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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**¹
12 **EHUD YUHJTMAN AND**) Case No. 772960
13 **DALIA YUHJTMAN**)
14 _____)

15 Year Proposed
16 2007 Assessment²
17 \$18,379.40

17 Representing the Parties:

18 For Appellants: Ehud Yuhjtman and Dalia Yuhjtman
19 For Franchise Tax Board: Anne Mazur, Specialist

21 **QUESTION:** Whether appellants have shown reasonable cause to abate the accuracy-related
22 penalty.

24 ¹ This matter was originally scheduled for hearing for the September 23, 2014 Sacramento meeting. Appellants failed to
25 respond to the hearing notice and this matter was scheduled for decision on the nonappearance consent calendar for the
26 Board's October 14-15, 2014 Culver City meeting. Appellants subsequently contacted the Board Proceedings Division,
27 requesting a hearing and this matter was recalendared for the Board's September 23, 2014 Sacramento meeting. Appellants
28 then contacted the Board Proceedings Division and requested a postponement due to a scheduling conflict. This matter was
then rescheduled for Board hearing for the December 17-18, 2014 Sacramento meeting. Appellants then requested that the
matter be deferred due to a scheduling conflict. The matter was then rescheduled for hearing at the Board's March 25-26,
2015 Sacramento meeting.

² This amount represents the assessment of an accuracy-related penalty.

1 HEARING SUMMARY

2 Background

3 After filing as California residents for several years, appellants filed a nonresident return
4 for 2007 (Form 540NR). Appellants reported a federal adjusted gross income (AGI) of \$1,239,265,
5 less California adjustments of \$3,941 and the standard deduction of \$7,032, for a California taxable
6 income of \$68,490 and a prorated California tax of \$6,123. The California Adjustments Schedule CA
7 (Schedule CA) of Form 540NR requested appellants' residency information, including the dates that
8 appellants became nonresidents, the number of days spent in California, and whether appellants owned
9 a home or other property in California. Appellants' response to each question was "N/A", except as to
10 whether appellants owned a home or other property in California, to which their response was "no."
11 On Schedule CA, appellants reported a capital gain from all sources of \$1,024,064 and a capital loss
12 from California sources of \$3,000. On Schedule D, Capital Gains and Losses, which was included with
13 appellants' federal return (and was attached to appellants' California return), appellants reported a
14 January 3, 2007 sale of 780,000 shares of Jungo stock for a gain of \$1,162,476 and a net capital gain
15 from all Schedule D transactions of \$1,024,064. (Resp. Opening Br., p. 1, Ex. A.)

16 Subsequently, respondent audited appellants' 2007 return and determined, and
17 appellants agreed, that appellants were California residents at the time they sold the Jungo stock.³
18 Therefore, the capital gain resulting from the sale of Jungo stock was taxable by California.
19 Respondent determined that appellants were subject to an accuracy-related penalty on the grounds that
20 their tax underpayment was attributable to a substantial understatement of tax. Respondent issued a
21 Notice of Proposed Assessment (NPA) on March 13, 2012, which indicated a revised California taxable
22 income of \$1,086,725⁴ and a prorated California tax of \$98,020. As a result, respondent assessed
23 additional tax of \$91,897.00 and an accuracy-related penalty of \$18,379.40, plus applicable interest.
24 (Resp. Opening Br., p. 2, Ex. B.)

25 _____
26 ³ Respondent asserted that it was determined that appellant-husband became a Nevada resident on May 1, 2007. The date of
27 the change in residency was acknowledged in appellant-wife's declaration dated May 2, 2013. (App. Opening Br.)

28 ⁴ This amount included the Jungo capital gain and other Schedule D transactions, totaling \$1,024,064. (Resp. Opening Br.,
p. 2, Ex. B.)

