

1 Neha Garner
2 Tax Counsel III
3 Board of Equalization, Appeals Division
4 450 N Street, MIC: 85
5 P.O. Box 942879
6 Sacramento, CA 95814
7 Tel: (916) 323-3094
8 Fax: (916) 324-2618

6 Attorney for the Appeals Division

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

10 In the Matter of the Appeal of:

) **HEARING SUMMARY**
) **PERSONAL INCOME TAX APPEAL**
)
) Case No. 800216

12 **GARRETT J. ZELEN**

		Proposed Assessment	
	<u>Year</u>	<u>Tax</u>	<u>Penalty</u>
	2007	\$ 13,369.00	\$ 2,673.80

16 Representing the Parties:

17 For Appellant: Garrett J. Zelen, Esq.

18 For Franchise Tax Board: Eric A. Yadao, Tax Counsel

20 QUESTIONS: (1) Whether appellant has established error in respondent Franchise Tax Board's
21 (respondent or FTB) proposed assessment, which is based on a federal
22 determination; and
23 (2) Whether appellant has demonstrated that the accuracy-related penalty should be
24 abated.

26 HEARING SUMMARY

27 Background

28 Appellant filed a timely California income tax return, reporting a federal adjusted gross

1 income (AGI) of \$7,420, a California AGI of \$9,386, and a California taxable income of \$5,870.

2 Appellant reported no tax liability. (Resp. Opening Br., p. 1, Ex. A.)

3 Subsequently, respondent received information from the Internal Revenue Service (IRS)
4 which indicated that federal adjustments made to appellant's self-employment tax deduction,
5 Schedule C gross income and expenses, and a reduction of the claimed exemption credit, for
6 adjustments totaling of \$176,715. The IRS increased appellant's taxable income by \$162,381.00,
7 assessed additional tax of \$53,549.00 and imposed an accuracy-related penalty of \$10,709.80.
8 Appellant did not inform respondent of these adjustments.

9 On February 23, 2012, respondent issued a Notice of Proposed Assessment (NPA) made
10 corresponding adjustments to appellant's California taxable income, as applicable under state law,
11 appellant's taxable income by \$162,109 from \$5,870 to \$167,979. The \$162,109 in adjustments
12 included the following: (1) a \$140,786 increase in Schedule C Gross Receipts or Sales; (2) a \$28,490
13 decrease in Schedule C Other Expenses; and (3) the allowance of an adjustment to gross income, in the
14 amount of \$7,167, for the one-half self-employment tax deduction. As a result of these adjustments,
15 respondent proposed additional tax of \$13,369.00 and an accuracy-related penalty of \$2,673.80, plus
16 interest. (Resp. Opening Br., pp. 1-2, Exs. B & C.)

17 Appellant timely protested the NPA, which respondent acknowledged it received in a
18 letter dated April 27, 2012. After the consideration of appellant's protest, respondent issued a Notice of
19 Action (NOA) for the 2007 tax year on February 13, 2014,¹ affirming the NPA. Appellant then filed
20 this timely appeal. (Resp. Opening Br., p. 2, Exs. D & E.)

21 Contentions

22 Appellant's Contentions

23 Appellant asserts that he is a criminal defense attorney and that he cannot divulge some
24 information indicating that the federal audit was incorrect because it would violate the attorney-client
25

26 ¹ Respondent asserted that the time elapsed between protest acknowledgement and issuance of the NPA exceeded the
27 timeframe typical for evaluating protests during this period. Pursuant to R&TC section 19104, respondent asserted that it
28 will revise its assessment to abate interest that accrued on the tax deficiency for the 9-month period beginning on May 13,
2013, through February 13, 2014.

We note that respondent mistakenly stated that May 13, 2014, was the beginning date of the interest suspension period.

1 privilege, his Fifth Amendment rights, and the attorney-work privilege. Appellant acknowledges that
2 his objections were denied by the IRS and that he reached a settlement with the IRS. Appellant
3 contends, however, that this resulted in an unjustified and unsupported determination of additional
4 income. Appellant contends that he did not settle with the IRS “because of any truth to the
5 allegations.” Rather, he asserts that the burden of litigating the dispute in the United States Tax Court
6 would have been too costly. Appellant contends that he did not agree to the underlying dispute which
7 led to the eventual settlement with respondent. Appellant also contends that respondent was notified of
8 the settlement, and that he does not owe any additional tax or penalties to respondent. Appellant
9 contends that he timely protested respondent’s assessment and that the NOA is “untimely and beyond
10 the lawful period in which to make such a demand.” Appellant further contends that respondent’s
11 assessment is incorrect because the amount indicated as income by the IRS in the 2007 settlement was
12 not actually income. (App. Opening Br., pp. 1-2.)

