

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:)	OTA Case No. 21068086
D. KIM)	
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OPINION

Representing the Parties:

For Appellant:	Cindy L. Ho, Attorney
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For Respondent:	Brian Werking, Attorney
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For Office of Tax Appeals:	Louis Ambrose, Attorney
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J. ALDRICH, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, D. Kim (appellant) appeals actions by respondent Franchise Tax Board (FTB) proposing additional tax of \$12,872, an accuracy-related penalty of \$2,574.40, and applicable interest for the 2013 tax year and additional tax of \$20,845, an accuracy-related penalty of \$4,169, and applicable interest for the 2014 tax year.¹

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

ISSUES

1. Whether appellant has shown error in the proposed assessments, which are based on final federal determinations.
2. Whether appellant is entitled to abatement of the accuracy-related penalties.

¹ The appeal letter discusses only the 2014 tax year NOA, but appellant enclosed the 2013 tax year NOA with the letter. This Opinion addresses the 2013 and 2014 tax years as appellant protested both years.

FACTUAL FINDINGS

1. Appellant timely filed a 2013 California Resident Income Tax Return (Form 540) reporting tax due of \$35,555, interest and penalties of \$3,410, and total amount due of \$38,965. FTB processed appellant's return, accepted it as filed, and imposed a late payment penalty of \$2,844.40 and interest. Appellant's return payment satisfied the balance due.
2. Appellant timely filed a 2014 Form 540 reporting tax due of \$96,862, interest and penalties of \$9,290, underpayment of estimated tax penalty of \$2,231, and total amount due \$108,383. FTB processed appellant's tax return, accepted it as filed, and imposed an estimated tax penalty of \$2,231.16 a late payment penalty of \$7,748.96, interest, and applied an agency offset of \$73.02 to appellant's 2014 tax year account. Appellant's return payment satisfied the balance due.
3. FTB subsequently received information from the IRS regarding examination of appellant's 2013 and 2014 federal tax returns.
4. For the 2013 tax year, the IRS disallowed a Schedule C1 deduction for returns and allowances and a depreciation deduction, recharacterized a Schedule C1 legal expense and an "other expenses" deduction and allowed an additional deduction for self-employment tax. As a result, appellant's federal AGI increased by \$350,323. The IRS assessed additional tax and imposed an accuracy related penalty.
5. For the 2014 taxable year, the IRS disallowed Schedule C1 depreciation deductions, recharacterized a Schedule C1 legal expense deduction and an "other expenses" deduction, and allowed an additional deduction for additional self-employment tax. The adjustments increased appellant's federal AGI by \$571,035 and the IRS assessed additional tax, and imposed an accuracy-related penalty.
6. For the 2013 taxable year, FTB made corresponding adjustments and issued a Notice of Proposed Assessment (NPA), which increased appellant's California taxable income by \$113,913, and proposed to assess additional tax of \$12,872, an accuracy-related penalty of \$2,574.40, and interest.
7. For the 2014 taxable year, FTB made corresponding adjustments and issued an NPA, which increased appellant's California taxable income by \$113,913, and proposed to assess additional tax of \$20,845, an accuracy-related penalty of \$4,169, and interest.

8. Appellant timely protested the NPAs stating that he was pursuing an offer in compromise with the IRS. FTB notified appellant by letter dated April 5, 2021, that it had suspended its proposed assessment action and requested that appellant provide any information indicating that the IRS was reconsidering or still reviewing the federal adjustments. The letter informed appellant that if no response was received, FTB would issue Notices of Action (NOA) affirming the NPAs. Appellant did not respond and FTB issued NOAs.
9. Appellant filed this timely appeal.

DISCUSSION

Issue 1: Whether appellant has shown error in the proposed assessments, which are based on final federal determinations.

If the IRS changes or corrects an item reported by a taxpayer on their federal income tax return, the taxpayer shall report the change or correction to FTB within six months of the final federal determination, either conceding the accuracy of that determination, or stating where the determination is erroneous. (R&TC, § 18622(a).) It is well settled that a deficiency assessment based on federal adjustments is presumed correct, and the taxpayer has the burden of proving that FTB's determination is erroneous. (*Appeal of Valenti*, 2021-OTA-093P.) In the absence of credible, competent, and relevant evidence showing that FTB's determination is incorrect, it must be upheld. (*Ibid.*) In addition, income tax deductions are a matter of legislative grace, and the taxpayer who claims a deduction has the burden of proving by competent evidence that they are entitled to that deduction. (*Appeal of Vardell*, 2020-OTA-190P.)

