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

10 In the Matter of the Appeal of:) **HEARING SUMMARY**
11) **PERSONAL INCOME TAX APPEAL**
12 **JOHN KUNAK AND**) Case No. 740944
13 **MARY FLEMING¹**)

<u>Years</u>	<u>Proposed Assessments</u>	
	<u>Taxes</u>	<u>Penalties²</u>
2007	\$9,166.00	\$1,833.20
2008	\$35,876.00	\$7,175.20
2009	\$2,034.00	\$0.00

19 Representing the Parties:

20 For Appellants: John Kunak and Mary Fleming

21 For Franchise Tax Board: Natasha Sherwood Page, Tax Counsel III

23 **QUESTIONS:** (1) Whether appellants have shown error in respondent's assessments for 2007,
24 2008, and 2009, which are based on federal determinations; and
25 (2) Whether appellants have shown reasonable cause to abate the accuracy-related

27 ¹ Appellants reside in Castaic, California.
28 ² The penalties imposed are accuracy-related penalties.

1 penalties for 2007 and 2008.

2 HEARING SUMMARY

3 Background

4 Appellants filed timely joint California tax returns (Form 540) for the 2007, 2008, and
5 2009 tax years. On their 2007 return, appellants reported federal adjusted gross income (AGI) of
6 \$136,804, California adjustments (subtractions) totaling \$421, California itemized deductions of
7 \$68,113, taxable income of \$68,270, and tax of \$2,292. After subtracting exemption credits of \$482,
8 appellants reported a tax liability of \$1,810. Appellants reported withholding credits of \$2,138 and an
9 overpayment of \$328, which was refunded to appellants by respondent. (Resp. Opening Br., pp. 1-2,
10 Ex. A.)

11 On their 2008 return, appellants reported federal AGI of \$178,485, California
12 adjustments (subtractions) totaling \$328, California itemized deductions of \$107,601 taxable income of
13 \$70,556, and tax of \$2,340. After subtracting exemption credits of \$507, appellants reported a tax
14 liability of \$1,833. Appellants reported withholding credits of \$2,260 and an overpayment of \$427 that
15 respondent refunded. (Resp. Opening Br., p. 2, Ex. B.)

16 On their 2009 return, appellants reported federal AGI of \$288,298, California itemized
17 deductions of \$186,568, taxable income of \$101,730, and tax of \$5,176. After subtracting exemption
18 credits of \$294, appellants reported a tax liability of \$4,882. Appellants reported withholding credits of
19 \$2,329 and estimated tax payments of \$1,000. Appellants had a balance due of \$1,553. Since the
20 balance due was paid after the April 15, 2010 deadline, appellants estimated and paid \$157 in interest
21 and a late filing penalty. Appellants paid \$1,710 with their return and, after recalculating interest and
22 penalties, respondent refunded appellants \$1.30. (Resp. Opening Br., p. 2, Ex. C.)

23 Subsequently, respondent received information from the Internal Revenue Service (IRS)
24 which indicated that federal adjustments had been made to appellants' federal returns for the 2007,
25 2008, and 2009 tax years. For 2007, the IRS made adjustments for non-cash contributions of \$2,151,
26 gambling losses of \$7,782, and gambling winnings of \$92,197. The federal adjustments resulted in a
27 \$9,234 adjustment to appellants' Schedule A itemized deductions. The IRS also imposed an accuracy-
28 related penalty of \$5,221. (Resp. Opening Br., p. 2, Ex. E.)

1 For 2008, the IRS made adjustments for gambling winnings of \$371,077 and made
2 several additional adjustments to appellants' itemized deductions and exemption credits. The IRS also
3 imposed an accuracy-related penalty of \$22,999.80. For 2009, according to respondent, the IRS made
4 adjustments for gross receipts and sales of \$22,920³ and made additional adjustments to appellants'
5 itemized deductions and self-employment tax. The IRS also imposed an accuracy-related penalty of
6 \$1,753. Appellants did not report these federal changes to respondent. (Resp. Opening Br., p. 3, Exs. F
7 & G.)