13 In appellant’s points and authorities, he states that “[s]ince the disputed amount as
14 settled with the IRS, required the production of confidential, privileged records, showing which client
15 hired Attorney [appellant], when, and with what attendant ancillary services, there should be a new
16 audit by the Franchise Tax Board as to the disputed amount, since there is a claim of numerous
17 privileges protected under California and U.S. Constitutional law. To fail to do so and require waiver
18 of these privileges for contesting the assessed amount by the Franchise Tax Board, would destroy the
19 very adversarial system the privilege was meant to uphold.” (App. Opening Br., Memorandum of
20 Points and Authorities (P&A), p. 6.)

21 On reply, appellant contends that he maintains both personal and separate law offices
22 and attorney-client trust bank accounts. Appellant contends that his personal bank account records
23 have been and were available to both the IRS and respondent regarding this matter. Appellant contends
24 that his law office bank records were also available to both the IRS and respondent regarding this
25 matter to the extent such accounts did not divulge privileged matters covered by a client’s Fifth
26 Amendment privilege, attorney-client privilege, or the work product privilege. Appellant contends that
27 he maintains an attorney-client trust account pursuant to the Rules of Professional Conduct of the State
28 Bar of California, which do not reflect any income or deductions specific to appellant. (App. Reply

1 Br., p. 2.)

2 Appellant contends that, during the IRS's audit, the IRS requested data from appellant
3 concerning his bank records, privileged information, and communication. Appellant contends that he
4 provided all non-privileged information to the IRS, including bank records. Appellant contends that the
5 IRS demanded such information, or indicated to appellant that it would assess an additional tax liability
6 and penalties against appellant. Appellant contends that he undertook internal review and appeal
7 within the IRS, but was unsuccessful. Appellant contends that he denied any additional tax liability or
8 penalties due to the IRS for the 2007 tax year, and denied any truth to the allegations of an additional
9 tax liability. Appellant contends that, contrary to respondent's allegations, appellant never stated that
10 additional sums of money were omitted from his initial 2007 return. Appellant contends that the IRS
11 assessment was based upon a sum that was not income. Appellant contends that, even though he
12 indicated to the IRS that he could not turn over the privileged information, the IRS still assessed an
13 additional tax liability and penalties against appellant. Appellant asserts that no admission on his
14 behalf should be inferred. Appellant contends that he did not appeal or litigate this matter further due
15 to the extreme cost associated with such an undertaking. Appellant also contends that, even though
16 respondent was notified immediately of the IRS's assessment, respondent still waited years before
17 making its own assessment. Appellant also contends that respondent has not conducted its own audit.
18 (App. Reply Br., pp. 3-4.)

19 In his supplemental brief, appellant questions whether respondent is also bound by
20 California law and court decisions, or whether it will be permitted to "blindly assert Federal actions and
21 decisions" by the IRS. Appellant contends he was not able to argue California privilege law to the IRS,
22 which is why it resulted in a federal reassessment, but that the same circumstances should not result in
23 a reassessment under California law. (App. Supplemental Br., pp. 1-2.)²

24 Respondent's Contentions

25 With regard to the proposed assessment based on the federal audit, respondent contends
26 that appellant failed to meet his burden of proving error in the federal changes, or error in respondent's
27

28 ² In this brief, appellant lists references 151 state and federal cases in support of his argument regarding the attorney-client privilege. Neither the Franchise Tax Board nor the Internal Revenue Service are named parties in any of these cases.

1 actions based on those federal changes, pursuant to Revenue and Taxation Code (R&TC)
2 section 18622. Respondent contends that it followed the federal adjustments to the extent allowable
3 under California law, citing the *Appeal of Edwin R. and Joyce E. Breitman*, 75-SBE-018, decided by
4 the Board on March 18, 1975.³ In response to appellant's assertion that he elected to settle with the
5 IRS on the federal adjustments because it would be too costly, respondent claims that a taxpayer's
6 claim that he or she acquiesced to a federal adjustment because of economic reasons only explains the
7 taxpayer's motivation and has no bearing on whether the federal determination was correct or not.
8 (Resp. Opening Br., p. 3, Ex. F.)