1 Appellants timely protested the NPA, asserting that the accuracy-related penalty should
2 be waived because they provided all of the information concerning their assets, including their home, to
3 their tax professionals. Appellants acknowledged their responsibility to pay the tax and asserted that
4 they already paid it. Appellants asserted that they had reasonable cause for the underpayment and acted
5 in good faith. They also asserted that they made a reasonable and honest mistake of law, that they are
6 not knowledgeable with regard to tax matters, and that they reasonably relied on the advice of their tax
7 professional. Appellants made a deposit payment of \$110,166.84 on April 15, 2012. Respondent's
8 protest hearing officer determined that appellants failed to demonstrate reasonable cause for the
9 underpayment. On September 12, 2013, respondent issued a Notice of Action, affirming the NPA.
10 This timely appeal followed. Appellants then made another deposit payment of \$18,379.40 on
11 December 20, 2013. (Resp. Opening Br., p. 2, Exs. C & D.)

12 Contentions

13 Appellants' Contentions

14 Appellants contend that they provided all information and documents regarding their
15 housing situation to their tax preparer, David Kalai (David), and later to Nadav Kalai (Nadav), both of
16 whom were from United Revenue Service. Appellants contend that David was aware of their residence
17 in California and of appellant-husband's job transfer and move to Nevada. Appellants contend that
18 they fully relied on David's expertise with regard to tax residence determinations. Appellants contend
19 that they reviewed the return to make sure the amounts reported were accurate, but that David never
20 requested that they complete Part 1 of the residency information on Schedule CA. Appellants also
21 contend that they did not notice the inaccurate answers to the questions. Appellants contend that they
22 made every attempt to report their correct tax liability by self-reporting a stock sale that never was
23 reported to the government. Appellants contend that they reasonably relied in good faith on their tax
24 professional in taking the position that the stock sale was not taxable in California since appellant-
25 husband's residence changed to Nevada that year. Appellants contend that they have paid the tax
26 liability and are only appealing the penalty assessment. (App. Opening Br.)

27 Respondent's Contentions

28 Respondent contends that it properly imposed an accuracy-related penalty under

1 Revenue and Taxation Code (R&TC) section 19164 of \$18,379.40 based on the underpayment of tax in
2 the amount of \$91,897.00 ($\$91,897.00 \times 20\% = \$18,379.40$). Respondent contends that it imposed the
3 accuracy-related penalty based upon appellants' substantial understatement of income tax for the 2007
4 tax year. (Resp. Opening Br., p. 3.)

5 Respondent contends that, under Internal Revenue Code (IRC) section 6662(d)(2)(B), an
6 accuracy-related penalty based upon a substantial understatement can be abated upon a showing of
7 substantial authority or upon a showing of adequate disclosure and a reasonable basis for the position
8 taken. In addition, respondent contends that the accuracy-related penalty can be abated, under IRC
9 section 6664(c), upon a showing of reasonable cause and good faith with respect to the underpayment.
10 (Resp. Opening Br., p. 3.)

11 Respondent states that, pursuant to IRC section 6664(c)(1) and Treasury Regulation
12 section 1.6664-4, no penalty shall be imposed under IRC section 6662 with respect to any portion of an
13 underpayment if it is shown that there was reasonable cause and that the taxpayer acted in good faith
14 with respect to the underpayment and that reasonable cause has been interpreted to mean the exercise of
15 ordinary business care and prudence. Respondent also notes that, under the Treasury regulation,
16 circumstances that may indicate reasonable cause and good faith include an honest misunderstanding of
17 fact or law that is reasonable in light of all of the facts and circumstances, including the experience,
18 knowledge, and education of the taxpayer and whether the reliance on professional advice was
19 reasonable and whether the taxpayer acted in good faith. (Resp. Opening Br., p. 4.)

20 Citing *Neonatology Assocs., P.A. v. Comm'r* (2000) 115 T.C. 43, 99, respondent
21 contends that, for appellants to qualify for the reasonable cause/reliance on a professional tax advisor
22 defense, appellants must demonstrate that they provided necessary and accurate information to their
23 advisor, that the tax advisor had sufficient experience to justify reliance, and that appellants actually
24 relied in good faith on the tax advisor's judgment. (Resp. Opening Br., p. 4.)

