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7 **BOARD OF EQUALIZATION**
8 **STATE OF CALIFORNIA**

10 In the Matter of the Appeal of:) **HEARING SUMMARY²**
11) **PERSONAL INCOME TAX APPEAL**
12 **DEBRA HACKLEY¹**) Case No. 728285

<u>Year</u>	<u>Proposed Assessment Additional Tax</u>	<u>Penalties and Fee³</u>
2002	\$476.00	\$227.74

17 Representing the Parties:

18 For Appellant: Tax Appeals Assistance Program (TAAP)⁴
19 For Franchise Tax Board: Cynthia D. Kent, Tax Counsel IV

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23 ¹ Appellant currently resides in Los Angeles, Los Angeles County.

24 ² This appeal was originally scheduled for an oral hearing at the Board’s August 5-6, 2014 meeting. However, appellant
25 failed to respond to the hearing notice and this appeal was rescheduled for the nonappearance consent calendar at the
26 Board’s September 23-24, 2014 meeting. Subsequently, appellant was granted a request to be heard before the Board and
the matter was placed on the October 14-15, 2014 oral hearing calendar.

27 ³ The penalties and fee amount consists of the following: (1) a late filing penalty of \$100.00; (2) an accuracy-related penalty
28 of \$95.20; and (3) a post-amnesty penalty of \$32.54.

⁴ Appellant filed her appeal letter. Golnaz Zandieh from TAAP filed a reply brief on behalf of appellant. Gabriel Vigh from
TAAP filed a supplemental brief on behalf of appellant.

- 1 QUESTIONS: (1) Whether appellant has shown error in the Franchise Tax Board's (FTB or
2 respondent) proposed assessment, which is based on federal changes provided by
3 the Internal Revenue Service (IRS);
4 (2) Whether the late filing penalty should be abated;
5 (3) Whether the accuracy-related penalty should be abated;
6 (4) Whether the Board has jurisdiction to review respondent's assessment of the
7 post-amnesty penalty; and
8 (5) Whether respondent's proposed assessment is barred by the statute of limitations.
9

10 HEARING SUMMARY

11 Background

12 Appellant did not file a 2002 tax return by the extended due date of October 15, 2003.
13 (Respondent's opening brief (ROB), p. 1; Appellant's reply brief (ARB), Exhibit 1.) Respondent
14 received information from its Non-Filer Compliance Program indicating that appellant received income
15 sufficient to prompt a return-filing requirement. (Respondent's reply brief (RRB), p. 3.) Respondent
16 issued a Request for Tax Return (Request) to appellant on January 12, 2004, requesting that appellant
17 file a 2002 return, show that a return had been filed, or explain why a return was not required. (RRB,
18 Ex. J.) After appellant failed to respond to the Request, respondent issued a 2002 Notice of Proposed
19 Assessment (NPA) on April 12, 2004.⁵ (RRB p. 3, Ex. K.) As no timely protest was filed, the NPA
20 became final and respondent issued a Notice of State Income Tax Due (Notice) on July 12, 2004.
21 (RRB, p. 3; ARB, Ex. 2.)

22 Subsequently, on April 20, 2005, appellant filed a California tax return (Form 540) for
23 tax year 2002, which reported a California adjusted gross income (AGI) of \$36,486, total claimed
24 itemized deductions of \$15,152, taxable income of \$21,334, tax of \$517, and after applying personal
25 exemption credits of \$80, a self-assessed tax liability of \$437. Appellant reported withholdings of
26 \$904, resulting in an overpayment of \$467, with \$65 of the overpayment distributed to charities as
27

28 ⁵ The NPA proposed an additional tax of \$319, a late filing penalty of \$100, and interest, based on an estimated taxable income of \$36,486.

1 requested by appellant, and \$402 of the overpayment transferred to the following tax year. (ROB,
2 pp. 1-2; Exs. A & B.) Respondent accepted the return as filed and revised appellant's account
3 accordingly. (RRB, p. 3.)

4 Thereafter, on May 24, 2010, respondent received a Fedstar IRS Data Sheet (Fedstar
5 Sheet), which stated that the IRS audited appellant's 2002 tax return and made multiple adjustments.
6 (ROB, p. 2, Ex. D.) Appellant did not notify respondent of these federal adjustments. (ROB, p. 2.)
7 Consistent with the Fedstar Sheet, respondent issued a second NPA on April 11, 2012, which
8 disallowed claimed miscellaneous deductions in the amount of \$8,101.00, increased appellant's taxable
9 income from \$21,334.00 to \$29,435.00 (i.e., \$21,334.00 + \$8,101.00), and proposed an additional tax
10 of \$476.00 (i.e., \$913.00 (the total tax proposed on the NPA) - \$437.00 (appellant's self-assessed tax,
11 which was paid through withholdings), a late filing penalty of \$100.00, an accuracy-related penalty of
12 \$95.20, a post-amnesty penalty of \$32.54, and interest. (ROB, p. 2; Appeal Letter (AL), attachments.)

13 In a letter dated June 11, 2012, appellant protested the NPA and explained the details of
14 her dispute with the IRS, attaching copies of her IRS correspondence and an expense list entitled "Misc
15 Expenses Incurred due to Uterine Fibroids," totaling \$8,107, which stated that appellant "had a
16 hysterectomy in Feb 2003 to alleviate problem." (ROB, Ex. E, p. 8.) Respondent replied in a letter
17 dated February 7, 2013, stating that information recently received from the IRS did not show that the
18 federal assessment had been cancelled or reduced, and also attaching a copy of the Fedstar Sheet.
19 Respondent requested that appellant send a copy of any revised IRS reports in case of a cancellation or
20 revision of the federal assessment. (ROB, Ex. F.) When no reply was received by the deadline
21 provided in the letter, respondent issued a Notice of Action on March 13, 2013, affirming the NPA.
22 (ROB, p. 2; AL, attachments.) This timely appeal followed. (ROB, p. 2.)