Here, FTB received information from the IRS that appellant's federal taxable income was adjusted for the 2013 and 2014 tax years and FTB's proposed assessments of tax were based on that federal information. According to appellant's 2013 and 2014 federal account transcripts in the record, there has been no change to the federal determinations. At protest and on appeal, appellant argued that the IRS erroneously recharacterized appellant's business legal expenses as personal expenses and disallowed reported depreciation. However, the IRS rejected appellant's arguments and determined the adjustments were not in error. Specifically, the IRS recharacterized the business legal expenses because appellant reported those lawsuit expenses as business expenses but reported the proceeds from the lawsuit as personal income not subject to self-employment tax. The IRS disallowed the depreciation expenses for the 2013 and 2014 tax

years because the business location for which depreciation was reported did not open until July of 2015, and the recovery period does not commence until the location being improved is placed in service. (See IRC, §§ 167, 179.) Appellant has not provided any evidence indicating any error in the IRS determination. Thus, appellant has not met his burden to show error in FTB's proposed assessment based on federal adjustments.

Issue 2: Whether appellant is entitled to abatement of the accuracy-related penalties.

IRC section 6662, incorporated by R&TC section 19164, provides for an accuracy-related penalty of 20 percent of the applicable underpayment. IRC section 6662(b) provides, in relevant part, that the penalty applies to the portion of the underpayment attributable to any substantial understatement of income tax. A substantial understatement of tax exists if the understated amount exceeds the greater of 10 percent of the tax required to be shown on the return or \$5,000. (IRC, § 6662(d)(1)(A).) An "understatement" is defined as the excess of the amount of tax required to be shown on the return for the tax year over the amount of the tax imposed which is shown on the return, reduced by any rebate. (IRC, § 6662(d)(2).) When FTB imposes a penalty, it is presumed to have been imposed correctly. (*Appeal of Xie*, 2018-OTA-076P.) The accuracy-related penalty shall not be imposed with respect to any portion of an underpayment if it is shown that there was reasonable cause for the portion and the taxpayer acted in good faith with respect to the portion. (IRC, § 6664(c)(1).)

Appellant's understatements of tax for 2013 and 2014 exceed the greater of 10 percent of the tax required to be shown on the return or \$5,000. For 2013, the amount of tax required to be shown was \$48,427, the amount shown on the return was \$35,555 and the excess or understatement was \$12,872 which is greater than 10 percent of the tax. For 2014, the amount of tax required to be shown was \$137,707, the amount shown on the return was \$116,862, and the excess or understatement was \$20,845 which is greater than 10 percent of the tax. Accordingly, the penalties are properly imposed based on substantial understatements of tax.

Appellant states that his 2014 returns were prepared by a CPA who had prepared his returns in prior years. He states that the CPA did not raise any concerns about the depreciation schedule or expenses deductions and that he reasonably relied on the CPA's knowledge and experience. A taxpayer claiming reliance on a professional must show: (1) the advisor was a competent professional who had sufficient expertise to justify reliance; (2) the taxpayer provided necessary and accurate information to the tax advisor; and (3) the taxpayer actually relied in

good faith on the advice. (*Neufeld v. Commissioner*, T.C. Memo. 2008-79, citing *Neonatology Associates P.A. v. Commissioner* (2000) 115 T.C. 43, 99, affd. (3d Cir. 2002) 299 F.3d 221.)


Here, appellant states that the CPA prepared his returns, but he makes no representations and there is no evidence that he sought or relied on any professional tax advice from the CPA. Thus, appellant has not shown reasonable cause for abatement of the accuracy-related penalties.

HOLDINGS

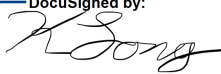
1. Appellant has not shown error in the proposed assessments, which are based on final federal determinations.
2. Appellant is not entitled to abatement of the accuracy-related penalties.


DISPOSITION

FTB's actions are sustained.

DocuSigned by:

48745B806914B4...
Josh Aldrich
Administrative Law Judge

We concur:

DocuSigned by:

DC88A60D8C3E442...
Keith T. Long
Administrative Law Judge

DocuSigned by:

6651E0AAC34B4F6...
Erica Parker
Administrative Law Judge

Date Issued: 2/18/2025