

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:)
D. MILLER AND)
C. MILLER)
_____)
OTA Case No. 230513393

OPINION

Representing the Parties:

For Appellants: D. Miller
For Respondent: Andrea Watkins, Attorney
Jaclyn Zumaeta, Deputy Chief Counsel

For Office of Tax Appeals: Sean Erdman, Graduate Student Assistant

T. STANLEY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, D. Miller and C. Miller (appellants) appeal an action by respondent Franchise Tax Board (FTB) proposing additional tax of \$19,611, an accuracy-related penalty of \$3,992.20, and applicable interest for the 2016 taxable year.

Office of Tax Appeals (OTA) Administrative Law Judges Teresa A. Stanley, Josh Aldrich, and Steven Kim held an oral hearing for this matter in Cerritos, California, on March 11, 2025. At the conclusion of the hearing, OTA closed the record, and this matter was submitted for an Opinion.

ISSUES

1. Have appellants established error in FTB’s proposed assessment of additional tax, which is based on federal adjustments?
2. Have appellants established reasonable cause to abate the accuracy-related penalty?

FACTUAL FINDINGS

1. Appellants timely filed their 2016 California Resident Income Tax Return.
2. On July 8, 2019, FTB received information that the IRS had adjusted appellants' 2016 federal taxable income including, as relevant here, disallowing claimed deductions of \$41,365 for improvements and repairs to a residential property (condo) appellants owned. Appellants moved into the condo in 2016.
3. FTB made corresponding adjustments to appellants' 2016 California tax liability and issued a Notice of Proposed Assessment (NPA), which increased appellants' taxable income by \$228,140,¹ and proposed additional tax of \$19,611 and an accuracy-related penalty of \$3,922.20, plus applicable interest.
4. Appellants timely protested the NPA with FTB, and on April 15, 2021, appellants submitted a payment of \$10,661.90 to FTB, which FTB is holding in suspense pending the outcome of this appeal.²
5. On February 24, 2023, FTB requested that appellants submit information showing that the IRS reduced or cancelled the federal assessment.³
6. Appellants responded with a letter to FTB asserting that the tax had been paid.⁴
7. On April 25, 2023, FTB issued a Notice of Action, affirming the NPA.
8. Appellants filed this timely appeal.

¹ The increase is due to several federal adjustments, not just due to the disallowed claimed deductions of \$41,635. The other adjustments are not explained in detail in this Opinion as appellants did not provide any evidence or argument with respect to the additional adjustments made by the IRS and FTB.

² When FTB applies the payment, interest will be charged up to the date of payment. The payment will be applied (with an effective date of April 15, 2021) once this appeal becomes final. Additional interest will be charged on any remaining balance until it is paid in full.

³ FTB agreed to abate interest from May 6, 2021, through February 24, 2023, which totals \$993.53, due to FTB's delay in the issuance of its position letter, which was dated May 6, 2021, but was not mailed until February 24, 2023.

⁴ Appellants assert the payment of tax was satisfied by: (1) their payment of \$10,661.90 and (2) because on September 2, 2020, the California Employment Development Department sent a letter to appellants indicating that appellant-husband was entitled to \$17,550 in pandemic relief funds that he never received.

DISCUSSION

Issue 1: Have appellants established error in FTB's proposed assessment of additional tax, which is based on federal adjustments?