23 Contentions

24 Appellant's Appeal Letter

25 Appellant argues that her original 2002 tax return was filed on time and that she was not
26 aware that her tax assessment was unresolved until the receipt of respondent's letter dated February 7,
27 2013. Appellant contends that, because of major surgery in February of 2003, she filed her tax return
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1 on August 3, 2003, after filing an extension, and re-filed on March 23, 2007.⁶ Appellant contends that
2 she requested an audit reconsideration with the IRS and, during her correspondence with the IRS, she
3 provided supporting documentation for the \$8,101⁷ in miscellaneous deductions. Appellant argues that
4 she was advised by a tax advocate that federal audit reconsideration assistance could not be given and
5 was advised to file an amended return. Appellant contends that, after requesting a collection due
6 process hearing with the IRS, she was informed that her 2002 account was paid in full. Appellant
7 asserts that she will visit the IRS in April 2013 to seek a resolution. (AL, pp. 1-2.)

8 Appellant contends that the proposed assessment is outside of the statute of limitations
9 because assessments and collection suits for taxes, penalties, and other additions, must occur within
10 three years from the day after the tax return is filed. (Citing Int.Rev. Code, §§ 6501(a) & 6665(a);
11 *Burnet v. Willingham Loan & Trust Co.* (1931) 282 U.S. 437.) (AL, p. 2.)

12 Respondent's Opening Brief

13 Assessment Based on a Federal Determination

14 Respondent contends that a deficiency assessment issued by the FTB based on a federal
15 audit report is presumptively correct, and that the taxpayer bears the burden of providing competent
16 evidence to prove it erroneous. Respondent contends that the adjustments to appellant's California
17 taxable income and appellant's proposed additional tax liability follow the federal adjustments
18 indicated on the 2002 Fedstar Sheet. Respondent asserts that it requested and reviewed a recently-
19 obtained copy of appellant's 2002 federal Account Transcript which shows that the current adjusted
20 federal liability is consistent with the Fedstar Sheet and that there is no indication of any pending
21 claims. (ROB, p. 4.)

22 Respondent contends that, other than a typed list of claimed miscellaneous deductions,
23 appellant has not provided any documentation, such as proof of payment, to establish an entitlement to
24 the disallowed deductions. Moreover, respondent argues, several items on the expense list do not meet
25 the definition of a deductible medical expense, such as "replacement of sofa," "loveseat", and "dining
26

27 ⁶ It is unclear whether appellant is referring to her state or federal tax return or both.

28 ⁷ We note the discrepancy with the \$8,107 mentioned above in appellant's June 11, 2012 letter.

1 room chairs.” Respondent argues that, unless supporting documentation is provided, appellant failed to
2 establish that the proposed assessment is in error. (ROB, p. 4.)

3 Late Filing Penalty

4 Respondent asserts that the late filing penalty was properly assessed pursuant to R&TC
5 section 19131 as a result of the late filing of appellant’s return and that a late filing penalty imposed at
6 the federal level has not been abated. Respondent contends that the FTB has no record of a 2002 return
7 being filed by appellant prior to the return filed on April 20, 2005, but that appellant should provide a
8 certified mail receipt if she can verify that her return was mailed timely. Respondent argues that
9 appellant has not provided any evidence that her surgery or illness prevented her from a timely filing
10 and, therefore, has failed to show reasonable cause for an abatement of the penalty. (ROB, p. 5.)

11 Accuracy-Related Penalty

12 Respondent asserts that the accuracy-related penalty was properly imposed under R&TC
13 section 19164 and by reference Internal Revenue Code (IRC) sections 6662 and 6664 as a result of a
14 substantial understatement of income tax. Respondent contends that, in accordance with the IRS, the
15 FTB imposed a 20 percent accuracy-related penalty and that the Fedstar Sheet and appellant’s federal
16 Account Transcript do not indicate an abatement of the federal penalty. Respondent argues that the
17 federal accuracy-related penalty is based on negligence and that negligence is indicated when a
18 taxpayer fails to make a reasonable attempt to ascertain the correctness of a deduction which would
19 seem to a reasonable and prudent person as “too good to be true” under the circumstances. (Citing
20 Treas. Reg. §§ 1.6662-3(b)(1)(i) & (ii).) Respondent argues that several items on appellant’s expense
21 list do not qualify as deductible medical care expenses and that no documentation was provided
22 establishing an entitlement to the deductions, such as proof of payment. Therefore, respondent
23 concludes, appellant has not submitted any substantial evidence to establish reasonable cause for the
24 abatement of the penalty. (ROB, pp. 6-7.)

25 Post-Amnesty Penalty

26 Respondent contends that the post-amnesty penalty was properly imposed pursuant to
27 R&TC section 19777.5, subdivision (a)(2). Respondent argues that the post-amnesty penalty is an
28 estimated amount and not final and, therefore, the Board does not have the jurisdiction to consider the

1 penalty in the context of this appeal. (ROB, p. 7.)

2 Statute of Limitations

3 Respondent contends that the issuance of the NPA was timely because, under R&TC
4 section 19057, the FTB is required to mail a proposed deficiency assessment to the taxpayer within
5 four years after the original due date of the taxpayer's return, except as otherwise expressly provided.
6 Respondent argues that one of the express exceptions, as provided by R&TC sections 19059 and 19060,
7 is when a proposed assessment is based on changes or corrections at the federal level. Respondent
8 argues that, pursuant to R&TC section 18622, a taxpayer is required to report each federal change or
9 correction within six months after the date of each change or correction. Respondent contends that, if
10 the federal determination is reported within this six-month time period, a notice of proposed deficiency
11 is timely if it is mailed within two years of the date that the federal action is reported to the FTB, citing
12 R&TC section 19059. Respondent contends that, because the FTB was notified of the federal action in
13 the form of a Fedstar Sheet on May 24, 2010, respondent had until May 24, 2012, two years from the
14 date of the Fedstar Sheet, to mail an NPA. Therefore, the FTB argues, the NPA dated April 11, 2012,
15 was not barred by the statute of limitations. (ROB, pp. 3-4.)

