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7 **BOARD OF EQUALIZATION**
8 **STATE OF CALIFORNIA**
9

10 In the Matter of the Appeals of:) **HEARING SUMMARY²**
11) **PERSONAL INCOME TAX APPEALS**
12 **RICHARD SCHOTTS, JR.; AND**) Case No. 798666
13 **ANDREA SCHOTTS¹**) Case No. 800099
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25 ¹ Appellants currently reside in Arizona.

26 ² This matter was originally scheduled for oral hearing at the Board’s February 24-26, 2015 Culver City meeting, but was
27 postponed at appellants’ request to allow them additional time to prepare for the hearing. This matter was then rescheduled
28 for the Board’s June 23-25, 2015 Culver City meeting. This matter was then postponed again at appellants’ request to allow
them additional time to prepare for the hearing. The matter was then rescheduled for the Board’s November 17-19, 2015
Culver City meeting.

| | <u>Appellants</u> | <u>Years</u> ³ | <u>Proposed Assessments</u> | |
|---|----------------------|---------------------------|-----------------------------|-------------------------------|
| | | | <u>Additional Tax</u> | <u>Penalties</u> ⁴ |
| 3 | Richard Schotts, Jr. | 1999 | \$91,277.00 | \$67,275.07 |
| 4 | | 2000 | \$49,779.00 | \$33,282.79 |
| 5 | Andrea Schotts | 1999 | \$89,585.00 | \$66,027.98 |
| 6 | | 2000 | \$48,024.00 | \$32,109.37 |

7 Representing the Parties:

8 For Appellants: Richard Schotts, Jr. and Andrea Schotts

9 For Franchise Tax Board: Cynthia D. Kent, Tax Counsel IV

11 QUESTIONS: (1) Whether appellants have demonstrated error in the Franchise Tax Board's (FTB
12 or respondent) proposed assessments of additional tax;
13 (2) Whether appellant-wife is entitled to the abatement of the late filing penalties;
14 (3) Whether appellant-wife is entitled to the abatement of the failure to furnish
15 information (failure to furnish) penalties;
16 (4) Whether the Board has jurisdiction to review respondent's assessment of
17 appellant-wife's post-amnesty penalties; and
18 (5) Whether the Board should impose a frivolous appeal penalty.

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22 ³ Respondent states that the length of time between the years at issue and the filing of this appeal is due to the time involved
23 in the audit and protest. Respondent also states that it was not until appellant-husband filed a lawsuit against respondent in
24 the California Superior Court in 2009 that unreported income, subject to this appeal, was identified. The Appeals Division
notes that, when a valid return has not been filed, there is no statute of limitations period for respondent's assessments.

25 ⁴ For appellant-husband, the penalty amounts consist of: (1) for 1999, a late filing penalty of \$22,819.25, a failure to furnish
26 information penalty of \$22,819.25, and a post-amnesty penalty of \$21,636.57; and (2) for 2000, a late filing penalty of
27 \$12,444.75, a failure to furnish information penalty of \$12,444.75, and a post-amnesty penalty of \$8,393.29. Respondent
states that it is abating these penalties for 1999 and 2000 because the penalties were discharged by appellant-husband's
bankruptcy filing.

28 For appellant-wife, the penalty amounts consist of: (1) for 1999, a late filing penalty of \$22,396.25, a failure to furnish
information penalty of \$22,396.25, and a post-amnesty penalty of \$21,235.48; and (2) for 2000, a late filing penalty of
\$12,006.00, a failure to furnish information penalty of \$12,006.00, and a post-amnesty penalty of \$8,097.37.

Appeals of Richard Schotts, Jr. and Andrea Schotts **NOT TO BE CITED AS PRECEDENT** - Document prepared for
Board review. It does not represent the Board's decision or opinion.

1 HEARING SUMMARY

2 Background

3 Appellants have not filed California income tax returns for tax years 1999 and 2000 that
4 have been accepted as valid by respondent. Respondent's Integrated Non-Filer (INC) Compliance
5 program annually matches income records obtained from various reporting sources against filed tax
6 returns to identify individuals who may not have fulfilled their legal requirement to file a California
7 income tax return. Respondent obtained information indicating that appellant-husband received income
8 in 1999 and 2000 sufficient to prompt a return-filing requirement.⁵ (Respondent's Opening Brief
9 (ROB), p. 2.)