9 Respondent asserts that appellant seeks to invalidate the federal action and respondent's
10 assessment by asserting the attorney-client privilege, the work product privilege, and his Fifth
11 Amendment rights. Respondent asserts that, on March 6, 2014, the United States District Court,
12 Central District of California, denied and dismissed appellant's motion to quash an IRS subpoena of
13 appellant's 2010 and 2011 tax year records based on objections identical to those made in this appeal.
14 Respondent asserts that the Court stated that appellant's "arguments have no merit." (*Zelen v.*
15 *United States* (C.D. Cal. 2014) 2014 U.S. Dist. LEXIS 49225.) Respondent also asserts that appellant
16 has appealed that decision. Citing *United States v. Bilzerian* (2d Cir. 1991) 926 F.2d 1285, 1292,
17 respondent argues that the privilege, which protects the disclosure of attorney and client
18 communications, may not be used both as a sword and a shield. Citing *United States v. Amlani*
19 (9th Cir. 1999) 169 F.3d 1189, 1195, respondent argues that the Ninth Circuit has held that the privilege
20 may be implicitly waived when "allowing the privilege would deny the opposing party access to
21 information vital to its case." Respondent argues that the attorney-client privilege protects confidential
22 communications between an attorney and his client and there is no confidentiality for checks written by
23 a client and deposited with a third-party bank whose employees see the information. Respondent also
24 argues that client identities and fee arrangements are not privileged and that the privilege only applies
25 to confidential communications, citing *United States v. Blackman* (9th Cir. 1995) 72 F.3d 1418.)
26 Respondent contends that the trust account bank records are not confidential communications. (Resp.
27

28 ³ Board of Equalization cases are generally available for viewing on the Board's website
(<http://www.boe.ca.gov/legal/legalopcont.htm>).

1 Opening Br., pp. 3-4, Ex. G.)

2 Citing *United States v. Richey* (9th Cir. 2011) 632 F.3d 559, 567, respondent argues that
3 the Ninth Circuit has also held that objections based on attorney work-product privilege or the Fifth
4 Amendment are groundless because the records that would be subject to review are bank statements,
5 which are not legal work product created in anticipation of litigation. Respondent also contends that a
6 new audit is not necessary because R&TC section 18622 requires taxpayers to concede the accuracy of
7 a federal determination or state wherein the determination is erroneous. Respondent contends that an
8 extensive federal audit determined that appellant did not maintain formal books and records, misplaced
9 worksheets to substantiate his position, and refused to provide retainer agreements for examination.
10 Respondent contends that appellant now relies on the attorney-client privilege to refuse to produce any
11 records that he asserts would prove that the federal determination incorrect. Respondent attached the
12 complete federal audit to its opening brief, and asserts that it includes the following IRS audit activity
13 and conclusions: (1) appellant's worksheet is missing to justify his unreported income of \$40,000;
14 (2) appellant invoked the attorney-client privilege; (3) the IRS summons bank records and appellant did
15 not file a motion to quash the summons; (4) appellant admitted that \$40,000 of his income was
16 accidentally omitted on his return; and (5) \$140,786 of additional income which appellant asserted,
17 without substantiation, was client cost reimbursement expenses. Respondent asserts that the IRS's
18 analysis of appellant's bank accounts reflected excess deposits of \$140,786, which the IRS
19 appropriately assessed as unreported income. Respondent contends that, in the absence of anything to
20 the contrary, respondent's assessment based upon the final federal determination is correct. (Resp.
21 Opening Br., p. 3, Exs. F & H.)

22 In response to appellant's argument that respondent's assessment is time barred under
23 R&TC section 19057, respondent argues that R&TC section 19057 requires that respondent issue a
24 deficiency assessment within four years after the return was filed. Respondent argues that appellant's
25 return was filed on April 4, 2008, and respondent's NPA was issued on February 23, 2012, which was
26 within the four-year statute. (Resp. Opening Br., p. 5.)