16 Appellant's Reply Brief

17 Appellant contends that, due to medical issues which included a hysterectomy, she filed
18 an extension on April 13, 2003, and 2002 state and federal returns in August of 2003. Appellant asserts
19 that she re-filed her Form 540 in April of 2005 after receiving a Notice on July 12, 2004, and after
20 being notified that the FTB had no record of her 2002 return. (ARB, p. 1.)

21 Assessment Based on a Federal Determination

22 Appellant breaks down the disallowed claimed miscellaneous deductions as follows:

- 23 1. Diapers/pads for constant heavy blood flow due to uterine fibroids from May 15,
24 2002 until December 31, 2002: \$3,554
- 25 2. Iron supplements for anemia: \$42
- 26 3. Replacement of mattress due to bleeding: \$867
- 27 4. Linens including towels: \$58
- 28 5. Pajamas and sweat pants for sleeping to prevent blood damage: \$86
6. Replacement of sheets and comforters soiled in blood: \$135
7. Mattress pads to protect the new mattress: \$265
8. Soap to prevent chafing due to constant cleansing and wipes: \$67
9. Replacement of clothing soiled by blood "coasts", suits, work: \$508

- 1 10. Blood remover: \$16
- 2 11. Advil, Tylenol due to pain: \$42
- 3 12. Special undergarments to protect clothing: \$152
- 4 13. Replacement of dining room chairs: \$260
- 5 14. Replacement of loveseat and sofa due to blood: \$2,055
- 6 Total: \$8,107

7 Appellant concedes that some of the items on the list are not deductible. Appellant
8 states that she has been trying to contact the IRS to re-open her case and to obtain documents to prove
9 that her federal case is pending. (ARB, pp. 2-3.)

10 Appellant contends that respondent has acknowledged that some of the expense items
11 meet the definition of medical deductions. Appellant argues that, pursuant to IRC section 213(a), a
12 taxpayer is permitted to deduct medical care expenses incurred during the year, not compensated for by
13 insurance, to the extent the expenses exceed 7.5 percent of the taxpayer's AGI. Appellant argues that
14 medical care includes “. . . amounts paid for the diagnosis, cure, mitigation, treatments, or prevention of
15 disease, or for the purpose of affecting any structure or function of the body. . . .” (Citing Int.Rev.
16 Code, § 213(d)(1)(A).) (ARB, p. 3.) Appellant argues that the following items are medical deductions
17 mistakenly itemized as miscellaneous deductions:

- 18 1. Diapers/pads to prevent the constant blood flow due to uterine fibroids: \$3,554
- 19 2. Iron supplement due to anemia: \$42
- 20 8. Soap to prevent chafing due to constant cleansing and wipes: \$67
- 21 11. Advil, Tylenol, due to pain: \$42
- 22 Total: \$3,705

23 Appellant contends that she had uterine fibroids in 2002, which led to a hysterectomy in
24 March of 2003. Appellant argues that, during 2002 and part of 2003, she incurred an excessive amount
25 of costs related to her uterine fibroids, which are “noncancerous tumors that generally grow in the walls
26 of [the] uterus” with symptoms that include “heavy menstrual or between cycles bleedings and
27 excruciating pain.” Appellant argues that she: (1) experienced heavy bleeding and excruciating pain;
28 (2) bought pads and diapers to cure and mitigate her condition and to conduct her work and day-to-day
activities; (3) used pain relievers to treat her unbearable pain; and (4) used soap to help with her
condition. Appellant states that she is unable to provide any documentation to substantiate the
expenses, but argues that, because the expenses were incurred 11 years ago, finding the appropriate

1 documentation is close to impossible. However, appellant argues, she was able to find documents that
2 prove she suffered from uterine fibroids in 2002 and 2003. (ARB, p.4-5.)

3 Appellant contends that the IRS was erroneous in disallowing the \$3,705 in deductions
4 because the medical expenses exceed the 7.5 percent ceiling, and appellant already has been allowed by
5 the IRS and FTB to deduct \$6,251 in medical expenses. Appellant argues that her unique medical
6 condition over the past 11 years, which includes uterine fibroids, multiple biopsies, and cancer tests,
7 contributed to her inability to locate the appropriate supporting documents. (ARB, p. 5.)

8 Late Filing Penalty

9 Appellant argues that it is well established that medical conditions can establish
10 reasonable cause. (Citing *Appeal of Allen L. and Jacqueline M. Seaman*, 75-SBE-080, Dec. 16, 1975.)⁸
11 Appellant argues that, on April 14, 2003, she filed an extension despite her tremendous pain, multiple
12 doctor visits, and surgery recovery, and re-filed her return once she discovered it was not in the FTB's
13 possession. Appellant contends that she was single and in her fifties when diagnosed with uterine
14 fibroids and that, after her hysterectomy, she could not conduct work or normal day-to-day activities.
15 Appellant contends that her medical difficulties, her extreme pain, and medication side effects,
16 prevented her from properly filing, verifying that her taxes were properly filed, and keeping a record of
17 her tax return. (Citing *Hayes v. Commissioner*, T.C. Memo. 1967-80.) Therefore, appellant concludes,
18 she has rebutted the presumption of bad faith and willful neglect. (ARB, pp. 5-8.)

19 Accuracy-Related Penalty

20 Appellant contends that she acted in good faith because she filed an extension and, as she
21 has no specialized knowledge of tax law, believed that, due to her medical condition and expenses, she
22 was entitled to her claimed deductions. Appellant contends that taxpayers should not be penalized
23 because of their condition, the complexity of the tax law, and the financial burden imposed on them.
24 Appellant argues that her medical condition was a major factor in her inability to comprehend the tax
25 laws and that, but for her reasonable mistake, she intended to pay her taxes in full. (ARB, pp. 8-9.)