10 Appellant-husband did not respond to the FTB's demands for tax returns and respondent
11 subsequently issued Notices of Proposed Assessment (NPAs) on October 18, 2001, and March 10,
12 2003, for tax years 1999 and 2000, respectively.⁶ (ROB, p. 2; Exs. A & B.) After appellant-husband
13 protested and appealed these assessments, the actions of respondent were sustained for tax years 1999
14 and 2000 by the Board and a frivolous appeal penalty of \$1,000 was imposed by the Board for tax year
15 2000. Thereafter, a petition for rehearing was denied for tax year 1999. (ROB, p. 2; Exs. C & D.)

16 In response to collection activity which included the issuance of liens, appellant-husband
17 contacted respondent contending that he had no income. Respondent advised appellant-husband that he
18 should file informational returns to support his position and, thereafter, appellant-husband filed
19 California income tax returns (Forms 540) for tax years 1999 and 2000.⁷ (ROB, p. 3; Exs. E & F.)
20

21 ⁵ For 1999, respondent received information indicating that appellant-husband made mortgage interest payments in the
22 amount of \$45,031 and received income of \$32,188 from Western Financial Savings Bank and Fidelity Federal Bank. For
23 2000, respondent received information indicating that appellant-husband made mortgage interest payments of \$51,817 and
received income of \$33,992 from Fidelity Federal Bank.

24 ⁶ The 1999 NPA dated October 18, 2001, indicated an estimated income of \$180,124, itemized deductions of \$45,031, and a
25 taxable income of \$135,093. The NPA proposed an assessment of additional tax of \$10,872, a late filing penalty of \$2,718,
a failure to file upon demand penalty of \$2,718, and a filing enforcement fee of \$109, plus interest. The 2000 NPA dated
26 March 10, 2003, indicated an estimated income of \$207,268, itemized deductions of \$51,817, and a taxable income of
\$155,451. The NPA proposed an assessment of additional tax of \$12,702.00, a late filing penalty of \$3,175.50, a failure to
27 file upon demand penalty of \$3,175.50, and a filing enforcement fee of \$108.00, plus interest.

28 ⁷ The 1999 Form 540 indicated a married filing separate filing status and reported a federal adjusted gross income of
\$35,000 and a taxable income of zero. The 2000 Form 540 indicated a married filing separate filing status and reported a
federal adjusted gross income of \$35,600 and a taxable income of zero.

1 Appellant-husband also demanded the removal of liens placed on property that he contended he did not
2 own and respondent replied that his returns were invalid and demanded that he file valid returns.⁸
3 (ROB, p. 3; Exs. G, H & I.) Appellant-husband exchanged correspondence with respondent on
4 multiple occasions, arguing that his return was valid. (ROB, p. 3; Exs. J, K, L & M.) Thereafter,
5 appellant-husband's outstanding balances were paid and he filed a claim for refund for tax years 1999
6 and 2000, attaching additional 1999 and 2000 Forms 540.⁹ (ROB, p. 4; Exs. N, O, & P.)

7 Respondent began its audit examination of both appellants, who respondent states did
8 not provide any requested documentation regarding their income. (ROB, p. 4.) With regard to
9 appellant-wife, the following communication occurred: (1) on January 14, 2010, respondent sent a
10 letter informing appellant-wife that the FTB was examining her income tax filing requirements for
11 1999 and 2000 and requested documents (ROB, p. 13; Ex. AF); (2) on January 22, 2010, appellant-
12 husband replied on appellant-wife's behalf, refusing to comply with the document requests (ROB,
13 p. 13; Ex. AG); (3) on January 22, 2010, respondent reiterated its document requests and provided
14 appellant-wife with instructions to allow appellant-husband to speak on her behalf (ROB, p. 13;
15 Ex. AH); (4) on March 9, 2010, after no response was received, respondent informed appellant-wife
16 that the requested documents were necessary to facilitate the examination and that a failure to furnish
17 penalty may be assessed (ROB, p. 13; Ex. AI); and (5) on April 12, 2010, respondent sent appellant-
18 wife a formal, legal demand for the requested information, stating that a failure to furnish penalty may
19 be assessed, and that third parties would be contacted to determine her tax liability. (ROB, p. 13;
20 Ex. AJ.)

21 Appellant-husband filed a lawsuit against respondent in the California Superior Court,
22 which appellant-husband dismissed with respect to tax years 1999 and 2000. (ROB, p. 4; Exs. Q, & R.)
23 During the course of litigation, respondent obtained from the Internal Revenue Service (IRS) financial
24 documents from appellants' businesses and personal accounts that covered the period of January 1,
25

26 ⁸ Respondent states that the properties in question were owned by appellant-husband's wholly-owned businesses or invalid
27 trust.