27 With respect to the accuracy-related penalty, respondent contends that, when based on a
28 federal action, its imposition of a penalty is presumptively correct. Respondent contends that the

1 accuracy-related penalty is based upon negligence and that it properly imposed the accuracy-related
2 penalty under R&TC section 19164 in the amount of \$2,670.80 based on the underpayment of tax of
3 \$13,369.00 ($\$13,369.00 \times 20\%$). Respondent contends that appellant does not offer any evidence to
4 establish any defenses to the accuracy-related penalty other than his request that respondent should
5 conduct a new audit because he never agreed with the federal determination. Respondent further notes
6 that the IRS did not abate the federal accuracy-related penalty. (Resp. Opening Br., pp. 5-6, Exs.
7 F & H.)

8 In its reply brief, respondent asserts that R&TC section 18622 states that, when any item
9 required to be shown on a federal tax return, including gross income and deductions, is changed or
10 corrected by the IRS, the taxpayer is required to report that change to respondent and shall concede the
11 accuracy of the determination or state wherein it is erroneous. Respondent contends that appellant did
12 not report the federal changes to respondent within six months of the final federal determination.
13 Respondent asserts that the federal determination became final on June 1, 2010, and that respondent
14 learned of the federal changes from the IRS on June 20, 2011. Respondent argues that California
15 income tax law generally is based upon federal income tax law and that, under California law, it
16 properly issued its assessment based upon the final federal determination. (Resp. Reply Br., p. 2,
17 Ex. B.)

18 Respondent argues that the authorities that appellant offers are inapposite to his appeal
19 of respondent's assessment and that appellant improperly extends such cases to suit his circumstance
20 and surmises that a bank deposit may constitute a privileged communication. Respondent argues that
21 the important distinction between appellant's proposed authorities and his factual circumstances is that
22 respondent has all the evidence needed under California law to issue its valid proposed assessment of
23 tax and penalties, which is a final federal determination that made various adjustments to appellant's
24 self-employment tax, exemption credit, and Schedule C expenses, all of which increased appellant's
25 taxable income. Respondent asserts that it is not issuing a subpoena, propounding discovery, or
26 demanding the production of evidence to establish the basis of its assessment. (Resp. Reply Br., p. 3.)

27 Respondent argues that appellant ignores applicable law in attempting to shift the burden
28 to respondent with regard to auditing appellant's 2007 account and revalidating its assessment based on

1 evidence that appellant would likely refuse to provide under privilege. Respondent argues that this
2 Board has previously considered and rejected a similar argument offered by a taxpayer who, when
3 subject to a federal audit that sought the substantiation of expenses, claimed he could not provide such
4 evidence because of the attorney-client privilege. (*Appeal of Robert J. and Evelyn Johnston*,
5 75-SBE-030, April 22, 1975.) Respondent argues that this Board concluded that it could not “see how
6 substantiation of the business expenses at issue would violate the attorney-client privilege of
7 confidentiality.” (*Id.*) (Resp. Reply Br., pp. 3-4.)

8 In response to appellant’s Fifth Amendment protection, respondent contends that it is
9 unclear to what extent appellant’s income tax accounts are not the subject of appeal. Finally, in
10 response to appellant’s contention that he never stated that additional sums of money were omitted
11 from his initial 2007 return, respondent notes that, during the federal audit, appellant’s representative
12 stated to the examining officer that “there was an error in income.” (Resp. Reply Br., p. 4, Ex. H.)

13 Applicable Law

14 Burden of Proof

15 Revenue and Taxation Code (R&TC) section 18622 provides that a taxpayer shall either
16 concede the accuracy of a federal determination or state wherein it is erroneous. It is well-settled that a
17 deficiency assessment based on a federal audit report is presumptively correct and that a taxpayer bears
18 the burden of proving that the determination is erroneous. (*Appeal of Sheldon I. and Helen E. Brockett*,
19 86-SBE-109, June 18, 1986; *Todd v. McColgan* (1949) 89 Cal.App.2d 509.) Likewise, a deficiency
20 assessment based on a final federal determination resulting from a settlement agreement between the
21 taxpayer and the IRS is presumed to be correct.⁴ (*Appeal of David Chow*, 86-SBE-130, July 29, 1986.)
22 “The taxpayer cannot merely assert the incorrectness of a determination of a tax or the method used and
23 thereby shift the burden to the commissioner to justify the tax and the correctness thereof.” (*Todd v.*
24 *McColgan, supra.*) Unsupported assertions are not sufficient to satisfy an appellant’s burden of proof.
25 (*Appeal of Aaron and Eloise Magidow*, 82-SBE-274, Nov. 17, 1982.) Furthermore, while a taxpayer’s
26 claim that he only acquiesced to federal adjustments because of coercion or economic reasons explains
27

28 ⁴ IRC section 6213(a) limits the ability of the IRS to assess a deficiency until the decision of the United States Tax Court becomes final if a taxpayer appeals the assessment. However, a taxpayer can waive his right to appeal a federal assessment.