R&TC section 18622(a) requires a taxpayer to concede the accuracy of federal changes to a taxpayer's income or state where the changes are erroneous. It is well settled that a deficiency assessment based on federal adjustments to income is presumed to be correct and that taxpayers bear the burden of proving that FTB's determination is incorrect. (*Appeal of Valenti*, 2021-OTA-093P.) FTB's determination must be upheld in the absence of credible, competent, and relevant evidence showing that its determination is incorrect. (*Appeal of Chen and Chi*, 2020-OTA-021P.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid.*)

Here, FTB received information from the IRS that appellants' federal taxable income was adjusted for the 2016 taxable year and subsequently made corresponding adjustments to appellants' 2016 California taxable income. Appellants assert that they provided information to the IRS seeking a modification of the federal determination. Appellants agree, and OTA's record reflects, that the IRS did not reduce or cancel its assessment. Appellants continue to assert that they are entitled to deductions for repairs and improvements to the condo where they resided starting in 2016, stating that conditions were unsafe and repairs were necessary, so FTB should not have disallowed the deductions. Appellants also contend that they should be able to offset any disallowed deductions by a home office deduction (using the average of the claimed home office deductions for 2014 through 2018) because they did not need the deduction until other deductions were disallowed. Appellants' overarching contention is that, even if they owe the proposed assessment, they have already paid by sending FTB a payment of \$10,661.90, and because the California Employee Development Department (EDD) never paid appellant-husband the \$17,550 pandemic unemployment assistance award to which he was entitled, so OTA should use this amount to cancel out or offset the money owed to FTB.

Home Repairs and Improvements

Deductions from gross income are a matter of legislative grace, and taxpayers have the burden of proving entitlement to all deductions claimed. (*Appeal of Vardell*, 2020-OTA-190P.) To support a deduction, the taxpayer must establish by credible evidence, other than mere assertions, that the deduction claimed falls within the scope of a statute authorizing the deduction. (*Ibid*; *Appeal of Dillahunty*, 2024-OTA-024P.) Unsupported assertions cannot satisfy a taxpayer's burden of proof. (*Appeal of Vardell*, *supra*.)

Internal Revenue Code (IRC) section 162(a) authorizes a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. (See also *Roberts v. Commissioner*, T.C. Memo. 2012-197.)⁵ A trade or business expense is ordinary for purposes of IRC section 162 if it is normal or customary within the particular trade, business, or industry, and is necessary if it is appropriate and helpful for the development of the business. (*Roberts v. Commissioner*, *supra*.) In contrast, personal, living, or family expenses are generally nondeductible. (IRC, § 262(a); *Roberts v. Commissioner*, *supra*.)

Appellants appear to assert that they were in the rental business; i.e., they rented the condo at issue to one of their adult children. Appellants claim that when that child moved out in 2016, appellants decided to move into the condo. Appellants contend that the prior owner of the condo made repairs and improvements that were not permitted, were unsafe, and were not up to code. Appellants provide photos and invoices in support of the claimed deduction for repairs totaling \$41,365.

Starting in 2016, appellants did not intend to continue renting the condo after their child moved out. Instead, appellants used this property as their primary residence. Appellants, therefore, converted the condo from a business (rental) property into a property solely for their personal use and enjoyment. The IRS disallowed the entire amount noting that the \$41,365 was “disallowed in full because they were personal expenses.”⁶ Appellants have not established that the claimed repairs and improvements were made for a non-personal business purpose. As such, appellants have not established that they are entitled to the claimed deductions.

⁵ IRC sections 162, 262, and 280A are generally incorporated into California law at R&TC section 17201, except as otherwise provided.

⁶ The IRS further advised appellants that the amounts for the repairs and improvements may increase the basis in their home and reduce their gains when they sell the condo.

Home Office Deduction

Generally, expenses of maintaining a household, including amounts paid for rent, water, utilities, and similar expenses, are not deductible. (Treas. Reg. § 1.262-1(b)(3).) However, an exception to the general rule permits a deduction of certain expenses for business use of a home under certain circumstances. (IRC, § 280A(c)(1).)⁷

Appellants assert that they claimed a home office deduction of \$10,995 for 2014, \$0 for 2015 and 2016, \$16,073 for 2017, and \$13,197 for 2018. Appellants request that the average of the home office deduction for taxable years 2014, 2017, and 2018 (\$13,421) be applied as an offset to disallowed deductions in 2016. However, each taxable year stands on its own and must be separately considered. (*Pekar v. Commissioner* (1999) 113 T.C. 158, 166; *Appeals of Kwon, et al.*, 2021-OTA-296P.) Moreover, FTB is not required in any given year to allow the same treatment permitted in a previous year. (*Pekar v. Commissioner, supra.*) Appellants' request is based on a speculative average for a deduction they may have been able to claim, but did not, in 2016. Without documentation showing that appellants met the requirements for a home office deduction pursuant to IRC section 280A(c) in 2016, appellants have not established that they are entitled to a home office deduction for 2016.