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28 ⁸ Board of Equalization cases (designated "SBE") may generally be found at: www.boe.ca.gov.

1 evaluation on May 23, 2012; (11) a mammogram on September 24, 2013; and (12) a breast biopsy on
2 October 9, 2013. (ARB, Ex. 4.)

3 Respondent's Reply Brief

4 Assessment Based on a Federal Determination

5 Respondent asserts that appellant has acknowledged in her reply brief that she is unable
6 to provide documentation to prove that the medical expenses were incurred and, therefore, has not
7 presented any evidence other than her typed list to establish error in the disallowance of the claimed
8 deductions. (RRB, p. 2.)

9 Late Filing Penalty

10 Respondent argues that appellant did not respond to the initial NPA or the Request, and
11 filed her 2002 return on April 20, 2005, over 10 months after the receipt of the Notice, which is not the
12 action of an ordinarily intelligent and prudent person. (RRB, p. 3.)

13 Respondent contends that many of the records provided are for "routine medical
14 screenings or are for periods well outside the time frame for filing a timely 2002 tax return" and
15 presents the following timeline based on documents provided by appellant:

16 2002

- 17 • June 14, 2002: Colonoscopy and esophagogastroduodenoscopy
- 18 • July 12, 2002: Barium Enema Study
- 19 • July 24, 2002: Pap smear
- 20 • August 26, 2002: Doctor's care note for August 12, 2002, to
21 August 26, 2002, for unknown condition; to return to work and
22 resume regular duties on August 27, 2002
- 23 • September 4, 2002: Outpatient hysteroscopy
- 24 • October 10, 2002: Doctor's note indicating appellant's need for
25 future surgery and six-week recovery period
- 26 • October 15, 2002: Doctor's note advising limited physical activity
27 for unknown duration due to uterine fibroids and fatigue following
28 excess bleeding
- October 28, 2002: Chest x-ray; note from La Vida Medical to
return to work on October 29, 2002

26 2003

- 27 • January 20, 2003: Note from doctor regarding scheduled surgery
28 on February 24, 2003, and anticipated need for appellant to be off
work for approximately six weeks

- 1 • February 24, 2003: Scheduled hysterectomy and six-week medical
2 leave

3 2009

- 4 • November 25, 2009: Doctor's note regarding recent non-urgent
5 lab results

6 2011

- 7 • March 17, 2011: Extremity Doppler study for calf pain
8 • March 23, 2011: Mammogram
9 • April 19, 2011: Breast biopsy
10 • October 10, 2011: Diagnostic mammogram – follow up for breast
11 lesion

12 2012

- 13 • May 15, 2012: Mammogram
14 • May 23, 2012: Bone density exam
15 • July 16, 2012: Doctor office visit for unspecified reason
16 • July 26, 2012: Doctor office visit for unspecified reason

17 2013

- 18 • October 9, 2013: Breast biopsy

19 Respondent contends that the time frame for filing a timely 2002 tax return under
20 extension is from January 1, 2003, to October 15, 2003, and the only medical documentation provided
21 by appellant relevant to that time frame relates to her six-week medical leave following her
22 hysterectomy on February 24, 2003. (RRB, p. 4-5.) Respondent argues that appellant has not provided
23 any evidence showing that she was unable to file before or after her six-week medical leave, but that
24 appellant was able to work in 2003, as evidenced by wages of \$24,880 reported on her 2003 tax return.
25 (RRB, p. 5, Ex. L.)

26 Accuracy-Related Penalty

27 Respondent contends that appellant's medical records and medical condition of uterine
28 fibroids do not suggest interference with tax law comprehension and do not establish reasonable cause
because the records only indicate an approximate six-week period of disability during the time period
for filing a 2002 tax return. Additionally, respondent argues, by claiming deductions for home
furnishings, appellant failed to establish that she exercised ordinary business care and prudence. (RRB,

1 p. 5.)

2 Appellant's Supplemental Brief

3 Assessment Based on a Federal Determination

4 Appellant concedes that, while some of the expenses are not deductible, expenses of
5 \$3,705 are deductible because the items were necessary to sustain a minimal level of comfort from the
6 medical hardships resulting from her hysterectomy. (Appellant's supplemental brief (ASB), p. 2.)

7 Appellant states that she does not have much documentation regarding the listed medical
8 expenses, but that she has reasonable cause for lacking documentation. Appellant states that her
9 mother passed away in February of 2006 and has attached a death certificate and a probate court letter
10 appointing her as the estate administrator. (ASB, p. 2, attachments.) Appellant argues that she had to
11 probate her mother's estate, settle her mother's financial affairs, sell her mother's home, and move over
12 40 years of her parents' belongings by April of 2007. (ASB, p. 2, attachments.) Appellant contends
13 that the stress of this constant activity, her ailing medical condition, and her strict time constraints,
14 made it extremely difficult to manage her affairs, causing her to misplace medical expense
15 documentation, a reasonable occurrence considering her circumstances. (ASB, pp. 2-3.)

16 Late Filing Penalty

17 Appellant contends that she originally filed on August 3, 2003, and after receiving the
18 Notice, personally filed with the IRS and FTB on April 20, 2005. Appellant argues that heavy bleeding
19 and pelvic pain resulted from her hysterectomy, which led to fibroid tumors, menorrhagia, and anemia,
20 causing symptoms of fatigue, loss of energy, dizziness, insomnia, and difficulty concentrating.
21 Appellant argues that she cannot fulfill the reasonable person standard because that standard applies to
22 taxpayers in perfect health instead of taxpayers suffering from severe ailments and troubling
23 circumstances. (ASB, pp. 3-4.)