1 a taxpayer's motivation, it has no bearing on whether the federal determination was correct. (*Appeal of*
2 *Robert J. and Evelyn Johnston, supra*; *Appeal of Ronald J. and Eileen Bachrach*, 80-SBE-011, Feb. 6,
3 1980; *Appeal of Barbara P. Hutchinson*, 82-SBE-121, June 29, 1982.)

4 In general, taxpayers are required to keep records adequate to establish their income,
5 deductions, or other matters required to be shown on their return. (Treas. Reg., § 1.6001-1(a).) The
6 failure to provide evidence within a taxpayer's control gives rise to a presumption that such evidence is
7 unfavorable to the taxpayer's position. (*Appeal of Don A. Cookston*, 83-SBE-048, Jan. 3, 1983.) In the
8 absence of uncontradicted, credible, competent, and relevant evidence showing error in respondent's
9 determinations, respondent's proposed assessment must be upheld. (*Appeal of Oscar D. and*
10 *Agatha E. Seltzer*, 80-SBE-154, Nov. 18, 1980.) An appellant's failure to produce evidence that is
11 within his control gives rise to a presumption that such evidence is unfavorable to his case. (*Appeal of*
12 *Don A. Cookston, supra*.) To hold otherwise would establish skillful concealment as an invincible
13 barrier to the determination of a tax liability. (*Id.*) A taxpayer's burden of proof is not relieved merely
14 because it may be difficult or impossible to substantiate their position. (*Appeal of Frederick A. and*
15 *Jean C. Giese*, 86-SBE-016, Feb. 4, 1986.)

16 While respondent may rely on the findings of the IRS, it is not necessarily bound to
17 follow a federal action. (*Appeal of Der Weinerschnitzel International, Inc.*, 79-SBE-063, Apr. 10,
18 1979; *Appeal of Raymond and Rosemarie J. Pryke*, 83-SBE-212, Sept. 15, 1983.) Furthermore, income
19 tax deductions are a matter of legislative grace, and the burden is on a taxpayer to show by competent
20 evidence that he is entitled to the deductions he has claimed. (*Appeal of James C. and Monablanche A.*
21 *Walshe*, 75-SBE-073, Oct. 20, 1975.) To carry the burden of proof, a taxpayer must point to an
22 applicable statute and show by credible evidence that the deductions claimed come within its terms.
23 (*Appeal of Robert R. Telles*, 86-SBE-061, Mar. 4, 1986.)

24 Taxpayer Records

25 An attorney being investigated cannot invoke the attorney-client privilege to protect
26 against the disclosure of financial information and other documents merely because the disclosure of
27 such information might reveal his clients' identities. (*Reiserer v. United States* (9th Cir. 2007)
28 479 F.3d 1160, 1166.) *Reiserer* involved an attorney under investigation for an abusive tax

1 arrangement that involved his clients possibly participating in an offshore employee leasing scheme.
2 (*Id.* at p. 1162.) The IRS sought bank records and the attorney invoked the attorney-client privilege.
3 (*Id.*) The court held that the attorney-client privilege did not apply even if the disclosure of the
4 information might eventually lead to those clients becoming targets of investigation by the IRS. (*Id.* at
5 p. 1166 (citing *In re Horn* (9th Cir. 1992) 976 F.2d 1314, 1317.) The IRS issued its summons as part of
6 an investigation of the attorney, and not of his clients, and therefore, the attorney-client privilege was
7 not applicable. (*Id.*) Documents that merely revealed those clients' identities were not protected by the
8 privilege. (*Id.* at p. 1165.)

