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

10 In the Matter of the Appeal of:

) **HEARING SUMMARY**
) **PERSONAL INCOME TAX APPEAL**
) Case No. 793495

11 **ROBERT CARPIO AND**
12 **VIRGINIA CARPIO¹**

14 Proposed
15 Assessment

| | | |
|----------------|-----------------------|---------------------------------|
| 16 <u>Year</u> | <u>Additional Tax</u> | <u>Accuracy-Related Penalty</u> |
| 2003 | \$15,806.00 | \$3,161.20 |

17 Representing the Parties:

18 For Appellants: Ernest H. Mattison, Jr., CPA
19 For Franchise Tax Board: Eric R. Brown, Tax Counsel III
20

21 QUESTION: Whether appellants have shown that the proposed assessment was issued by the
22 Franchise Tax Board (FTB or respondent) within the statute of limitations.
23

24 HEARING SUMMARY

25 Background

26 Appellants filed a timely joint 2003 California Resident Income Tax Return, reporting a
27

28 ¹ Appellants list an address in Orange County California.

1 California taxable income of \$456,452. After taking into account appellants' credits and withholdings,
2 appellants reported a balance due of \$12,453, which they paid with their return. (FTB opening brief
3 (FTB OB), p. 1 & Ex. B.)

4 The Internal Revenue Service (IRS) examined the return and made adjustments
5 (described below). On March 20, 2009, appellants signed a federal Form 870 agreeing to the federal
6 changes. (Appeal Letter (AL), p. 2; FTB OB, p. 1 & Exs. D & F.)

7 Appellants did not report the federal adjustments to the FTB. On June 6, 2011, the FTB
8 received a federal Revenue Agent Report (RAR), showing that the IRS made the following adjustments
9 to appellants' 2003 federal return: (a) one-half of self-employment tax of -\$38; (b) capital gain of
10 \$144,663; (c) schedule C other expenses of \$20,501; (d) schedule C depreciation of \$5,163;
11 (e) schedule C commissions and fees of \$4,000; (f) schedule C car and truck expenses of \$1,767;
12 (g) schedule C gross receipts or sales of \$700; (h) schedule E items (net) totaling \$9,871; and
13 (i) schedule A adjustments (taxes of \$3,534 and total interest of \$26,254) totaling \$29,788. The RAR
14 also assessed a 20 percent accuracy-related penalty. (FTB OB, p. 1 & Ex. D.)

15 On January 31, 2012, the FTB issued a Notice of Proposed Assessment (NPA) that
16 conformed to the federal adjustments "a-i" above. In addition, the NPA set forth a California itemized
17 deduction limitation adjustment of \$13,120 (adjustment "j"). Accordingly, based on adjustments "a-j"
18 above, the NPA increased appellant's 2006 California taxable income by \$169,959 from \$456,452 to
19 \$626,411, resulting in an additional tax of \$15,806. The NPA also assessed a 20 percent accuracy-
20 related penalty of \$3,161, plus interest. (FTB OB, Ex. E.)

21 Appellants filed a timely protest, arguing that the NPA was not issued in a timely
22 manner. Specifically, appellants asserted that in all probability the IRS must have reported the federal
23 adjustments within six months of the final federal determination, which occurred in early 2009, and
24 therefore, the FTB had only until early 2011 to issue the NPA. In their protest letter, appellants
25 requested a protest hearing, which occurred on August 1, 2013. After reviewing the matter, the FTB
26 affirmed the NPA in a Notice of Action (NOA) dated December 9, 2013. In response, appellants filed
27 this timely appeal. (FTB OB, pp. 2-3 & Ex. F.)

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1 Contentions

2 Appellants' Contentions

3 Appellants assert that during the pendency of their FTB protest proceedings, an FTB
4 employee told appellants that there was prior evidence in the FTB's records of the IRS tax adjustments.
5 Appellants contend that they promptly requested the FTB provide appellants with all such evidence
6 (which appellants refer to as "timeline evidence") before the protest hearing. Appellants assert that the
7 FTB did not provide any timeline evidence before the date of the FTB protest hearing, which occurred
8 on August 1, 2013. In addition, appellants contend that only after the protest hearing did the FTB
9 provide any timeline evidence, which consisted solely of a federal Form 5278 (Statement of Income
10 Tax Changes). (AL, pp. 2-3.)

