

FACTUAL FINDINGS

1. Appellants timely filed a 2018 California Resident Income Tax Return.
2. Subsequently, FTB received information from the Internal Revenue Service (IRS) showing the following federal adjustments to appellants' 2018 federal tax return: (1) reduced IRA deduction by \$6,500 (from \$13,000 to \$6,500); (2) increased other income by \$14,382 (from cancellation of debt)¹; and (3) reduced medical expense deduction by \$1,566.48.² Based on the IRS information, FTB increased appellants' taxable income by \$22,448 (\$6,500 + \$14,382 + \$1,566).
3. Then, FTB issued appellants a Notice of Proposed Assessment (NPA) proposing additional tax of \$2,088, an accuracy-related penalty of \$417.60, and accrued interest. Appellants timely protested the NPA.
4. Subsequently, FTB issued appellants a Notice of Action, affirming the NPA.
5. Appellants timely filed this appeal.

DISCUSSION

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

A taxpayer shall either concede the accuracy of a federal determination or state how it is erroneous. (R&TC, § 18622(a).) A deficiency assessment based on a federal audit report is presumptively correct, and the taxpayer bears the burden of proving that the determination is erroneous. (*Appeal of Gorin*, 2020-OTA-018P.) 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. (*Appeal of Vardell*, 2020-OTA-190P.) To meet this burden, 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. (*Appeal of Jindal*, 2019-OTA-372P; *Appeal of Dandridge*, 2019-OTA-458P.)

¹ Gross income includes income from the discharge of indebtedness. (R&TC, § 17071; IRC, § 61(a)(12); *Appeal of Black*, 2023-OTA-023P.)

² Appellants' IRS Wage and Income Transcripts, dated July 23, 2024, show E. Asturias made an IRA contribution of \$6,500 for 2018, but E. Paniagua did not make any IRA contribution. The transcripts also show that E. Asturias was issued a 1099-C, Cancellation of Debt, in 2018 for \$14,382 of discharged debt. Appellants' FEDSTAR IRS Data Sheet dated July 23, 2024, shows no changes to the federal adjustment. Appellants' IRS account transcript dated July 23, 2024, shows that appellants paid the IRS for additional tax, penalty, and interest resulting from the federal adjustment for the 2018 tax year.

Here, FTB assessed additional tax based on federal adjustments which reduced appellant's IRA deduction to \$6,500, increased appellants' other income by \$14,382, and disallowed \$1,566 of medical expense deductions. Appellants argue that they did not earn the income that FTB is attributing to appellants for 2018. However, the evidence on record shows that appellants only made \$6,500 of IRA contributions for 2018, and that appellants had debt discharged in 2018 in the amount of \$14,382. Appellants do not argue that these amounts are incorrect. Instead, appellants ask that the assessment be "forgiven." Regarding the \$1,566 of disallowed medical deductions, appellants have not argued or provided any evidence showing that they are entitled to the disallowed deductions. Furthermore, the IRS did not make any further changes to its adjustments, and appellants have already paid the IRS for any additional tax, penalties, and interest resulting from the federal adjustment. Therefore, appellants have not satisfied their burden to demonstrate error in FTB's proposed assessment.

Issue 2: Whether appellants have demonstrated that the accuracy-related penalty should be abated.

Internal Revenue Code (IRC) section 6662, incorporated by R&TC section 19164, provides for an accuracy-related penalty of 20 percent of the applicable underpayment. As relevant here, the accuracy-related penalty applies to the portion of the underpayment attributable to: (1) negligence or disregard of rules and regulations (negligence), or (2) any substantial understatement of income tax (substantial understatement).³ (IRC, § 6662(b)(1) & (2).) When FTB's proposed assessment is based on a federal determination that imposed the accuracy-related penalty based on negligence, FTB's imposition of the penalty based on negligence is presumed correct. (*Appeal of Dillahunty*, 2024-OTA-024P.) The accuracy-related penalty may be reduced or abated to the extent a taxpayer shows that: (1) there is a reasonable basis for the taxpayer's 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) the taxpayer acted in good faith and had reasonable cause for the understatement. (*Ibid.*)

Here, the evidence shows that the IRS assessed appellants an accuracy-related penalty based on negligence because the amount of the federal understatement does not exceed the

³ "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.*) "Substantial understatement of income tax" exists when the understatement for a taxable year exceeds the greater of either 10 percent of the tax required to be shown on the return or \$5,000. (IRC, § 6662(d)(1)(A).)

substantial understatement of income tax thresholds.⁴ Thus, it is presumed that FTB properly imposed the accuracy-related penalty.

Appellants have not provided any specific argument regarding the accuracy-related penalty. Moreover, the evidence does not establish that the imposition to the accuracy-related penalty should be reduced or abated. Accordingly, appellants have failed to demonstrate that the accuracy-related penalty should be abated.

HOLDINGS

1. Appellants have not demonstrated error in FTB's proposed assessment.
2. Appellants have not demonstrated that the accuracy-related penalty should be abated.

DISPOSITION

FTB's action is sustained.

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Steven Kim
Administrative Law Judge

Date Issued: 2/7/2025

⁴ Appellants' federal understatement does not exceed \$5,000, which is greater than 10 percent of the tax required to be shown on the return.