9 Ultimately, the attorney-client privilege only protects confidential communications.
10 (*United States v. Blackman* (9th Cir. 1995) 72 F.3d 1418.) Client identity and the nature of the fee
11 arrangement between an attorney and client are not protected from disclosure by the attorney-client
12 privilege. (*Id.* at p. 1424 (citing *Ralls v. United States* (9th Cir. 1995) 52 F.3d 223, 225.) In *Blackman*,
13 an attorney was under investigation for certain filings that were made with the IRS over a three-year
14 period. (*Id.* at p. 1421.) The attorney invoked the attorney-client privilege with regard to the disclosure
15 of his fee arrangement with clients and other documents that might reveal his clients' identities. (*Id.*)
16 The court held that the attorney-client privilege only applied if the information sought would
17 compromise confidential communications or would constitute the "last link" leading to a client's
18 indictment. (*Id.* at p. 1424 (citing *Tornay v. United States* (9th Cir. 1988) 840 F.2d 1424, 1428 and
19 *United States v. Gray* (9th Cir. 1989) 876 F.2d 1411, 1415.)

20 The Board has previously dealt with an appeal in which an attorney invoked the
21 attorney-client privilege to protect against the disclosure of information that went beyond canceled
22 checks in order to substantiate certain business expenses. (*Appeal of Robert J. and Evelyn A. Johnston*,
23 75-SBE-030, Apr. 22, 1975.) The appellants contended that such disclosure would necessitate the
24 release of confidential information, jeopardize their professional license, and thereby unconstitutionally
25 deprive them of due process of law. (*Id.*) The Board stated that it could not see how information
26 necessary for the substantiation of an attorney's businesses expenses would violate the attorney-client
27 privilege of confidentiality between that attorney and his clients. (*Id.*)

28 ///

1 Statute of Limitations

2 In general, respondent must issue a proposed deficiency assessment within four years of
3 the date the taxpayer filed its California return. (Rev. & Tax. Code § 19057.) A taxpayer is required to
4 report federal changes to income or deductions to respondent within six months of the date the federal
5 changes become final. (Rev. & Tax. Code, § 18622.) If the taxpayer complies with that requirement,
6 respondent may issue the NPA within two years of the date of notification, or within the general four-
7 year period, whichever expires later. (Rev. & Tax. Code, § 19059.) If the taxpayer notifies respondent
8 more than six months after the date the federal changes became final, then respondent may issue the
9 NPA within four years of the date of notification. (Rev. & Tax. Code, § 19060, subd. (b).) Finally, if
10 the taxpayer fails to notify respondent of the federal changes, then respondent may issue the NPA at
11 any time. (Rev. & Tax. Code, § 19060, subd. (a); *Ordlock v. Franchise Tax Board* (2006) 38 Cal.4th
12 897.)

13 Accuracy-Related Penalty

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

26 There are three exceptions to the imposition of the accuracy-related penalty. Under the
27 first exception, the penalty shall be reduced by the portion of the understatement attributable to a tax
28 treatment of any item if there is substantial authority for such treatment. (Int.Rev. Code,

1 § 6662(d)(2)(B).) Under the second exception, the penalty shall be reduced by the portion of the
2 understatement attributable to a tax treatment of any item if the relevant facts affecting the item's tax
3 treatment are adequately disclosed and there is a reasonable basis for the tax treatment of such item.
4 (Int.Rev. Code, § 6662(d)(2)(B).) Under the third exception, the penalty will not be imposed to the
5 extent that appellant shows a portion of the underpayment was due to reasonable cause and that he
6 acted in good faith with respect to such portion of the underpayment. (Int.Rev. Code, § 6664(c)(1);
7 Treas. Regs., §§ 1.6664-1(b)(2) & 1.6664-4.)

8 A determination of whether a taxpayer acted with reasonable cause and in good faith is
9 made on a case-by-case basis and depends on the pertinent facts and circumstances, including his
10 efforts to assess the proper tax liability, his knowledge and experience, and the extent to which he
11 relied on the advice of a tax professional. (Treas. Reg., § 1.6664-4(b).) Generally, the most important
12 factor is the extent of the taxpayer's effort to assess his proper tax liability. (*Id.*) The reliance on the
13 advice of a professional tax advisor does not necessarily demonstrate reasonable cause and good faith.
14 (*Id.*) However, the reliance on professional advice constitutes reasonable cause and good faith if, under
15 all the circumstances, such reliance was reasonable and the taxpayer acted in good faith. (*Id.*)