11 Appellants contend that immediately after the FTB protest hearing, they submitted a
12 federal Freedom of Information Act (FOIA) request, demanding that the IRS provide evidence
13 regarding the exact date it notified the FTB of the federal changes. Appellants contend that after
14 "normal delays," the IRS provided 1,492 pages of information with a total of 152 pages fully or
15 partially withheld for various reasons. Appellants assert that as of the date of their appeal letter to the
16 Board (January 8, 2014), they needed more time to obtain documents from the IRS.² (AL, pp. 2-3.)

17 On May 9, 2014, appellants send a document request to the FTB, requesting under the
18 California Public Records Act that the FTB provide evidence regarding the date the IRS first notified
19 the FTB of the federal changes.³ (App. Add. Information Brief, p. 2 & unlabeled exhibit attached
20 thereto.)

21 On appeal, appellants are not disputing the amount of the federal changes. Appellants
22 contend that the NPA is untimely because it was issued more than two years after the final federal
23 determination. Specifically, appellants contend that the two-year statute of limitations is applicable
24 because a "shared information" protocol existed between the IRS and the FTB, and thus the IRS must
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26 ² This appeal was deferred from January of 2014 to September 14, 2014, to allow more time for appellant to seek further
27 information from the IRS.

28 ³ The appeal record does not indicate whether the FTB responded to appellants' document request. At or prior to the
hearing, the FTB should address whether it replied to the request.

1 have notified the FTB within six months of the federal determination. (AL, p. 2.)

2 The FTB's Contentions

3 The FTB states that appellants' 2003 IMF transcript shows that a final federal
4 determination occurred on May 4, 2009. Based on the foregoing, the FTB asserts that in accordance
5 with R&TC section 18622, subdivision (a), appellants were required to report the federal adjustments
6 by November 4, 2009 (six months after the final federal determination date), which they failed to do.

7 The FTB contends that the IRS first reported the federal adjustments on June 6, 2011,
8 which is more than six months from the final determination date of May 4, 2009. The FTB argues that
9 the NPA was timely because it was issued on January 31, 2012, which is within four years of the
10 June 6, 2011 reporting date. (Rev. & Tax Code, § 19060.) (FTB OB, pp. 4-5.)

11 *IRS Source Database (ISDB):* The FTB asserts that the IRS is not mandated by law to
12 share information with the FTB, or to do so within a fixed timeframe. The FTB states that quarterly
13 and annually, the IRS sends the FTB an "electronic data extract" of the examination and appeals that
14 have been opened and closed. The FTB states that the data extract is limited to (i) the taxpayer's name,
15 (ii) identification number, (iii) tax year, and (iv) an indicator of whether the case is open or closed, and
16 if it is closed, the additional tax assessed. The FTB asserts that the data extract does not include any
17 information on the amount or nature of the adjustment. The FTB contends that it keeps an inventory—
18 referred to as the IRS Source Database (ISDB)—of the open and closed files and tracks each open case
19 until the federal examination is closed and an Income Tax Examination Changes report, commonly
20 referred to as RAR, is received. (FTB OB, pp. 4-5.)

21 *Revenue Agent Report:* The FTB contends that under normal procedures, the IRS
22 provides the FTB with a copy of an RAR within three to six months of the close of a federal action—
23 but the FTB notes that such an occurrence is not always the case and it is sometimes years before the
24 FTB receives federal changes from the IRS. In fact, the FTB asserts that in a number of cases the IRS
25 provides the RAR only after repeated requests from the FTB. The FTB asserts that since 2003 the IRS
26 has been sending most RARs to the FTB electronically, with only a few being sent in hard copy (paper)
27 form. The FTB states that it receives over 150,000 RARs annually. The FTB states that the monthly
28 RAR transmission from the IRS is not tax year specific, as it might include RARs for recent or past tax

1 years. The FTB contends that upon receipt of the RARs, the FTB compares the closure information to
2 the open ISDB inventory, and the FTB states that a federal examination is not complete until the
3 additional tax posts to the taxpayer's Individual Master File (IMF) or the Business Master File (BMF)
4 transcript. (FTB OB, p. 5.)

5 The FTB asserts that if an RAR is not received within six months after the IRS indicates
6 an examination or appeal is closed, the FTB initiates efforts to determine if, in fact, the examination or
7 appeal has closed by requesting a copy of the IMF or BMF transcript. The FTB contends that upon
8 confirmation that the examination or appeal is closed, the FTB will then request a copy of the RAR,
9 which the IRS will generally provide within three months, if available. The FTB notes, however, that if
10 the RAR is not available, the IRS will instruct the FTB to re-request the RAR in 90 days—and the FTB
11 states that it must repeat this process until the RAR is received, which sometimes can take several
12 years. The FTB asserts that the current matter is an example of an instance when the IRS did not
13 provide an RAR until a couple years after it was final. (FTB OB, p. 5.)