28 ⁹ The 1999 Form 540 reported \$35,000 in federal adjusted gross income and tax of \$815. The 2000 Form 540 reported
\$35,600 in federal adjusted gross income and tax of \$790.

1 1999, through December 31, 2000.¹⁰ In reconstructing appellants' income, respondent added together
2 account deposits and account withdrawals related to personal expenses while also including personal
3 expenses paid out of the J.R. Trust, a Nevada trust, and personal expenses paid out of RAAR
4 Enterprises, Inc., as appellants were bank account signatories of the business. Respondent determined
5 unreported income attributable to appellants in the amount of \$1,962,941 for 1999, and \$1,070,500 for
6 2000, resulting in a one-half community property share for each appellant in the amount of \$981,471
7 for 1999, and \$535,250 for 2000. (ROB, pp. 4-6.)

8 Respondent issued the following NPAs to appellant-husband: (1) a 1999 NPA dated
9 March 19, 2013, which increased his taxable income by \$981,471.00, from \$135,093.00 to
10 \$1,116,564.00 (i.e., \$135,093.00 + \$981,471.00), and proposed an additional tax of \$91,277.00, a late
11 filing penalty of \$22,819.25, a failure to furnish penalty of \$22,819.25, and a post-amnesty penalty of
12 \$21,636.57, plus interest; and (2) a 2000 NPA dated March 19, 2013, which increased his taxable
13 income by \$535,250.00, from \$155,451.00 to \$690,701.00 (i.e., \$155,451.00 + \$535,250.00), and
14 proposed an additional tax of \$49,779.00, a late filing penalty of \$12,444.75, a failure to furnish penalty
15 of \$12,444.75, and a post-amnesty penalty of \$8,393.29, plus interest. (ROB, p. 6; Exs. S & T.)

16 Respondent issued the following NPAs to appellant-wife: (1) a 1999 NPA dated
17 March 19, 2013, which increased her taxable income by \$981,471.00, from \$0 to \$981,471.00 (i.e.,
18 \$0.00 + \$981,471.00), and proposed an additional tax of \$89,585.00, a late filing penalty of \$22,396.25,
19 a failure to furnish penalty of \$22,396.25, and a post-amnesty penalty of \$21,235.48, plus interest; and
20 (2) a 2000 NPA dated March 19, 2013, which increased her taxable income by \$535,250.00, from
21 \$0.00 to \$535,250.00 (i.e., \$0.00 + \$535,250.00), and proposed an additional tax of \$48,024.00, a late
22 filing penalty of \$12,006.00, a failure to furnish penalty of \$12,006.00, and a post-amnesty penalty of
23 \$8,097.37, plus interest. (ROB, p. 6; Exs. U & V.)

24 Appellants timely protested the NPAs, stating that neither of them earned the income
25 respondent attributed to them as unreported. (ROB, p. 6; Exs. W & X.) Respondent replied that it
26 reconstructed their earnings by analyzing financial records and that the J.R. Trust was an invalid trust
27

28 ¹⁰ Respondent states that most of these documents were obtained by subpoena.

1 because it had no beneficiaries. (ROB pp. 6-7; Exs. Y & Z.) Appellant-husband argued that J.R. Trust
2 was a valid trust and that beneficiary information was not required, pursuant to Nevada trust law.
3 (ROB, p. 7; Ex. AA.) Respondent replied that monies used for personal expenses qualify as income
4 and that J.R. Trust also did not use the initials “B.T.” as legally required for a Nevada business trust.
5 (ROB, p. 7; Ex. AB.)

6 Respondent affirmed the NPAs by issuing Notices of Action for 1999 and 2000 to each
7 appellant on February 14, 2014. These timely appeals followed. (ROB, p. 7; Appellant-Husband’s
8 Appeal Letter (AHAL), attachments; Appellant-Wife’s Appeal Letter (AWAL), attachments.)

9 Appellants’ Contentions

10 Appellants contend that respondent did not “pay any attention” to their submitted
11 February 2014 tax returns. Appellants argue that respondent “used a combination of numbers” from
12 their business checking accounts to make its own “self-determination” that it was appellants’ income,
13 but did not take into account any business expenses or payments. Appellants contend that their
14 businesses are not within California’s jurisdiction, and that they are not required to file any California
15 income tax returns. Appellants state that “the issue is that the tax return has been filed and if an audit is
16 required, so be it, and the employee’s numbers are not justified and not correct.” (AHAL, p. 1-2;
17 AWAL, p. 1-2.)