Payments to FTB and by EDD

Appellants claim that the proposed assessment is satisfied due to a payment of \$10,661.90 to FTB, and due to a pandemic unemployment assistance award of \$17,550, which the EDD was to administer to appellant-husband. Appellants detail a harrowing scenario in which they were unable to retrieve those funds from EDD.⁸ Appellants assert that it is all California State money, and that FTB should get the funds from EDD, not from them. Such arguments are unrelated to whether FTB's proposed assessment is in error. OTA's only power is to determine the correct amount of the taxpayer's California income tax liability. (*Appeal of*

⁷ The portion of the home must be exclusively used on a regular basis: (A) as the principal place of business for any trade or business of the taxpayer, (B) as a place of business which is used by patients, clients, or customers in meeting or dealing with the taxpayer in the normal course of the trade or business, or (C) in the case of a separate structure which is not attached to the dwelling unit, in connection with the taxpayer's trade or business.

⁸ Appellant-husband testified at the oral hearing that someone called EDD to change his address the day before the first check was to be mailed. When appellants attempted to make a fraud claim, EDD told them that they would need the address where the checks were actually sent. When appellants tried to obtain the address to which EDD mailed the checks, they were allegedly told that information could not be disclosed. At the hearing, FTB volunteered to assist appellants in filing a fraud claim to seek reimbursement of the misdirected funds.

Sheward, 2022-OTA-228P.) Consequently, appellants have not met their burden to establish error in FTB's proposed assessment.

Issue 2: Have appellants established reasonable cause to abate the accuracy-related penalty?⁹

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 taxable year over the amount of the tax imposed which is shown on the return, reduced by any rebate. (IRC, § 6662(d)(2).) 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).)

Here, appellants' understatement of tax exceeds the greater of 10 percent of the tax required to be shown on the return or \$5,000. Accordingly, the accuracy-related penalty is properly imposed based on the substantial understatement of tax. Appellants do not provide any argument or evidence to show reasonable cause or good faith with respect to the underpayment or that any other exceptions to the penalty apply.¹⁰ As mentioned above, appellants' main assertion is that appellants already fully paid the balance due for the 2016 taxable year. That does not constitute reasonable cause to abate the accuracy-related penalty. Thus, appellants have not shown that the accuracy-related penalty should be abated.

⁹ Appellants provide no specific arguments or evidence in support of abating the accuracy-related penalty. OTA addresses it, however, as the parties agreed at the oral hearing that the penalty was still at issue.


¹⁰ A taxpayer may also reduce or eliminate the understatement if he or she successfully demonstrates substantial authority for the treatment of any item giving rise to the understatement, or the relevant facts affecting the item's tax treatment were adequately disclosed and there is a reasonable basis for the tax treatment of such item. (IRC, § 6662(d)(2)(B).)

HOLDINGS

1. Appellants have not established error in FTB’s proposed assessment of additional tax, which is based on federal adjustments.
2. Appellants have not established reasonable cause to abate the accuracy-related penalty.


DISPOSITION

FTB’s action is sustained in full.


DocuSigned by:


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 Teresa A. Stanley
 Administrative Law Judge

We concur:

DocuSigned by:


 48745BB800914B4...
 Josh Aldrich
 Administrative Law Judge

DocuSigned by:


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 Steven Kim
 Administrative Law Judge

Date Issued: 4/16/2025