14 Next, the FTB states that appellants have not argued (or provided evidence showing)
15 that the federal adjustments (as set forth in appellants' federal transcript) and the California assessment
16 based thereon were made in error. Thus, the FTB contends that appellants failed to carry their burden
17 of proving error. Finally, the FTB argues that appellants have not argued (or provided any evidence
18 showing) good cause for abatement of the accuracy-related penalty. (FTB OB, at p. 6.)

19 Applicable Law

20 Statute of Limitations

21 In general, the FTB must issue an NPA within four years of the date a taxpayer files his
22 or her California return. (Rev. & Tax. Code, § 19057.) However, there are special statutes of
23 limitations when federal adjustments are involved.

24 A taxpayer is required to report federal changes to income or deductions to the FTB
25 within six months of the date the federal changes become final. (Rev. & Tax. Code, § 18622.) A
26 notification must be sufficiently detailed to allow computation of the resulting California tax change
27 and shall be reported in the form and manner prescribed by the FTB. (Rev. & Tax. Code, § 18622,
28 subd. (c).) If the taxpayer notifies the FTB within six months of the date the federal changes become

1 final or the IRS reports that change to the FTB within six months after the final federal determination,
2 then the FTB may issue a proposed assessment within two years of the date of notification, or within
3 the general four-year period, whichever expires later. (Rev. & Tax. Code, § 19059.) If the taxpayer or
4 the IRS notifies the FTB more than six months after the date the federal changes become final, then the
5 FTB may issue the NPA within four years of the date of notification. (Rev. & Tax. Code, § 19060,
6 subd. (b).) If the taxpayer fails to notify the FTB of the federal changes, then the FTB may issue the
7 NPA at any time. (Rev. & Tax. Code, § 19060, subd. (a); *Ordlock v. Franchise Tax Board* (2006)
8 38 Cal.4th 897.)

9 As noted above, the FTB generally has four years from the date a taxpayer files a return
10 to issue an NPA; however, if the taxpayer omits more than 25 percent of his or her gross income, that
11 time period is extended to six years. (Rev. & Tax. Code, §§ 19057, subd. (a), and 19058, subd. (a).)

12 R&TC section 19058 provides as follows:

13 (a) If the taxpayer omits from gross income an amount properly includable therein
14 which is in excess of 25 percent of the amount of gross income stated in the return, a
15 notice of proposed deficiency assessment may be mailed to the taxpayer within six years
16 after the return was filed. . . .

17 (b) For purposes of this section both of the following shall apply:

18 (1) In the case of a trade or business, the term “gross income” means the total of the
19 amounts received or accrued from the sale of goods or services (if the amounts are
20 required to be shown on the return) prior to diminution by the cost of the sales or
21 service.

22 (2) In determining the amount omitted from gross income, there shall not be taken into
23 account any amount which is omitted from gross income stated in the return if the
24 amount is disclosed in the return, or in a statement attached to the return, in a manner
25 adequate to apprise the Franchise Tax Board of the nature and amount of the item.
26 (Rev. & Tax Code § 19058.)

27 Subdivision (d) of Section 18622 provides that the date of the final federal determination
28 shall be “the date on which each adjustment or resolution resulting from an Internal Revenue Service
examination is assessed pursuant to Section 6203 of the Internal Revenue Code.” Section 6203 of the
Internal Revenue Code (IRC) states that “the assessment shall be made by recording the liability of the
taxpayer in the office of the Secretary in accordance with the rules or regulations prescribed by the

1 Secretary.” Therefore, the date of the final federal determination is the date that the adjusted liability of
2 the taxpayer is recorded (not the date of either a Form 870 or a Form 906). (See *Appeal of Don L. and*
3 *Marilu Eddlemon*, 95-SBE-015, Dec. 12, 1995.)⁴

