgage interest expense ratio was approximately \$14 to \$1. Here, FTB proposed a \$6 to \$1 ratio. Since FTB has provided a minimal, factual foundation supporting its assessment, FTB’s proposed assessment is presumed correct, and the burden shifts to appellant to show that FTB’s assessment is erroneous.

Appellant contends that FTB's proposed assessment is incorrect because she had zero taxable income in the 2019 tax year. Appellant contends the mortgaged property was owned by appellant's limited liability company Aspire LLC, and the mortgage interest was paid with funds from a loan Aspire LLC received from Mad Atom LLC, another business entity. Appellant asserts the mortgaged property was used as a short-term rental house through 2018, and that the house was demolished in order to build a new, larger house. In essence, appellant argues the mortgage interest was a business expense of Aspire LLC.

In support of these contentions, appellant offers her 2019 California Return, a 2019 Federal Return that the IRS has no record of receiving, and an unsigned 2019 return from Mad Atom LLC. All three of these returns list the same return preparer.

While it is true a loan is generally not taxable because the receipt of the loan is offset by the obligation for repayment, this rule only applies where a loan is "existing, unconditional, and legally enforceable." (*Milenbach v. Commissioner* (9th Cir. 2003) 318 F.3d 924, 930, citing *Noguchi v. Commissioner* (9th Cir. 1993) 992 F.2d 226, 227.) The substantiation provided by appellant in this case does not establish that the mortgage payments were made by Aspire LLC, that Aspire LLC owned the underlying property, or the existence of a loan between Mad Atom LLC and Aspire LLC. Appellant has not provided a copy of her Schedule K-1 from Aspire LLC, or explained why the mortgage interest payments were listed as paid by her individually if they were paid instead by Aspire LLC.

The only evidence of the loan is Mad Atom LLC's federal tax return, but an uncorroborated assertion that a figure appearing in a tax return is true is insufficient to satisfy a taxpayer's burden of proof. (*Appeal of Lew, supra.*) Moreover, the federal tax return for Mad Atom LLC is not signed or dated, and it is unknown whether this tax return was filed.

While appellant's explanation concerning how the mortgage interest payments were made while having no taxable income is plausible, appellant has not provided sufficient evidence to show, by a preponderance of the evidence, that FTB's proposed assessment is erroneous.

HOLDING

Appellant has not shown error in FTB’s proposed assessment of tax.

DISPOSITION

FTB’s Notice of Action is sustained.

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Veronica I. Long
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Veronica I. Long
Administrative Law Judge

We concur:

DocuSigned by:
Josh Lambert
CB1F7DA37831416...

Josh Lambert
Administrative Law Judge

DocuSigned by:
Kenneth Gast
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Kenneth Gast
Administrative Law Judge

Date Issued: 6/14/2024