8 Respondent issued Notices of Proposed Assessment (NPAs) to appellants for all
9 three years on December 28, 2012, in which respondent increased appellants' California taxable income
10 by \$102,130 for 2007, \$384,468 for 2008, and \$21,300 for 2009.⁴ As a result, respondent assessed
11 additional tax of \$9,166 for 2007, \$35,876 for 2008, and \$2,034 for 2009. Respondent also assessed
12 accuracy-related penalties for 2007 and 2008 in the amounts of \$1,833.20 and \$7,175.20 respectively.
13 (Resp. Opening Br., p. 3, Ex. H.)

14 Appellants timely protested the NPAs, asserting that they promptly paid the IRS
15 assessments for 2007 and 2009, but that there was no additional assessment noted on the 2008
16 transcript and therefore, no tax due. Appellants asserted that there was "significant confusion regarding
17 the IRS audit" for the relevant years and that they had "incompetent representation." Appellants also
18 asserted that the additional assessments would cause them financial difficulty. On March 28, 2013,
19 appellants had a phone conference with respondent. Respondent replied to appellants' protest in
20 writing on April 5, 2013, requesting evidence that appellants' case was not yet settled with the IRS.
21 Respondent affirmed its assessments and, on June 14, 2013, issued Notices of Action (NOAs) to
22 appellants, affirming the NPAs. Appellants then filed this timely appeal. (Resp. Opening Br., p. 3,
23

24 ³ According to the Fedstar IRS Data Sheet, these adjustments include \$11,083 for Schedule C1- Gross Receipts or Sales and
25 \$11,837 for Schedule C2- Gross Receipts or Sales. (Resp. Opening Br., Ex. G.)

26 ⁴ The 2007 NPA reflected the following adjustments totaling \$102,130: (1) a \$92,197 increase in gross income for
27 gambling winnings; (2) a \$7,782 decrease in Schedule A gambling losses; and (3) a \$2,151 decrease in Schedule A
28 contributions. The 2008 NPA reflected the following adjustments totaling \$384,468: (1) a \$371,077 increase in gross
income for gambling winnings; and (2) a \$13,391 itemized deduction limitation. The 2009 NPA reflected the following
adjustments totaling \$21,300: (1) a \$1,620 increase in the one-half self-employment tax deduction; (2) a \$11,083 Schedule
C1 increase in gross receipts or sales; and (3) a \$11,837 increase in Schedule C2 gross receipts or sales.

1 Exs. I, J & K.)

2 Contentions

3 Appellants' Contentions

4 Appellants contend that, on February 28, 2013, they were advised that their protest was
5 acknowledged and that they would be receiving "many notifications before anything occurs."

6 Appellants assert that, if respondent will agree there is no balance due for 2008, as appellants contend
7 is supported by IRS documents, appellants believe they can negotiate and resolve the assessments at
8 issue for 2007 and 2009. (App. Opening Br.)

9 In their reply, appellants contend that respondent's opening brief was untimely.⁵
10 Appellants requested a copy of their tax returns as well as their account status for 2007, 2008, and
11 2009. Appellants attach a copy of the transcripts and contend that, for the three years, there was a
12 balance due for 2007 and 2009, but that no balance was due for 2008. Appellants contend that they
13 have relied on the transcripts and have paid balances they believed were due. Appellants contend that
14 the IRS has not provided any further information to appellants, but respondent received and relied on
15 appellants' federal Account Transcripts in the interim. Appellants contend that there are several
16 inconsistencies in the federal Account Transcripts on which respondent relied, inconsistencies which
17 rendered the transcripts unreliable. (App. Reply Br.)

