



### FACTUAL FINDINGS

1. Appellants timely filed their joint California Resident Income Tax Return for 2013, reporting total tax of \$5,262.
2. Appellants' Schedule E, attached to their federal tax return, reported a net loss from appellants' two S corporations (pizza shops) of \$69,867. Appellants' Schedules K-1, attached to their federal tax return for one of the pizza shops, reported distributions of \$63,299, which appellants did not report on their federal or California tax returns.
3. On October 25, 2018, FTB received IRS information indicating that the IRS increased appellants' federal taxable income by \$133,166. According to the 2013 FEDSTAR IRS Data Sheet, the IRS disallowed the claimed Schedule E losses of \$69,867, added capital gains income of \$63,299, and imposed a federal accuracy-related penalty.
4. Based on the IRS information, FTB issued a Notice of Proposed Assessment (NPA) on September 8, 2022, which followed the IRS adjustments. As a result, the NPA proposed to assess additional California tax of \$12,235 and an accuracy-related penalty of \$2,447, plus applicable interest.
5. Appellants protested the NPA, and FTB responded that the IRS information did not indicate that the federal assessment had been canceled or reduced. When appellants did not respond, FTB issued a Notice of Action on May 3, 2023, affirming the NPA. This timely appeal followed.

### DISCUSSION

Issue 1: Have appellants shown error in the proposed assessment, which is based on a final federal determination?

R&TC section 18622(a) provides that a taxpayer must either concede the accuracy of a final federal determination or state why it is erroneous. It is well settled that a deficiency assessment based on federal adjustments to income is presumptively correct and that the taxpayer bears the burden of proving that the determination is erroneous. (*Appeal of Gorin*, 2020-OTA-018P.) In the absence of credible evidence showing that FTB's determination is incorrect, it must be upheld. (*Appeal of Valenti*, 2021-OTA-093P.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof with respect to a deficiency assessment based on a federal action. (*Appeal of Gorin*, *supra*.)

In this appeal, FTB's proposed assessment was based on a final federal determination, and appellants have the burden of proving that FTB's proposed assessment is incorrect. Appellants assert that they should be allowed to "balance the gains and losses" between their two pizza shops. Appellants contend they transferred inventory between the two shops and had no net gains between the two.

The IRS adjustments consisted of disallowed claimed Schedule E losses of \$69,867 and capital gains distributions of \$63,299 that appellants did not report on their tax return. It is unclear how balancing gains and losses might hypothetically impact the specific IRS adjustments or FTB's proposed assessment. Pass-through gains and losses from both S corporations should be reported on appellants' personal return, so to the extent that gains and losses do offset each other, the return would reflect that. (Internal Revenue Code (IRC), § 1366.)<sup>1</sup> The information from the IRS does not specify why the Schedule E losses were disallowed, and appellants do not provide an explanation or any evidence that would show the IRS was incorrect in doing so. The Schedules K-1 attached to appellants' tax return show that the distributions of \$63,299 were made, and appellants did not provide evidence showing that those distributions were nontaxable. Therefore, appellants fail to show that FTB's proposed assessment is erroneous.

Issue 2: Have appellants established a basis to abate the accuracy-related penalty?

IRC section 6662, incorporated into California law 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. In general, 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).) 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 tax shown on the return, reduced by any rebate. (IRC, § 6662(d)(2).) The accuracy-related penalty does not apply to any portion of an underpayment if it is shown that there was reasonable cause for the underpayment and the taxpayer acted in good faith with respect to the underpayment. (IRC, § 6664(c)(1).)

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<sup>1</sup> California conforms to IRC section 1366 per R&TC section 17087.5.

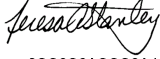
In this appeal, the imposition of the accuracy-related penalty for the 2013 taxable year was appropriate. Since the amount of tax required to be shown on the return is \$17,497, and appellants only reported total tax of \$5,262 on their tax return, the understatement of tax exceeds \$5,000. Appellant does not argue that the penalty was improperly calculated. Appellants have not argued, and the evidence does not show, that any exception to this penalty might potentially apply. Therefore, the accuracy-related penalty cannot be abated.

HOLDINGS

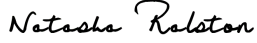
1. Appellants have not shown any error in the proposed assessment.
2. Appellants have not established a basis to abate the accuracy-related penalty.


DISPOSITION

FTB’s proposed assessment is sustained.

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 Teresa A. Stanley  
 Administrative Law Judge

We concur:

Signed by:  
  
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 Natasha Ralston  
 Administrative Law Judge

DocuSigned by:  
  
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 Sheriene Anne Ridenour  
 Administrative Law Judge

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