25 Respondent disputes appellants' argument that their asserted reliance on tax
26 professionals for the return preparation constitutes grounds for abatement. Respondent contends that
27 appellants did not verify the tax professional's accuracy on Part 1 of Schedule CA regarding their
28 residency. Respondent states that appellants answered "NO" to the question of whether they owned a

1 home in California and answered “N/A” to the other residency-related questions on the form. (Resp.
2 Opening Br., pp. 3-4.)

3 Respondent contends that, according to appellants, appellant-husband (an engineer) took
4 a new job in Reno and moved there on May 1, 2007, while appellant-wife and their children remained
5 in Sunnyvale (Santa Clara County). However, respondent asserts that appellants’ 2007 return indicated
6 that appellants owned no home or property in California and that they were nonresidents for the entire
7 year. (Resp. Opening Br., pp. 4-5.)

8 Respondent contends that appellants have provided no contemporaneous evidence of
9 their asserted reasonable and good faith reliance on David Kalai, other than the submission of a blank
10 tax preparation questionnaire and, during the protest, appellant-wife provided her declaration signed
11 under penalty of perjury to demonstrate reliance on David Kalai. Respondent argues that this
12 declaration must be weighed against all of the other relevant facts and circumstances in making a
13 reasonable cause determination, including appellants’ acknowledgment that they failed to review the
14 residency information portion of Schedule CA. Respondent asserts that appellants have a duty to
15 review their return and, even when reliance on a competent tax advisor has been established, taxpayers
16 have an obligation to review their tax returns before filing the returns, citing *Prudhomme v.*
17 *Commissioner* (2008) T.C. Memo. 2008-83 and other cases. Citing *Metra Chem Corp. v.*
18 *Commissioner* (1987) 88 T.C. 654, 662, respondent further argues that this rule is applicable where the
19 error would have been discovered if the taxpayers had made even a cursory review of their returns.
20 (Resp. Opening Br., p. 5.)

21 Respondent states that appellant-husband is an engineer and that appellant-wife is an
22 architect. As such, respondent asserts that both appear to be well-educated. Respondent argues that
23 appellants need not be well-educated, nor tax experts, to verify statements of fact made on their tax
24 return. As such, respondent asserts that it should have been obvious to appellants, even on a cursory
25 review of their return, that Part 1 of Schedule CA was incomplete and inaccurate (i.e., the form
26 indicated that appellants did not own a home in California) based upon the information they provided to
27 the tax preparer. (Resp. Opening Br., p. 5.)

28 Respondent also questions whether appellants relied reasonably and in good faith on

1 David Kalai and his firm.⁵ Respondent states that, according to this firm’s web site, United Revenue
2 Service, Inc. is a national tax preparation and compliance firm with several offices, has been in business
3 for over 20 years, and specializes in small businesses, executives, and professionals. However,
4 respondent notes that neither of appellants’ tax preparers were certified public accountants (CPA),
5 attorneys, enrolled agents (EA), or tax preparers registered with the California Tax Education Council
6 (CTEC).⁶ (Resp. Opening Br., p. 5.)

7 Respondent concludes that appellants have not established that they relied reasonably
8 and in good faith on their tax professional with respect to the underpayment of tax. In addition,
9 respondent contends that appellants have not demonstrated that: (1) they provided necessary and
10 accurate information to their advisor; (2) the tax advisor had sufficient experience to justify reliance;
11 and (3) they actually relied in good faith on the tax advisor’s judgment. Respondent asserts that
12 appellants have failed to establish reasonable cause and good faith for the abatement of the accuracy-
13 related penalty. (Resp. Opening Br., pp. 5-6.)