18 Respondent' Contentions

19 With regard to the proposed assessments based on the federal audits, respondent
20 contends that appellants failed to meet their burden of proving error in the federal changes, or error in
21 respondent's actions based on those federal changes. Respondent contends that it followed the federal
22 adjustments to the extent allowable under California law, citing the *Appeal of Edwin R. and*
23 *Joyce E. Breitman*, 75-SBE-018, decided by the Board on March 18, 1975.⁶ In addition, based on a
24 recent review of appellants' federal accounts for the subject years, respondent contends that there is no
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26 ⁵ Staff notes that, pursuant to section 5422, subdivision (b), of the Rules of Tax Appeals, respondent's opening brief
27 apparently was filed timely as indicated by the date stamp by Board Proceedings. (Cal. Code Regs., tit. 18, § 5422,
28 subd. (b).)

⁶ Board of Equalization cases may be found on the Board's website: www.boe.ca.gov.

1 indication that the IRS abated any additional tax at the federal level and that there are no current claims
2 pending. Respondent contends that, without such evidence, appellants have not established that the
3 federal action, upon which respondent based its NOAs, are in error. (Resp. Opening Br., pp. 4-5,
4 Exs. L & M.)

5 With regard to the imposition of the accuracy-related penalties, respondent contends that
6 appellants failed to offer any evidence that the accuracy-related penalties based on the IRS's
7 determinations were incorrect. Respondent contends that appellants have not met their burden to prove
8 that the accuracy-related penalties were imposed improperly. Respondent contends that the state's
9 accuracy-related penalties imposed for the 2007 and 2008 tax years were imposed properly pursuant to
10 R&TC section 19164 and Internal Revenue Code (IRC) sections 6662 and 6664. (Resp. Opening Br.,
11 p. 5.)

12 Applicable Law

13 Accuracy of Assessment

14 R&TC section 18622, subdivision (a), provides that a taxpayer shall either concede the
15 accuracy of a federal determination or state wherein it is erroneous. It is well-settled that a deficiency
16 assessment based on a federal audit report is presumptively correct and that the appellant bears the
17 burden of proving that the determination is erroneous. (*Appeal of Sheldon I. and Helen E. Brockett*,
18 86-SBE-109, June 18, 1986; *Todd v. McColgan* (1949) 89 Cal.App.2d 509.) Unsupported assertions
19 are not sufficient to satisfy an appellant's burden of proof with respect to an assessment based on a
20 federal action. (*Appeal of Aaron and Eloise Magidow*, 82-SBE-274, Nov. 17, 1982.)

21 Deductions from gross income are a matter of legislative grace and a taxpayer has the
22 burden of proving an entitlement to the deductions claimed; unsupported assertions are not sufficient to
23 satisfy the taxpayer's burden of proof. (*New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435;
24 *Appeal of James C. and Monablanche A. Walshe*, 75-SBE-073, Oct. 20, 1975.) To carry the burden of
25 proof, the taxpayers must point to an applicable statute and show by credible evidence that the
26 deductions claimed come within its terms. (*Appeal of Robert R. Telles*, 86-SBE-061, Mar. 4, 1986.) In
27 the absence of uncontradicted, credible, competent, and relevant evidence showing that respondent's
28 determinations are incorrect, respondent's determination must be upheld. (*Appeal of Oscar D. and*

1 *Agatha E. Seltzer*, 80-SBE-154, Nov. 18, 1980.)

2 Accuracy-Related Penalty

3 R&TC section 19164, which incorporates the provisions of IRC section 6662, provides
4 for an accuracy-related penalty of 20 percent of the applicable underpayment. As relevant to this
5 appeal, the penalty applies to the portion of the underpayment attributable to (1) negligence or to the
6 disregard of rules and regulations or (2) any substantial understatement of income tax. (Int.Rev. Code,
7 § 6662(b).) The Internal Revenue Code defines “negligence” to include “any failure to make a
8 reasonable attempt to comply” with the provisions of the code. (Int.Rev. Code, § 6662(c).) The term
9 “disregard” is defined to include any “careless, reckless, or intentional disregard.” (*Ibid.*) IRC
10 section 6662 provides that a substantial understatement of tax exists if the amount of the
11 understatement exceeds the greater of 10 percent of the tax required to be shown on the return or
12 \$5,000. (Int.Rev. Code, § 6662(d)(1).) “Understatement” means the excess of the amount required to
13 be shown on the return for the taxable year over the amount of the tax imposed which is shown on the
14 return, reduced by any rebate. (Int.Rev. Code, § 6662(d)(2).)