18 Respondent’s Contentions¹¹

19 Proposed Assessments of Additional Tax as to Both Appellants

20 Respondent contends that appellants have not demonstrated any error in respondent’s
21 proposed assessments of additional tax for 1999 and 2000 and that appellants have made no legitimate
22 effort to prove that respondent’s proposed assessments are inaccurate. (ROB, p. 7.)

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24 ¹¹ Respondent states that appellants argue that their proposed assessments were discharged in appellant-husband’s
25 bankruptcy, filed on June 28, 2011. However, it does not appear that appellants make such an argument in their appeal
26 letters.

27 Respondent states that the Board has repeatedly and consistently held that it lacks subject-matter jurisdiction to determine
28 whether an amount was or should have been discharged in bankruptcy. Respondent also states that the proposed assessments
are not final as they remain on appeal and, therefore, the proposed assessments could not have been discharged by the
bankruptcy court. However, respondent states that appellant-husband’s penalties associated with the proposed assessments
did not survive the bankruptcy filing and, therefore, respondent has agreed to abate appellant-husband’s 1999 and 2000
penalties, but not appellant-wife’s penalties because she was not a party to the bankruptcy filing. (ROB, p. 12; Ex. AD.)

1 Respondent contends that appellants have not filed valid 1999 and 2000 California tax
2 returns. Respondent asserts that to determine the validity of a return, pursuant to *United States v. Porth*
3 (10th Cir. Kan. 1970) 426 F.2d. 519, and *Beard v. Commissioner* (T.C. 1984) 82 T.C. 766, the federal
4 courts provide a four-part test: (1) there must be sufficient data to calculate the tax liability; (2) the
5 document must purport to be a return; (3) there must be an honest and reasonable attempt to satisfy the
6 requirements of the tax law; and (4) the taxpayer must execute the return under the penalty of perjury.
7 Respondent states that appellants have not filed a return that satisfies these requirements for the years at
8 issue. (ROB, p. 8.)

9 Respondent states that the initial 1999 and 2000 returns provided in January 2007 by
10 appellant-husband reported federal adjusted gross incomes (AGIs) of \$35,000 and \$35,600,
11 respectively, with taxable incomes of zero. (ROB, p. 8; Exs. E & F.) Respondent states that the 1999
12 and 2000 returns included with appellant-husband's claim for refund letter reported the same AGIs as
13 the initial submitted returns but, for 1999, reported a taxable income of \$32,289 and tax of \$815, and
14 for 2000, a taxable income of \$32,789 and tax of \$790. (ROB, p. 8; Ex. P.) Respondent also states that
15 appellants' recently-submitted returns indicate a married filing jointly filing status with a federal AGI
16 of \$57,652 and tax of \$1,532 for 1999, and a federal AGI of \$27,460 and tax of \$445 for 2000.
17 (AHAL, attachments; AWAL, attachments.)

18 Respondent contends that the returns submitted by appellants are frivolous because
19 appellant-husband failed to prove error in the previously-sustained assessments of taxable incomes of
20 \$135,093 for 1999 and \$155,451 for 2000, and he has not provided any substantiating documentation
21 such as federal Forms W-2, 1099, or 1040 to verify his income. Respondent contends that appellant-
22 husband's deposition testimony taken during the lawsuit indicates that he "just came up with the figures
23 on the initial returns for both years without looking at any documents related to the 1999 and 2000 tax
24 years."¹² Respondent states that appellant-husband testified that he considered his current bills and
25 estimated his household expenses and claimed he lost all documentation when his computer's "main
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28 ¹² Respondent states that it has only provided the relevant pages of the voluminous deposition transcript and will provide the entire transcript upon request.

1 frame memory chip fried” in 2007.¹³ Respondent also states that the income claimed on the submitted
2 returns is far below the actual income attributed to appellants pursuant to their financial records. (ROB,
3 p. 8; Ex. AC, pp. 144-148.)