24 Accuracy-Related Penalty

25 Appellant argues that she could not focus on interpreting the complex tax code because
26 of the stress of dealing with the probate of her mother's estate and the dizziness, fatigue, insomnia, and
27 concentration problems resulting from her anemia. (ASB, p. 4, attachments.)

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1 Applicable Law

2 Assessment Based on a Federal Determination

3 R&TC section 18622 provides that a taxpayer shall either concede the accuracy of a
4 federal determination or state wherein it is erroneous. It is well-settled that a deficiency assessment
5 based on a federal audit report is presumptively correct and that a taxpayer bears the burden of proving
6 that the determination is erroneous. (*Appeal of Sheldon I. and Helen E. Brockett*, 86-SBE-109, June 18,
7 1986; *Todd v. McColgan* (1949) 89 Cal.App.2d 509.) Unsupported assertions are not sufficient to
8 satisfy a taxpayer's burden of proof with respect to an assessment based on a federal action. (*Appeal of*
9 *Aaron and Eloise Magidow*, 82-SBE-274, Nov. 17, 1982.) In the absence of credible, uncontradicted,
10 competent, and relevant evidence showing that the FTB's determination is incorrect, it must be upheld.
11 (*Appeal of Oscar D. and Agatha E. Seltzer*, 80-SBE-154, Nov. 18, 1980.) A taxpayer's failure to
12 produce evidence that is within his or her control gives rise to a presumption that such evidence is
13 unfavorable to his or her case. (*Appeal of Don A. Cookston*, 83-SBE-048, Jan 3, 1983.)

14 Tax deductions are a matter of legislative grace, meaning that taxpayers must show that
15 such deductions clearly meet all of the statutory requirements for a deduction. (See *Appeal of James C.*
16 *and Monablance A. Walshe*, 75-SBE-073, Oct. 20, 1975; *New Colonial Ice Co. v. Helvering* (1934)
17 292 U.S. 435.)⁹ In addition, it is equally well-established that taxpayers who claim deductions must
18 keep sufficient records to substantiate the claimed deductions. (*Sparkman v. Commissioner*
19 (9th Cir. 2007) 509 F.3d 1149, 1159.) A taxpayer's inability to produce records does not relieve the
20 taxpayer of the burden of proof. (*Villarreal v. Commissioner*, T.C. Memo. 1998-420.) When a
21 taxpayer's records have been lost or destroyed through circumstances beyond his or her control, he or
22 she is entitled to substantiate the deductions by reconstructing the expenditures through other credible
23 evidence. (*Inzano v. Commissioner*, T.C. Memo 1998-282; *Priestly v. Commissioner*, T.C. Memo.
24 2003-267.)

25 Under R&TC section 17201, California conforms to IRC section 213, which states that
26 taxpayers are allowed to deduct the expenses paid for their "medical care" to the extent the expenses
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⁹ When a California statute is substantially identical to a federal statute, we may consider federal law interpreting the federal statute as highly persuasive. (*Douglas v. State of California* (1942) 48 Cal.App.2d 835.)

1 exceed 7.5 percent of AGI and are not compensated for by insurance or otherwise. The term “medical
2 care” includes amounts paid for the “diagnosis, cure, mitigation, treatment, or prevention of disease, or
3 for the purpose of affecting any structure or function of the body.” (Int.Rev. Code, § 213(d)(1)(A).)

4 An amount paid during the taxable year for medicine or a drug shall be taken into
5 account only if such medicine or drug is a prescribed drug or is insulin. (Int.Rev. Code, § 213(b).)
6 Medicine and drugs shall not include toiletries or similar preparations nor shall it include cosmetics or
7 sundry items. Amounts expended for items which, under this subparagraph, are excluded from the term
8 “medicine and drugs” shall not constitute amounts expended for “medical care”. (Treas. Reg.
9 § 1.213-1(e)(2).) Additionally, IRS Publication 502 states that: (1) a taxpayer cannot include in
10 medical expenses the cost of an item ordinarily used for personal, living, or family purposes unless it is
11 used primarily to prevent or alleviate a physical or mental defect or illness; (2) in order to accommodate
12 an individual with a physical defect, a taxpayer may have to purchase an item ordinarily used as a
13 personal, living, or family item in a special form and can include the excess of the cost of an item in a
14 special form over the cost of the item in normal form as a medical expense; (3) a taxpayer can include
15 in medical expenses the amount paid for diapers or diaper services if needed to relieve the effects of a
16 particular disease; and (4) a taxpayer cannot include in medical expenses the cost of nutritional
17 supplements, vitamins, herbal supplements, “natural medicines,” etc. unless such items are
18 recommended by a medical practitioner as treatment for a specific medical condition diagnosed by a
19 physician.

20 Additionally, a taxpayer must also substantiate claims for deductible medical expenses
21 under the heightened scrutiny of Treasury Regulation section 1.213-1 by furnishing “the name and
22 address of each person to whom payment for medical expenses was made and the amount and date of
23 the payment.” (Treas. Reg. § 1.213-1(h).) When requested, claims must be substantiated by a
24 statement or invoice from the service provider showing the nature of the service rendered and to or for
25 whom rendered, the nature of any other item of expense and for whom incurred and for what specific
26 purpose, the amount paid therefor and the date of the payment thereof; and by such other information as
27 deemed necessary. (*Id.*)

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1 Late Filing Penalty

2 R&TC section 19131 provides that the FTB shall impose a late filing penalty when a
3 taxpayer fails to file a tax return on or before its due date, computed at five percent of the tax due, after
4 allowing for timely payments, for every month that the return is late, up to a maximum of 25 percent,
5 and may not be less than \$100.

