

FACTUAL FINDINGS

1. Appellant timely filed a 2019 California Resident Income Tax Return (Form 540) on February 1, 2020, reporting adjusted gross income (AGI) from appellant's federal return less the appropriate standard deduction. After applying credits and withholdings, appellant claimed a refund, which respondent issued on February 3, 2020.
2. Respondent later learned from the IRS that amounts reported by appellant on the Form 540 did not include pension/annuity payments of \$32,178, interest of \$17, and cancellation of debt income of \$4,858. On the basis of this information, respondent issued an October 23, 2023 Notice of Proposed Assessment (NPA) of additional tax of \$2,663, and interest of \$272.52, for a total additional amount due of \$2,935.52.¹
3. On December 20, 2023, appellant protested the NPA.
4. Respondent's September 12, 2024 position letter to appellant explained that the NPA was based on the AGI reported on appellant's federal return and that California law requires that a taxpayer use the same AGI on both returns.² The letter invited appellant to provide additional information within 30 days and stated that respondent would otherwise affirm the proposed assessment.
5. On November 5, 2024, respondent issued a Notice of Action (NOA) affirming the proposed assessment of additional tax and modifying the interest to include interest for the periods July 15, 2020, through January 14, 2023, and November 7, 2023, through the date of the NOA.³
6. This timely appeal followed.

¹ The Notice of Action subsequently removed interest imposed before July 15, 2020, as a result of FTB's postponement of the due date for 2019 tax return payments to July 15, 2020.

² Form 540 essentially begins the taxable income calculation with the AGI reported on the federal tax return. (See also R&TC, § 17072(a).)

³ Where an individual timely files a tax return, as appellant did here, interest on underpayments will accrue for three years, but per R&TC section 19116, accrual of interest is thereafter suspended if respondent has not yet provided notice to the taxpayer of the liability and the basis of the liability. (R&TC, § 19116(a), (b)(1).) Interest accrual resumes following the fifteenth day after the notice is provided. (R&TC, § 19116(b)(2).) According to the NOA, respondent suspended interest from January 15, 2023, through November 6, 2023, a period of almost 10 months, which appears to exceed the relief provided by R&TC section 19116. Because this error benefits the taxpayer, OTA will not address it further in this Opinion.

DISCUSSION

Issue 1: Does the evidence show error in respondent's proposed assessment for the 2019 tax year?

California imposes a tax on every California resident's entire taxable income. (R&TC, § 17041(a)(1).) R&TC section 17071 incorporates IRC section 61, which defines "gross income" as "all income from whatever source derived," including interest, annuity and pension income, and income from discharge of indebtedness. (IRC, § 61(a)(4), (8), (10), (11).) Generally, a distribution from a qualified retirement plan or an individual retirement account is included in income for the year of distribution. (IRC, §§ 402(a), 408(d)(1).) IRC section 72(t)(1) imposes an additional tax of 10 percent of the amount of a distribution made to a taxpayer under the age of 59 ½ unless certain statutory exceptions are met.⁴ (See, e.g., IRC, § 72(t)(2).) R&TC section 17085(c)(1) adopts IRC section 72(t) for California tax purposes but reduces the rate of the early distribution tax from 10 percent to 2.5 percent.

Appellant argues that all taxes and penalties were withheld from the pension/annuity withdrawal before the net amount was paid to appellant, and that appellant was informed that the Form 540 was correct because the net funds were used to purchase a home.⁵

All the additional income at issue here (interest, annuity and pension income, and income from discharge of indebtedness) was taxable unless exempt. OTA finds no basis for an exemption, and appellant does not argue otherwise. The evidence shows no known exception to the additional early withdrawal tax, and only federal taxes were withheld from the early pension/annuity payments. It appears from the evidence that appellant correctly reported her income on her federal tax return, however she did not report all her income on her California tax return. Therefore, OTA finds that the evidence does not show error in respondent's proposed assessment for the 2019 tax year.

⁴ Appellant was under the age of 59 1/2 years at the time of the payments.

⁵ At protest, appellant also argued that she cannot afford to pay the additional tax and interest. Inability to pay is not a defense to a proposed assessment. (See *Appeal of Robinson*, 2018-OTA-059P.) Respondent has informed appellant that payment options can be discussed between the parties after the liability is final. This argument will not be discussed further.

Issue 2: Is appellant entitled to additional relief of interest?

If any amount of tax is not paid by the due date, respondent is required to impose interest from the payment due date until the date the taxes are paid. (R&TC, § 19101(a).) Interest is not a penalty but is compensation for the taxpayer's use of money that should have been paid to the state. (*Appeal of GEF Operating, Inc.*, 2020-OTA-057P.) Imposition of interest is mandatory, and it can only be abated in certain limited situations when authorized by law.⁶ (R&TC, § 19101(a); *Appeal of GEF Operating, Inc.*, *supra.*) There is no reasonable cause exception to the imposition of interest. (*Appeal of Moy*, 2019-OTA-057P.)

OTA interprets appellant's argument as one based on unreasonable delay by respondent. Respondent may abate interest related to a proposed deficiency to the extent the interest is attributable in whole or in part to: (1) an unreasonable error or delay; (2) by an officer or employee of FTB acting in his or her official capacity; (3) in performing a ministerial or managerial act; and (4) which occurred after respondent contacted the taxpayer in writing regarding the proposed deficiency, provided no significant aspect of that error or delay can be attributable to the taxpayer. (R&TC, § 19104(a)(1), (b)(1); *Appeal of Gorin*, 2020-OTA-018P.) OTA reviews FTB's failure to abate interest for abuse of discretion. (R&TC, §19104(b)(2)(B).) To show an abuse of discretion, a taxpayer must establish that, in refusing to abate interest, FTB exercised its discretion arbitrarily, capriciously, or without sound basis in fact or law. (*Appeal of Gorin*, *supra.*)

Here, respondent first contacted appellant in writing regarding the proposed deficiency when it issued the October 23, 2023 NPA. Appellant promptly filed a protest on December 20, 2023, but it took respondent almost nine months to issue its position letter. Respondent has previously informed OTA that six months was a reasonable time to allow for issuance of a position letter to reply to a protest. (See *Appeal of Gorin*, *supra.*) While OTA recognizes that the circumstance here may differ from those in *Appeal of Gorin*, respondent has not explained why it took nine months to respond here, and it has offered no factual basis for its statement that there has been no unreasonable delay. Consequently, OTA finds that appellant is entitled to relief of interest for the period June 20, 2024, through September 12, 2024.


⁶ As relevant here, circumstances that may warrant relief of interest are described in R&TC sections 19104 (unreasonable error or delay by respondent) and 21012 (reasonable reliance on respondent's written advice). There is no evidence appellant reasonably relied on any written advice from respondent. Respondent also has discretion to grant interest relief under the financial hardship provisions of R&TC section 19112; however, OTA has no authority to review respondent's exercise of discretion under that section. (*Appeal of Moy*, 2019-OTA-057P.)

HOLDINGS

1. The evidence does not show error in respondent's proposed assessment for the 2019 tax year.
2. Appellant is entitled to relief of interest for the period June 20, 2024, through September 12, 2024.

DISPOSITION

Interest is relieved for the period June 20, 2024, through September 12, 2024, but respondent's action proposing additional tax and interest for the 2019 tax year is otherwise sustained.

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Michael F. Geary
Administrative Law Judge

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