4 Respondent asserts that, in the absence of a return providing the information necessary
5 to accurately determine a tax liability, respondent is empowered to estimate appellants’ net income
6 from “any available information” and assess the amount of tax, interest, and penalties due, pursuant to
7 R&TC section 19087. Respondent states that, when a taxpayer fails to file a valid return, respondent’s
8 use of income from various sources to estimate a taxpayer’s income is a reasonable and rational method
9 of estimating income. Respondent argues that, if it has satisfied its initial burden to show that the
10 proposed assessment is reasonable and rational, the proposed assessment is presumed correct.

11 Respondent contends that appellants failed to file valid returns for 1999 and 2000. Respondent also
12 contends that appellants failed to provide information concerning their income or a realistic explanation
13 of the source from which they derived funds to sustain their standard of living. Therefore, respondent
14 argues, it was necessary to reconstruct appellants’ income by reviewing financial documents from the
15 IRS and financial entities regarding appellants’ business and personal accounts. (ROB, pp. 9-10;
16 Ex. Q.)

17 Respondent asserts that the salaries and earnings of California spouses, except for
18 separate property, are community property owned equally by both spouses. Respondent states that the
19 1999 NPAs indicated that each appellant’s taxable income included \$981,471, or one-half of the 1999
20 unreported income of \$1,962,941. Respondent also states that the 2000 NPAs indicated that each
21 appellant’s taxable income included \$535,250, or one-half of the 2000 unreported income of
22 \$1,070,500. (ROB, p. 11.)

23 Late-Filing Penalties as to Appellant-Wife

24 Respondent states that its imposition of the late filing penalty is proper unless the
25 taxpayer is able to show that the failure to file timely was due to reasonable cause and not due to willful
26 neglect. Respondent asserts that the taxpayer bears the burden of proof that reasonable cause exists to
27 support an abatement of the penalty and, that to show reasonable cause, a taxpayer must show that the
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¹³ Respondent notes that the initial returns were signed on January 12, 2007.

1 failure to timely file occurred despite the exercise of ordinary business care and prudence and that the
2 reason for failing to timely file was such that an ordinarily intelligent and prudent businessperson
3 would have acted similarly under the circumstances. (ROB, p. 12.)

4 Respondent states that it imposed late filing penalties for 1999 and 2000 pursuant to
5 R&TC section 19131 because appellant-wife failed to file a 1999 and 2000 return on or before the
6 respective due dates of April 15, 2000, and April 15, 2001. Respondent states that it computed the
7 penalty at 5 percent of the tax due, after allowing for timely payments, for every month the return was
8 late, up to a maximum of 25 percent. Respondent states that the only returns filed by appellant-wife
9 were those filed in February 2014 that were deemed invalid. Therefore, respondent asserts, the penalty
10 was properly computed at the maximum rate of 25 percent of the tax due for each year in the amount of
11 \$22,396.25 (i.e., \$89,585.00 x 25 percent) for 1999 and \$12,006.00 (i.e., \$48,024.00 x 25 percent) for
12 2000. Respondent contends that appellant-wife has not offered any explanation for the failure to timely
13 file and, therefore, has failed to show reasonable cause to support the abatement of the late filing
14 penalties. (ROB, pp. 12-13.)

15 Failure to Furnish Penalties as to Appellant-Wife

16 Respondent states that it may impose a penalty equal to 25 percent of the additional tax
17 deficiency when a taxpayer fails or refuses to furnish information requested by respondent in writing,
18 pursuant to R&TC section 19133. Respondent asserts that the law presumes that the penalty is correct
19 and that the penalty may be abated if the taxpayer's failure to respond was due to reasonable cause and
20 not willful neglect. Respondent contends that it properly imposed the failure to furnish penalties
21 because appellant-wife failed to provide requested information and did not provide any evidence
22 establishing reasonable cause for her failure to respond. Respondent argues that, throughout the audit
23 process, appellant-wife continually failed to provide requested information which required respondent
24 to obtain needed financial documents from the IRS and directly from financial entities. Thus,
25 respondent states that it properly imposed the penalty at 25 percent of the tax due for each year in the
26 amount of \$22,396.25 (i.e., \$89,585.00 x 25 percent) for 1999 and \$12,006.00 (i.e., \$48,024.00 x
27 25 percent) for 2000. Respondent argues that appellant-wife has not offered any explanation for her
28 failure to furnish information and has, therefore, not met her burden of proving reasonable cause to

1 support the abatement of the penalties. (ROB, p. 14.)