6 The late filing penalty shall be imposed unless the taxpayer establishes that the late
7 filing was due to reasonable cause and not willful neglect. (Rev. & Tax. Code, § 19131.) When the
8 FTB imposes a late filing penalty, the law presumes that the penalty was imposed correctly. (*Todd v.*
9 *McColgan, supra*, 89 Cal.App.2d 509.) The burden is on the taxpayer to establish reasonable cause for
10 the untimely filing. (*Appeal of M.B. and G.M. Scott*, 82-SBE-249, Oct. 14, 1982.) For these purposes,
11 reasonable cause exists if it can be shown that the taxpayer acted as an ordinarily intelligent and
12 prudent businessperson would have acted under similar circumstances. (*Appeal of Howard G. and*
13 *Mary Tons*, 79-SBE-027, Jan. 9, 1979; *Appeal of Joseph W. and Elsie M. Cummings*, 60-SBE-040,
14 Dec. 13, 1960; *Appeal of J.B. Ferguson*, 58-SBE-024, Sept. 15, 1958.) A taxpayer must show that the
15 failure to timely file occurred despite the exercise of ordinary business care and prudence. (*Appeal of*
16 *Stephen C. Bieneman*, 82-SBE-148, July 26, 1982; *Appeal of Howard G. and Mary Tons, supra.*) To
17 satisfy the burden of proof, a taxpayer must provide credible and competent evidence to support the
18 claim of reasonable cause; otherwise, the penalty will not be abated. Incomplete and unsupported
19 statements are insufficient to carry this burden of proof. (*Appeal of David A. and Barbara L. Beadling*,
20 77-SBE-021, Feb. 3, 1977; *Appeal of James C. and Monablance A. Walshe, supra.*)

21 In determining whether reasonable cause exists, a taxpayer must demonstrate a
22 relationship between the alleged hardship and the failure to timely file. (*Appeal of Michael J. and*
23 *Diane M. Halaburka*, 85-SBE-025, Apr. 9, 1985; *Appeal of Allen L. and Jacqueline M. Seaman*,
24 *supra.*) A taxpayer must show that he or she was incapacitated and continuously precluded from filing
25 timely. (*Appeal of Michael J. and Diane M. Halaburka, supra.*) To show reasonable cause by reason
26 of illness, the taxpayer must present credible and competent proof that the circumstances of the illness
27 prevented either the preparation or the signing of a timely return. (*Appeal of Allen L. and*
28 *Jacqueline M. Seaman, supra.*) Illness or other personal difficulties do not constitute reasonable cause

1 when the difficulties simply caused the taxpayer to sacrifice the timeliness of one matter, so that other
2 matters could be pursued. (*Appeal of Michael J. and Diane M. Halaburka, supra; Appeal of William T.*
3 *and Joy P. Orr*, 68-SBE-010, Feb. 5, 1968.) “The type of illness or debilitation that might create
4 reasonable cause is one that because of severity or timing makes it virtually impossible for the taxpayer
5 to comply - things like emergency hospitalization or other incapacity occurring around tax time.”
6 (*Carlson v. United States (In re Carlson)* (7th Cir. 1997) 126 F.3d 915.) A taxpayer’s selective
7 inability to perform tax obligations, while participating in regular business activities, does not excuse
8 the failure to file timely. (*Watts v. Commissioner*, T.C. Memo. 1999-416; *Coury v. Commissioner*,
9 T.C. Memo. 2010-132 [reasonable cause was not found when a taxpayer with health complications
10 generated employment compensation during the years at issue].)

11 The incapacity of a taxpayer due to illness may constitute reasonable cause for a delay in
12 filing a return if the duration of the incapacity approximates that of the failure to file. (*Nasir v.*
13 *Commissioner*, T.C. Memo. 2011-283; *Taylor v. Commissioner*, T.C. Memo. 2009-27 [evidence of
14 illness and hospitalization did not constitute reasonable cause because: (i) the evidence did not address
15 the taxpayer’s medical condition at the time her taxes were due; and (ii) the taxpayer returned to work
16 after the hospitalization before her taxes were due].) To establish reasonable cause, a taxpayer’s
17 incapacity must render him or her unable to meet the obligation to timely file during the overall time
18 period relevant to the filing obligation. (*Hazel v. Commissioner*, T.C. Memo. 2008-134 [reasonable
19 cause was not found when: (i) neither medical records nor evidence of incapacity were presented
20 relating to the time the taxpayer should have filed; and (ii) the taxpayer was able to continue his
21 business affairs, as demonstrated by the existence of income for the period in which he would have
22 timely filed his return]; *Harbour v. Commissioner*, T.C. Memo. 1991-532 [reasonable cause was found
23 when a taxpayer was hospitalized during the tax filing period for approximately a month until a day
24 before the filing deadline].) There is no reasonable cause for a delay in filing beyond the term of a
25 taxpayer’s illness. (*Kwosh v. Commissioner*, T.C. Memo. 2008-204.)

26 Accuracy-Related Penalty

27 When the FTB assesses an accuracy-related penalty based on a federal action, the
28 assessment of the penalty is presumptively correct. (*Appeal of Robert and Bonnie Abney*, 82-SBE-104,

1 June 29, 1982.) The FTB's determination of negligence is presumed to be correct, and the taxpayer has
2 the burden of proving the contrary as well as any defenses to abate the penalty. (*Neely v.*
3 *Commissioner* (1985) 85 T.C. 934; *Recovery Group, Inc. v. Commissioner*, T.C. Memo. 2010-76.) To
4 overcome the presumption of correctness of a penalty, the taxpayer must provide credible and
5 competent evidence to support the claim; otherwise, the penalty should not be abated. (*Appeal of*
6 *Wintson R. Schwyhart*, 75-SBE-035, Apr. 22, 1975.)