4 Federal Adjustments

5 A taxpayer must concede the accuracy of federal changes or prove that those changes,
6 and any California deficiency assessment based thereon, are erroneous. (Rev. & Tax. Code, § 18622,
7 subd. (a); *Appeal of Sheldon I. and Helen R. Brockett*, 86-SBE-109, June 18, 1986; *Appeal of Aaron*
8 *and Eloise Magidow*, 82-SBE-274, Nov. 17, 1982.) It is well-settled that a deficiency assessment based
9 upon federal adjustments to income and deductions is presumed correct and the taxpayer bears the
10 burden of proving the FTB’s determination is erroneous. (*Appeal of Sheldon I. and Helen R. Brockett*,
11 *supra.*) Unsupported assertions are not sufficient to satisfy a taxpayer’s burden of proof. (*Appeal of*
12 *Aaron and Eloise Magidow, supra.*)

13 Accuracy-Related Penalty

14 R&TC section 19164, which generally incorporates the provisions of IRC section 6662,
15 provides for an accuracy-related penalty of 20 percent of the applicable underpayment. The penalty
16 applies to the portion of the underpayment attributable to (1) negligence or disregard of rules and
17 regulations, or (2) any substantial understatement of income tax. (Int.Rev. Code, § 6662(b).) For an
18 individual, there is a “substantial understatement of income tax” when the amount of the
19 understatement for a taxable year exceeds the greater of ten percent of the tax required to be shown on
20 the return, or \$5,000. (Int.Rev. Code, § 6662(d)(1).) In determining whether there is a substantial
21 understatement, the taxpayer excludes any portion of the understatement for which (1) there is
22 *substantial authority* for the treatment of the position, or (2) the position was adequately disclosed in
23 the tax return (or a statement attached to the return) and there is a reasonable basis for the treatment of
24 the item. (Int.Rev. Code, § 6662(d)(2)(B).) The penalty shall not be imposed to the extent the taxpayer
25 can show reasonable cause and good faith. (Rev. & Tax. Code, § 19164, subd. (d); Int.Rev. Code,
26 § 6664(c)(1); Cal. Code Regs., tit. 18, § 19164, subd. (a).) A determination of whether a taxpayer acted
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28 ⁴ Board of Equalization cases are generally available for viewing on the Board’s website (www.boe.ca.gov).

1 with reasonable cause and in good faith is made on a case-by-case basis and depends on the pertinent
2 facts and circumstances, including the taxpayer's efforts to assess the proper tax liability, the taxpayer's
3 knowledge and experience, and the extent to which the taxpayer relied on the advice of a tax
4 professional. (Treas. Reg., § 1.6664-4(b)(1).)

5 STAFF COMMENTS

6 Appellants' federal IMF transcript shows that a final federal determination was recorded
7 on May 4, 2009.⁵ Thus, the final federal determination occurred on May 4, 2009. Staff notes that,
8 pursuant to R&TC section 18622, subdivision (c), the notification of a federal determination must be
9 sufficiently detailed to allow computation of the California tax due. Here, the FTB's records show that
10 it received the final federal determination information on June 6, 2011, which would mean that its
11 proposed assessment was timely. At the oral hearing, appellants should be prepared to substantiate
12 their argument that the two year statute of limitations is applicable because allegedly a "shared
13 information" protocol existed between the IRS and the FTB, and thus, the IRS must have notified the
14 FTB within six months of the federal determination. At or prior to the oral hearing, the FTB should
15 indicate whether it replied to appellants' document request dated May 9, 2014.

16 If appellants are disputing the imposition of the accuracy-related penalty, they should be
17 prepared to present evidence substantiating a basis for relief from the penalty. Appellants do not
18 directly address the penalty, but they do contend they were assured that the transaction they undertook
19 satisfied legal requirements. If appellants contend they reasonably relied on the advice of a
20 professional, they should provide evidence of the facts they provided the professional, when they
21 received any advice, and be prepared to demonstrate that any reliance on the advice was reasonable.

22 Pursuant to California Code of Regulations, title 18, section 5523.6, if a party has any
23 additional evidence that it wants the Board to consider, that party should provide such evidence to
24 Board Proceedings at least 14 days prior to the oral hearing.⁶

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27 ⁵ As noted in Applicable Law, the date of the final federal determination is the date that the adjusted liability of the taxpayer
is recorded, not the date of a Form 870. (See *Appeal of Don L. and Marilu Eddlemon, supra.*)

28 ⁶ Evidence exhibits should be sent, with a copy to the other party, to: Khaaliq A. Abd'Allah, Appeals Analyst, Board
Proceedings Division, State Board of Equalization, P.O. Box 942879 MIC: 80, Sacramento, California, 94279-0080.