2 Post-Amnesty Penalties as to Appellant-Wife

3 Respondent contends that the post-amnesty penalty was imposed properly pursuant to
4 R&TC section 19777.5, subdivision (a)(2). Respondent explains that legislation enacted in 2004
5 authorized respondent to institute an income tax amnesty program for taxable years prior to January 1,
6 2003, and those taxpayers who participated and paid their tax and interest liabilities were granted a
7 waiver of most penalties. Respondent further explains that, for eligible taxpayers who did not
8 participate, respondent imposes a penalty in an amount equal to 50 percent of the interest computed
9 under R&TC section 19101 on the tax underpayment for a specified period. Respondent argues that the
10 post-amnesty penalty is an estimated amount and not final and, therefore, the Board does not have the
11 jurisdiction to consider the penalty in this appeal. (ROB, pp. 14-15.)

12 Applicable Law

13 Proposed Assessments of Additional Tax as to Both Appellants

14 R&TC section 17041 imposes a tax “. . . upon the entire taxable income of every
15 resident of this state . . .” R&TC section 18501 requires every individual subject to the Personal
16 Income Tax to make and file a return with the FTB “stating specifically the items of the individual’s
17 gross income from all sources and the deductions and credits allowable . . .” R&TC section 19087,
18 subdivision (a), provides:

19 If any taxpayer fails to file a return, or files a false or fraudulent return with intent to
20 evade the tax, for any taxable year, the Franchise Tax Board, at any time, may require a
21 return or an amended return under penalties of perjury or may make an estimate of the net
22 income, from any available information, and may propose to assess the amount of tax,
23 interest, and penalties due.

24 If the FTB makes a tax assessment based on an estimate of income, the FTB’s initial
25 burden is to show why its assessment is reasonable and rational. (*Todd v. McColgan* (1949)
26 89 Cal.App.2d 509; *Appeal of Michael E. Myers*, 2001-SBE-001, May 31, 2001.)¹⁴ Federal courts have
27 held that the taxing agency need only introduce some evidence linking the taxpayer with the unreported

28 ¹⁴ Board of Equalization cases (designated “SBE”) may generally be found at: www.boe.ca.gov

1 income. (See *Rapp v. Commissioner* (9th Cir. 1985) 774 F.2d 932.) When a taxpayer fails to file a
2 valid return, respondent's use of income information from various sources to estimate a taxpayer's
3 taxable income is a reasonable and rational method of estimating taxable income. (See *Palmer v.*
4 *Internal Revenue Service* (9th Cir. 1997) 116 F.3d 1309, 1313; *Andrews v. Commissioner*, T.C. Memo.
5 1998-316; *Giddio v. Commissioner* (1970) 54 T.C. 1530, 1533; *Appeals of Walter R. Bailey*,
6 92-SBE-001, Feb. 20, 1992; *Appeal of R. and Sonja J. Tonsberg*, 85-SBE-034, Apr. 9, 1985.)

7 Returns that do not contain sufficient data from which respondent can compute and
8 assess the tax liability of a particular taxpayer, or that do not demonstrate an honest and genuine
9 endeavor to satisfy the requirements of California's tax law (including "zero returns") are not valid
10 returns. Filing such a return places the filer at risk of the sanctions adopted by the Legislature to
11 enforce compliance with the tax laws. (*Appeal of LaVonne A. Hodgson*, 2002-SBE-001, Feb. 6, 2002.)

12 Once the FTB has met its initial burden, the assessment is presumed correct and the
13 taxpayer has the burden of proving it to be wrong. (*Todd v. McColgan, supra; Appeal of*
14 *Michael E. Myers, supra.*) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of
15 proof. (*Appeal of Aaron and Eloise Magidow*, 82-SBE-274, Nov. 17, 1982.) In the absence of
16 uncontradicted, credible, competent, and relevant evidence showing error in the FTB's determinations,
17 respondent's proposed assessments must be upheld. (*Appeal of Oscar D. and Agatha E. Seltzer*,
18 80-SBE-154, Nov. 18, 1980.) A taxpayer's failure to produce evidence that is within his or her control
19 gives rise to a presumption that such evidence is unfavorable to his or her case. (*Appeal of*
20 *Don A. Cookston*, 83-SBE-048, Jan. 3, 1983.) "A taxpayer is not in a good position to criticize
21 respondent's estimate of his or her liability when he or she fails to file a required return and, in
22 addition, subsequently refuses to submit information upon request." (*Appeals of Fred R. Dauberger*
23 *et al.*, 82-SBE-082, Mar. 31, 1982.)