7 R&TC section 19164, which incorporates the provisions of IRC section 6662, provides
8 for an accuracy-related penalty of 20 percent of any portion of an underpayment of tax required to be
9 shown on a return. The penalty applies to the portion of the underpayment attributable to:

10 (1) negligence or to the disregard of rules and regulations; or (2) any substantial understatement of
11 income tax. (Int.Rev. Code, § 6662(b).) For an individual, there is a "substantial understatement of
12 income tax" when the amount of the understatement for a taxable year exceeds the greater of ten
13 percent of the tax required to be shown on the return, or \$5,000. (Int.Rev. Code, § 6662(d)(1).) IRC
14 section 6662(c) defines "negligence" as any failure to make a reasonable attempt to comply with the
15 provisions of the Internal Revenue Code. Courts have stated that, for purposes of the penalty for the
16 underpayment of tax, "negligence is lack of due care or failure to do what a reasonable and ordinarily
17 prudent person would do under the circumstances." (*Neely v. Commissioner, supra.*)

18 An accuracy-related penalty applicable to the portion related to negligence applies if the
19 taxpayer fails to keep adequate books and records or to properly substantiate deductions. (Treas. Reg.
20 § 1.6662-3(b)(1); *Sanderlin v. Commissioner*, T.C. Memo. 2008-209.) A strong indicator of negligence
21 is when a taxpayer fails to make a reasonable attempt to ascertain the correctness of a deduction.
22 (Treas. Reg. § 1.6662-3(b)(1)(i)-(ii).) Negligence may also be found by a breach of a duty to timely
23 file without a showing of reasonable cause, by an inability to produce secondary records to substantiate
24 disputed deductions, and by a failure to present persuasive evidence of any attempt to replace or
25 reconstruct missing records. (*Cook v. Commissioner*, T.C. Memo. 1991-590; *Kolbeck v.*
26 *Commissioner*, T.C. Memo. 2005-253.)

27 An accuracy-related penalty shall not be imposed to the extent the taxpayer can show
28 reasonable cause and good faith. (Rev. & Tax. Code, § 19164, subd. (d); Int.Rev. Code, § 6664(c)(1);

1 Cal. Code Regs., tit. 18, § 19164, subd. (a).) A determination of whether or not a taxpayer acted with
2 reasonable cause and in good faith is made on a case-by-case basis and depends on the pertinent facts
3 and circumstances, including the taxpayer's efforts to assess the proper tax liability, the taxpayer's
4 knowledge and experience, and the extent to which the taxpayer relied on the advice of a tax
5 professional. Circumstances that may indicate reasonable cause and good faith include an honest
6 misunderstanding of fact or law that is reasonable in light of all of the facts and circumstances,
7 including the experience, knowledge, and education of the taxpayer. (Treas. Reg. § 1.6664-4(b)(1).)
8 Generally, the most important factor is the extent of the taxpayer's effort to assess his or her proper tax
9 liability. (*Goode v. Commissioner*, T.C. Memo. 2006-48.) The kinds of activities that show a
10 reasonable attempt to comply with tax law are maintaining records sufficient to support an entitlement
11 to claimed deductions, conducting tax research, and discussing the situation with the IRS, FTB, or tax
12 advisors. (*Id.*; *Gomez v. Commissioner*, T.C. Memo. 1999-94.)

13 Difficult circumstances may establish reasonable cause and good faith for the abatement
14 of an accuracy-related penalty if the difficult circumstances occurred at the time the tax return was
15 filed. (*Abdelhak v. Commissioner*, T.C. Memo. 2006-158 [reasonable cause was found when a
16 taxpayer lost his job, his house, his interest in a deferred compensation account, and his marriage, at the
17 time his tax returns were filed].) A taxpayer's mental and physical condition at the time the tax return
18 was completed may be considered in determining whether the taxpayer acted with reasonable cause and
19 good faith for the abatement of the accuracy-related penalty. (*Ruckman v. Commissioner*, T.C. Memo.
20 1998-83 [reasonable cause was found when a taxpayer with cancer underwent surgeries, radiation, and
21 chemotherapy during the period in which the tax returns were completed].) To establish reasonable
22 cause by reason of mental incapacitation, a taxpayer must prove that he or she was so mentally
23 incapacitated during the relevant time period as to render him or her incapable of exercising ordinary
24 business care and prudence. (*Tamberella v. Commissioner*, T.C. Memo. 2004-47.)

25 Post-Amnesty Penalty

26 In 2004, the California Legislature enacted the income tax amnesty program. (Rev. &
27 Tax. Code, §§ 19730-19738.) Eligible taxpayers could participate in this program by filing an amnesty
28 application and paying their outstanding tax and interest liabilities, or alternatively, entering into an

1 installment payment plan, during the period from February 1, 2005, through March 31, 2005. (Rev. &
2 Tax. Code, §§ 19730 & 19731.) For liabilities which remained outstanding after the last day of the
3 amnesty period, the penalty is to be imposed equal to 50 percent of the accrued interest payable. (Rev.
4 & Tax. Code, § 19777.5, subd. (a).)

5 The governing statute does not provide a taxpayer with a right to appeal an unpaid
6 amnesty penalty or to file an administrative refund claim for a paid amnesty penalty, except upon the
7 basis that the penalty was not properly computed. (Rev. & Tax. Code, § 19777.5, subd. (d).) Thus, the
8 Board's jurisdiction to review the post-amnesty penalty, under R&TC section 19777.5, is limited to
9 situations where the penalty has been assessed and paid, the taxpayer has filed a timely appeal from a
10 denial of a refund claim, and the taxpayer has attempted to show a computational error.

11 Statute of Limitations

12 The statute of limitations on respondent's issuance of a proposed deficiency assessment
13 depends on when and if the taxpayer notifies respondent of federal changes. In general, regardless of
14 any federal action, respondent must issue a proposed assessment within four years of the date the
15 taxpayer filed his or her California return. (Rev. & Tax. Code, § 19057.) If there are federal changes
16 and the taxpayer or the IRS notifies respondent within six months of the date the federal changes
17 became final, then respondent must issue a proposed assessment within two years of the date of
18 notification, or within the general four-year period, whichever expires later. (Rev. & Tax. Code,
19 § 19059.) If the taxpayer or the IRS notifies respondent later than six months from the date the federal
20 changes became final, then respondent must issue a proposed assessment within four years of the date
21 of notification. (Rev. & Tax. Code, § 19060, subd. (b).) If, however, the taxpayer fails to notify
22 respondent of the federal changes, then respondent may issue a proposed assessment at any time.
23 (Rev. & Tax. Code, § 19060, subd. (a).) The California Supreme Court clarified that the specific
24 limitations periods set forth in R&TC section 19060 override the general limitations period set forth in
25 section 19057. (*Ordlock v. Franchise Tax Board* (2006) 38 Cal.4th 897.)