14 Applicable Law

15 Accuracy-Related Penalty

16 R&TC section 19164, which incorporates the provisions of IRC section 6662, provides
17 for an accuracy-related penalty of 20 percent of the applicable underpayment. As relevant to this
18 appeal, the penalty applies to the portion of the underpayment attributable to (1) negligence or to the
19 disregard of rules and regulations or (2) any substantial understatement of income tax. (Int.Rev. Code,
20 § 6662(b).) The Internal Revenue Code defines “negligence” to include “any failure to make a
21 reasonable attempt to comply” with the provisions of the code. (Int.Rev. Code, § 6662(c).) The term
22 “disregard” is defined to include any “careless, reckless, or intentional disregard.” (*Ibid.*) IRC
23

24 ⁵ Respondent asserts that the principals, David Kalai and Nadav Kalai, and branch manager, David Almog, of
25 United Revenue Services, Inc., were indicted by a federal grand jury on charges of conspiring to defraud the United States by
26 preparing false tax returns to help open and conceal clients’ offshore accounts. Respondent acknowledges there that is no
indication that appellants were a party to any of the alleged illegal activities. (Resp. Opening Br., p. 2, fn. 3.)

27 ⁶ Citing California Business and Professions Code (B&PC) sections 22250 through 22259, respondent asserts that California
28 law requires anyone who prepares tax returns for a fee to be a CTEC registered tax preparer if they do not meet one of the
exempt designations including an attorney who is an active member of the State Bar of California, a CPA with a current and
valid license issued by the California Board of Accountancy, or an EA actively enrolled to practice before the
Internal Revenue Service.

1 section 6662 provides that a substantial understatement of tax exists if the amount of the
2 understatement exceeds the greater of 10 percent of the tax required to be shown on the return or
3 \$5,000. (Int.Rev. Code, § 6662(d)(1).) “Understatement” means the excess of the amount required to
4 be shown on the return for the taxable year over the amount of the tax imposed which is shown on the
5 return, reduced by any rebate. (Int.Rev. Code, § 6662(d)(2).)

6 There are three exceptions to the imposition of the accuracy-related penalty. Under the
7 first exception, the penalty shall be reduced by the portion of the understatement attributable to a tax
8 treatment of any item if there is substantial authority for such treatment. (Int.Rev. Code,
9 § 6662(d)(2)(B).) Under the second exception, the penalty shall be reduced by the portion of the
10 understatement attributable to a tax treatment of any item if the relevant facts affecting the item’s tax
11 treatment are adequately disclosed and there is a reasonable basis for the tax treatment of such item.
12 (Int.Rev. Code, § 6662(d)(2)(B).) Under the third exception, the penalty will not be imposed to the
13 extent an appellant shows that a portion of the underpayment was due to reasonable cause and that he
14 acted in good faith with respect to such portion of the underpayment. (Int.Rev. Code, § 6664(c)(1);
15 Treas. Regs. §§ 1.6664-1(b)(2) & 1.6664-4.)

16 A determination of whether a taxpayer acted with reasonable cause and in good faith is
17 made on a case-by-case basis and depends on the pertinent facts and circumstances, including his
18 efforts to assess the proper tax liability, his knowledge and experience, and the extent to which he
19 relied on the advice of a tax professional. Generally, the most important factor is the extent of the
20 taxpayer’s effort to assess his proper tax liability. Reliance on the advice of a professional tax advisor
21 does not necessarily demonstrate reasonable cause and good faith. However, reliance on professional
22 advice constitutes reasonable cause and good faith if, under all the circumstances, such reliance was
23 reasonable and the taxpayer acted in good faith. (Treas. Reg. § 1.6664-4(b)(1).) The taxpayer bears the
24 burden of proving any defenses to abate the penalty. (*Recovery Group, Inc. v. Comm’r*, T.C. Memo.
25 2010-76.)

26 With respect to an underpayment attributable to reliance by a taxpayer on professional
27 advice, a taxpayer’s education, sophistication, and business experience are relevant in determining
28 whether the taxpayer’s reliance on tax advice was reasonable and made in good faith. (Treas. Reg.