24 Community Property

25 California Family Code, section 760 states that "[e]xcept as otherwise provided by
26 statute, all property, real or personal, wherever situated, acquired by a married person during the
27 marriage while domiciled in this state is community property." Both California domiciled spouses'
28 salaries and earnings (except for community property) are "community property and owned equally by"

1 both spouses. (*Appeal of Robert M. and Mildred Scott*, 81-SBE-020, Mar. 2, 1981.)

2 Late Filing Penalties

3 R&TC section 19131 provides that a late filing penalty shall be imposed when a
4 taxpayer fails to file a tax return on or before its due date, unless the taxpayer establishes that the late
5 filing was due to reasonable cause and not due to willful neglect. When the FTB imposes a late filing
6 penalty, the law presumes that the penalty was imposed correctly. (*Todd v. McColgan, supra; Appeal*
7 *of Yvonne M. Goodwin*, 97-SBE-003, Mar. 19, 1997.) The burden is on the taxpayer to prove that
8 reasonable cause prevented her from responding to the demand. (*Appeal of Kerry and Cheryl James*,
9 83-SBE-009, Jan. 3, 1983.) To establish reasonable cause, a taxpayer must show that the failure to file
10 a return occurred despite the exercise of ordinary business care. (*Appeal of Howard G. and Mary Tons*,
11 79-SBE-027, Jan. 9, 1979; *Appeal of Stephen C. Bieneman*, 82-SBE-148, July 26, 1982.) The
12 taxpayer's reason for failing to file must be such that an ordinarily intelligent and prudent
13 businessperson would have acted similarly under the circumstances. (*Appeal of Joseph W. and*
14 *Elsie M. Cummings*, 60-SBE-040, Dec. 13, 1960.)

15 Failure to Furnish Penalties

16 R&TC section 19133 provides that, if any taxpayer fails or refuses to furnish any
17 information requested in writing by the FTB or fails or refuses to make and file a return upon notice
18 and demand by the FTB, then, unless the failure is due to reasonable cause and not willful neglect, the
19 FTB may add a penalty of 25 percent of the amount of tax determined pursuant to R&TC section 19087
20 or of any deficiency tax assessed by the FTB concerning the assessment of which the information or
21 return was required. To establish reasonable cause for waiving the penalty, a taxpayer must show that
22 the failure to reply to the request for information occurred despite the exercise of ordinary business care
23 and prudence. (*Appeal of Stephen C. Bieneman, supra.*) The taxpayer's reason for failing to respond to
24 the request for information must be such that an ordinarily intelligent and prudent businessperson
25 would have acted similarly under the circumstances. (*Appeal of Eugene C. Findley*, 86-SBE-091,
26 May 6, 1986.) Unless a taxpayer provides credible and competent evidence to support her claim of
27 reasonable cause, the penalty will not be abated. (*Appeal of Michael J. and Diane M. Halaburka*,
28 85-SBE-025, Apr. 9, 1985.)

1 Post-Amnesty Penalties

2 In 2004, the California Legislature enacted the income tax amnesty program. (Rev. &
3 Tax. Code, §§ 19730-19738.) Eligible taxpayers could participate in this program by filing an amnesty
4 application and paying their outstanding liabilities of tax and interest, or by entering into an installment
5 plan, during the period of February 1, 2005, through March 31, 2005, inclusive. (Rev. & Tax. Code,
6 §§ 19730 & 19731.) For liabilities which remained outstanding after the last day of the amnesty period,
7 a penalty was imposed equal to 50 percent of the accrued interest payable. (Rev. & Tax. Code,
8 § 19777.5, subd. (a).) The governing statute does not provide a taxpayer with a right to appeal an
9 unpaid amnesty penalty and a taxpayer may file an administrative claim for refund of a paid amnesty
10 penalty only upon the basis that the penalty was not computed properly. (Rev. & Tax. Code,
11 § 19777.5, subd. (d).) Thus, the Board's jurisdiction to review a post-amnesty penalty, under R&TC
12 section 19777.5, is limited to situations where the penalty is assessed and paid, the taxpayer files a
13 timely appeal from a denial of a refund claim, and the taxpayer attempts to show a computational error
14 in the penalty.