26 STAFF COMMENTS

27 Assessment Based on a Federal Determination

28 At the hearing, appellant should be prepared to present evidence that demonstrates error

1 in the FTB's determination (i.e., invoices, receipts, third-party declarations, etc.)¹⁰ Appellant asserts:
2 (1) that other than expenses totaling \$3,705, the disallowed claimed expense deductions in the amount
3 of \$8,101 are not deductible; and (2) that she is unable to provide documentation to substantiate any of
4 the disallowed claimed deductions, including the \$3,705 she contends are valid medical care expense
5 deductions. Appellant should be prepared to present: (1) evidence that substantiates the disallowed
6 claimed deductions; (2) evidence that meets the medical expense deduction substantiation requirements
7 of Treasury Regulation section 1.213-1(h); (3) evidence that the expenses qualify as medical care
8 expense deductions within the meaning of IRC section 213; and (4) evidence supporting her contention
9 that substantiating documentation was lost through circumstances beyond her control.

10 Late Filing Penalty

11 Appellant's 2002 tax return originally was due on April 15, 2003. It appears to staff that
12 the late filing penalty was properly imposed pursuant to R&TC section 19131 because appellant
13 untimely filed her 2002 tax return on April 20, 2005. Appellant's account withholdings of \$904 were
14 received by the FTB before the original due date of April 15, 2003, and were subtracted from a total tax
15 due of \$913 as reported on the second NPA, leaving only \$9 remaining as outstanding. Therefore, it
16 appears that the minimum late filing penalty of \$100 was properly imposed pursuant to R&TC section
17 19131. Appellant should be prepared to present evidence, such as a certified mail receipt, in support of
18 her contention that she filed her return with the FTB on August 3, 2003.

19 The parties should be prepared to discuss whether appellant has established reasonable
20 cause for the abatement of the late filing penalty. Appellant contends that her failure to timely file
21 resulted from her medical condition. Respondent contends that appellant has not established reasonable
22 cause because appellant has not submitted evidence of a medical condition or disablement relevant to
23 her overall timely filing period (which respondent asserts is from January 1, 2003, to October 15,
24 2003), other than evidence of a hysterectomy and a six-week medical leave in February and March of
25 2003. Respondent also contends that appellant was able to work during 2003, citing wages of \$24,880
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27
28 ¹⁰ Pursuant to California Code of Regulations, title 18, section 5523.6, any additional evidence should be provided at least
14 days prior to the oral hearing in order to facilitate an orderly and productive hearing. Evidence exhibits should be sent to:
Khaalq Abd'Allah, Appeals Analyst, Board Proceedings Division, State Board of Equalization, P.O. Box 942879 MIC:80,
Sacramento, California, 94279-0080.

1 reported on appellant's 2003 tax return. Appellant should be prepared to present: (1) evidence that a
2 medical condition existed during the overall time period relevant to her filing obligation (i.e., medical
3 records, third-party declarations, etc.), from January 1, 2003, to her extended filing deadline of
4 October 15, 2003; (2) evidence that the medical condition caused her failure to timely file despite the
5 exercise of ordinary business care and prudence; and (3) evidence that the medical condition
6 continuously incapacitated and precluded her from timely filing and participating in regular business
7 and normal day-to-day activities, in light of the \$24,880 in wages earned in 2003.

8 Accuracy-Related Penalty

9 The IRS imposed a 20 percent accuracy-related penalty pursuant to R&TC
10 section 19164, as shown by appellant's 2002 federal Account Transcript and 2002 Fedstar Sheet.
11 According to the Account Transcript, there has been no subsequent abatement of the penalty at the
12 federal level. The federal understatement of tax of \$1,222.00 does not exceed \$5,000.00, which is
13 greater than ten percent of the tax required to be shown on the return or \$344.60 (i.e., (\$2,224.00 (tax
14 on original return as shown on appellant's Account Transcript) + \$1,222.00 (additional federal tax
15 assessed as shown on appellant's Account Transcript) x .10). Therefore, the federal accuracy-related
16 penalty was apparently imposed for an underpayment attributable to negligence or to a disregard of
17 rules and regulations. In accordance with the accuracy-related penalty imposed by the IRS, respondent
18 imposed a 20 percent accuracy-related penalty pursuant to R&TC section 19164 in the amount of
19 \$95.20 (i.e., \$476.00 (understatement of tax) x .20).

20 The parties should be prepared to discuss whether appellant has established reasonable
21 cause and good faith for the abatement of the accuracy-related penalty. Appellant should be prepared
22 to present: (1) evidence establishing reasonable cause and good faith; (2) evidence supporting her
23 contention that her medical condition and personal hardships caused the understatement of tax that is
24 relevant to when the return was filed on April 20, 2005 (i.e., medical records, third-party declarations,
25 etc.); and (3) evidence that she made a reasonable attempt to correctly ascertain her tax liability.

26 Statute of Limitations

27 According to the Fedstar Sheet, the FTB was notified of the federal changes on May 24,
28 2010, within six months of the final federal determination date, which, according to appellant's federal

1 Account Transcript, was April 12, 2010. Consequently, respondent apparently had until May 24, 2012,
2 two years from the date of the notice, to issue a proposed assessment. Therefore, it appears to staff that
3 respondent properly issued the 2002 NPA on April 11, 2012, within the applicable statute of limitations
4 period.

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8 Hackley_jl

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