1 § 1.6664-4(c)(1).) In addition, the advice must not be based on unreasonable factual or legal
2 assumptions and must not unreasonably rely on the representations, statements, findings, or agreements
3 of the taxpayers or any other person. (Treas. Reg. § 1.6664-4(c)(1)(ii).) For example, the advice must
4 not be based on a representation or assumption which the taxpayer knows or has reason to know is
5 unlikely to be true. (*Id.*) “Advice” is any communication, including the opinion of a professional tax
6 advisor, setting forth the analysis or conclusion of a person, other than the taxpayer, provided to (or for
7 the benefit of) the taxpayer and on which the taxpayer relies, directly or indirectly, and does not have to
8 be in any particular form. (Treas. Reg. § 1.6664-4(c)(2).) A taxpayer who claims reliance on a
9 professional must show that: (1) the tax preparer was a competent professional who had sufficient
10 expertise to justify reliance; (2) the tax preparer was supplied with necessary and accurate information;
11 and (3) the taxpayer actually relied in good faith on the advice. (*Neufeld v. Comm’r*, T.C. Memo.
12 2008-79, citing *Neonatology Assocs.*, *supra.*)

13 STAFF COMMENTS

14 The parties dispute whether the accuracy-related penalty should be abated on a basis of
15 reasonable reliance by appellants on their tax preparers. Treasury Regulation section 1.6664-4 notes
16 that, when determining whether an appellant reasonably has relied in good faith on advice to establish
17 reasonable cause for the abatement of an accuracy-related penalty, all facts and circumstances must be
18 taken into account. The regulation notes that “[g]enerally, the most important factor is the extent of the
19 taxpayer’s effort to assess the taxpayer’s proper tax liability,” and “[c]ircumstances that may indicate
20 reasonable cause and good faith include an honest misunderstanding of fact or law that is reasonable in
21 light of all of the facts and circumstances, including the experience, knowledge, and education of the
22 taxpayer.” (Treas. Reg. § 1.6664-4(b)(1).)

23 Appellants have a duty to examine their tax return. It does not appear to staff that the
24 duty to examine one’s return requires any legal knowledge or advice to understand that, when a tax
25 return asks whether a home or other property is owned in California, it should be answered correctly.
26 Here, appellants’ tax return indicated the answer as ‘no,’ when property records indicate that appellants
27 owned a home in Sunnyvale, California. Similarly, appellants’ tax return stated that during 2007 “[t]he
28 number of days I spent in California (for any purpose) is: N/A” when both appellants apparently lived

1 in California up to approximately May 1, 2007. Appellants should be prepared to address whether they
2 considered the California tax implications of recognizing over \$1 million of taxable gain from stock sold
3 on January 3, 2007 and whether they acted with reasonable care and diligence in failing to report any of
4 this gain to California. To the extent that appellants argue the errors were inadvertent, they should be
5 prepared to address whether an ordinarily diligent review of the tax return would have uncovered the
6 inaccuracies.

7 Based on appellant-husband's profession as an engineer and appellant-wife's profession
8 as an architect, they appear to be highly-educated individuals. The parties should be prepared to discuss
9 how appellants' experience, knowledge, and education affect their ability to claim reasonable reliance in
10 this situation, and whether it is reasonable to rely on tax preparers and allegedly not notice the
11 inaccuracies in the tax return.

12 Appellants assert that they acted in good faith by relying on their tax preparer to
13 calculate and report their tax liability, including their residency. In light of the fact that appellants'
14 preparers were not certified public accountants (CPAs), attorneys, enrolled agents (EAs), or tax
15 preparers registered with CTEC, appellants should be prepared to discuss whether their tax preparers
16 had sufficient expertise to justify reasonable reliance.

17 Pursuant to California Code of Regulations, title 18, section 5523.6, if either party has
18 any additional evidence to present, they should provide their evidence to the Board Proceedings
19 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.