15 Frivolous Appeal Penalty

16 The Board may impose a penalty of up to \$5,000 whenever it appears to the Board that
17 proceedings before it have been instituted or maintained primarily for delay or that the position is
18 frivolous or groundless. (Rev. & Tax. Code, § 19714; Cal. Code Regs., tit., 18, § 5454.) The following
19 factors are considered in determining whether, and in what amount, to impose the penalty: (1) whether
20 the taxpayer is making arguments that have been previously rejected by the Board in a Formal Opinion
21 or by courts; (2) whether the taxpayer is repeating arguments that he or she made in prior appeals;
22 (3) whether the taxpayer filed the appeal with the intent of delaying legitimate tax proceedings or the
23 legitimate collection of tax owed; and (4) whether the taxpayer has a history of filing frivolous appeals
24 or failing to comply with California's tax laws. (Cal. Code Regs., tit. 18, § 5454.) The Board may
25 consider other relevant factors in addition to the factors listed above. (Cal. Code Regs., tit. 18, § 5454.)
26 A taxpayer's prior pattern and practice of conduct is relevant when determining whether to impose a
27 frivolous appeal penalty and in what amount. (*Appeal of Alfons Castillo*, 92-SBE-020, July 20, 1992.)

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1 STAFF COMMENTS

2 At the hearing, appellants should be prepared to provide evidence that demonstrates
3 error in respondent's proposed assessments of additional tax. It appears that appellants have not filed
4 valid returns by failing to make honest and reasonable attempts to satisfy the requirements of the tax
5 law by omitting substantial amounts of income from their returns. (See *Appeal of LaVonne A.*
6 *Hodgson, supra.*) For instance, appellant-husband submitted returns with a federal AGI of \$35,000 for
7 1999 and \$35,600 for 2000 after the Board had sustained assessments of tax based on estimated
8 incomes of \$180,124 for 1999 and \$207,268 and 2000. Additionally, appellants submitted a joint
9 return indicating a federal AGI of \$57,652 for 1999 and \$27,460 for 2000, whereas it was determined
10 during the course of an audit that unreported income attributable to appellants existed in the amounts of
11 \$1,962,941 for 1999, and \$1,070,500 for 2000. When a taxpayer fails to file a valid return,
12 respondent's use of income information from various sources to estimate a taxpayer's taxable income is
13 a reasonable and rational method of estimating taxable income. (*Appeals of Walter R. Bailey, supra.*)

14 It appears that respondent has satisfied its initial burden by providing a reasonable
15 foundation for the proposed assessments, which are based on appellants' financial statements obtained
16 from the IRS. Appellants, who have the burden to produce evidence showing error in the proposed
17 assessments, have not provided any such evidence despite respondent's multiple requests to do so.
18 Appellant-wife should be prepared to present evidence demonstrating reasonable cause for failing to
19 timely file and for failing to furnish information requested in writing by the FTB. To date, appellant-
20 wife has not provided any such evidence demonstrating reasonable cause.

21 Additionally, both parties should be prepared to discuss whether a frivolous appeal
22 penalty should be imposed, as the Board has the authority under the Revenue and Taxation Code to
23 determine whether, and in what amount, to impose such a penalty.¹⁵ (Rev. & Tax. Code, § 19714;
24 Cal. Code Regs., tit., 18, § 5454.) Based on the facts and circumstances of this case, it appears to the
25 Appeals Division that appellants filed this appeal with the intent of delaying legitimate tax proceedings
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28 ¹⁵ R&TC section 19714 specifically provides that the penalty may be imposed if an appeal has "been instituted or maintained . . . primarily for delay" and Regulation 5454, subdivision (b)(3), provides, consistent with the statutory provision, that the penalty may be imposed when "the appellant filed the appeal with the intent of delaying legitimate tax proceedings or the legitimate collection of tax owed."

1 and the legitimate collection of tax owed. Appellants argue that respondent improperly estimated their
2 income, but appellants failed to file valid returns and failed to provide any evidence upon request by the
3 FTB.

4 Additionally, appellant-husband has a history of noncompliance with California's tax
5 laws. Appellant-husband has not filed a valid return since 1995 and the FTB, after appellant failed to
6 respond to the FTB's demands for tax returns, previously issued filing enforcement NPAs for 1999 and
7 2000 separate from the NPAs currently on appeal. This is appellant-husband's third appeal of this
8 nature. Appellant-husband filed an appeal for tax year 1999 (Case No. 202277) in which the Board
9 found against appellant-husband. Appellant-husband then filed a petition for rehearing, which was
10 denied on December 4, 2003. Appellant-husband filed an appeal for tax year 2000 (Case No. 253203),
11 in which the Board found against appellant-husband and imposed a frivolous appeal penalty of \$1,000.
12 (ROB, Exs. C & D.)

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