15 There are three exceptions to the imposition of the accuracy-related penalty. Under the
16 first exception, the penalty shall be reduced by the portion of the understatement attributable to a tax
17 treatment of any item if there is substantial authority for such treatment. (Int.Rev. Code,
18 § 6662(d)(2)(B).) Under the second exception, the penalty shall be reduced by the portion of the
19 understatement attributable to a tax treatment of any item if the relevant facts affecting the item’s tax
20 treatment are adequately disclosed and there is a reasonable basis for the tax treatment of such item.
21 (Int.Rev. Code, § 6662(d)(2)(B).) Under the third exception, the penalty will not be imposed to the
22 extent an appellant shows that a portion of the underpayment was due to reasonable cause and that he
23 acted in good faith with respect to such portion of the underpayment. (Int.Rev. Code, § 6664(c)(1);
24 Treas. Regs. §§ 1.6664-1(b)(2) & 1.6664-4.)

25 A determination of whether a taxpayer acted with reasonable cause and in good faith is
26 made on a case-by-case basis and depends on the pertinent facts and circumstances, including his
27 efforts to assess the proper tax liability, his knowledge and experience, and the extent to which he
28 relied on the advice of a tax professional. Generally, the most important factor is the extent of the

1 taxpayer's effort to assess his proper tax liability. Reliance on the advice of a professional tax advisor
2 does not necessarily demonstrate reasonable cause and good faith. However, reliance on professional
3 advice constituted reasonable cause and good faith if, under all the circumstances, such reliance was
4 reasonable and the taxpayer acted in good faith. (Treas. Reg., § 1.6664-4(b)(1).) The taxpayers bear
5 the burden of proving any defenses to abate the penalty. (*Recovery Group, Inc. v. Comm'r*, T.C. Memo
6 2010-76.)

7 STAFF COMMENTS

8 Appellants cite to federal Account Transcripts, dated March 9, 2012, and contend that
9 they have already paid the 2007 and 2009 assessments. However, appellants appear to be referring to
10 their federal assessments. Appellants also assert that the copy of their 2008 federal Account Transcript
11 dated March 9, 2012, indicates that there was no assessment for 2008. Respondent requested and
12 received a more recent version of appellants' federal Account Transcript, dated August 22, 2013, which
13 reflected an assessment for 2008. As respondent stated in its opening brief, the assessments made by
14 the IRS were added to appellants' federal Account Transcripts, and appellants have older versions of
15 these transcripts. Appellants should be prepared to provide evidence showing that the IRS made further
16 adjustments to their accounts, or that those accounts are still subject to federal examination.

17 Respondent imposed the state accuracy-related penalties for 2007 and 2008 in
18 accordance with the imposition of the federal accuracy-related penalties. Based on the revised
19 computation of tax for 2007, it appears that there is a substantial understatement of tax as the proposed
20 assessment of \$9,166.00 exceeds the greater of \$1,097.60, which is 10 percent of the revised tax
21 required to be shown on the return (\$10,976.00), or \$5,000.00. Similarly, based on the revised
22 computation of tax for 2008, it appears that there is a substantial understatement of tax as the proposed
23 assessment of \$35,876.00 exceeds the greater of \$3,770.00, which is 10 percent of the revised tax
24 required to be shown on the return (\$37,709.00), or \$5,000.00. The parties should be prepared to
25 discuss whether any of the exceptions to the accuracy-related penalty applies to appellants'
26 circumstances.

27 Pursuant to California Code of Regulations, title 18, section 5523.6, if either party has
28 any additional evidence to present, they should provide their evidence to the Board Proceedings

1 Division at least 14 days prior to the oral hearing.⁷

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⁷ Evidence exhibits should be sent to: Khaaliq Abd'Allah, Appeals Analyst, Board Proceedings Division, State Board of Equalization, P.O. Box 942879 MIC: 80, Sacramento, California 94279-0080.