16 The taxpayer bears the burden of proving any defenses, such as substantial authority,
17 disclosure and reasonable basis, and reasonable cause and good faith. (*Recovery Group, Inc. v.*
18 *Comm'r*, T.C. Memo. 2010-76.) An absence of records, due to loss or destruction, cannot standing
19 alone establish that a taxpayer's deductions were founded on reasonable cause and good faith when
20 made. (*Xuncax v. Comm'r*, T.C. Memo. 2001-226.) The alleged mistreatment of a taxpayer by the IRS
21 is not relevant to whether the taxpayer has established the existence of reasonable cause because the
22 reasonable cause exception is focused on the taxpayer's actions, not the IRS's actions. (*Moss v.*
23 *Comm'r* (T.C. 2010) 135 T.C. 365, 373.)

24 STAFF COMMENTS

25 The federal Account Transcript for the year at issue is final, as there are no pending
26 claims or adjustments. Failure on the part of the taxpayer to provide evidence that is within the
27 taxpayer's control, including personal tax returns, gives rise to a presumption that such evidence is
28 unfavorable to appellant's position. At the hearing, appellant should be prepared to provide evidence

1 that demonstrates error in respondent's determinations. Specifically, appellant should be prepared to
2 provide documentation that substantiates his contention that the federal adjustments are incorrect.

3 Upon a review of the IRS's audit workpapers, the workpapers note in various places
4 that, according to appellant's representative (Resp. Opening Br., Ex. H, p. 34), appellant did not keep
5 formal books and records and appellant no longer has the 2007 worksheet that included his 2007
6 income and expense information. In addition, the IRS workpapers (the IRS's "Sch C1 – Gross Receipts
7 or Sales Lead Sheet, dated May 27, 2010) provide (Resp. Opening Br., Ex. H, pp. 92-93):

8
9 . . . Per taxpayer, his cases consist of murder, drunk driving and white collar crime cases.
10 The taxpayer explained that he charges a flat fee for each case. The fee is determined by
11 the complexity of the case. Taxpayer explained that in 2007, his fee was as low as \$2500
12 and as high as \$25000. Per taxpayer, as soon as he is hired, he creates a retainer
13 agreement and request[s] payment in full. Taxpayer also explained that there were
14 instances where payments [were] received in increments and an upfront payment was
15 always required.

16 The taxpayer used the cash method of accounting. As far as the accounting procedures,
17 no formal books and records were maintained. The taxpayer explained that payments
18 were deposited into the operating bank account. He kept files per client and would make
19 a note on the client's file as payments were received. Taxpayer explained that at the end
20 of the year, he would go into each client file and add up payments received for the year.
21 Taxpayer did not have the worksheet that was used to calculate income for 2007. During
22 the interview with the [representative], the [representative] explained that \$40,000 of
23 additional income was not included on the return. Per the [representative], he used the
24 worksheet provided by the taxpayer to prepare the return, but the taxpayer misplaced the
25 worksheet.

26 Documents to support gross receipts in any form were not provided. The [representative]
27 provided an income worksheet with no source documents. The source documents as well
28 as the retainer agreements were requested by the revenue agent, but the taxpayer stated
that the information requested was attorney client privilege. As a result, the deposited
items as well as the bank statements were summons. Based on the bank deposit analysis,
there was \$140,786 of excess deposits. The revenue agent explained the analysis and
provided a copy of the bank deposit analysis to the [representative]. The [representative]
explained that \$74700 of the excess deposits included client cost reimbursement expenses
but was not able to provide substantiation. After numerous requests, the taxpayer has not
provided substantiation on client cost reimbursement expenses. As a result, the total
excess deposits are not included as additional income.

 At the hearing, appellant should be prepared to address: (1) why, as of the date of the
audit, which began in 2009, he no longer had any books and records for the 2007 tax year; (2) as the

1 IRS found \$140,786 of excess deposits in its analysis, why this amount should not be included in
2 appellant's Schedule C gross receipts; (3) if client costs were claimed as business expenses, why client
3 reimbursements would not also likewise be includible as part of appellant's Schedule C gross receipts;
4 and (4) since appellant's clients are not the subject of the IRS's audit or respondent's proposed
5 assessment, how the information sought constitutes confidential communications.

6 Respondent imposed the 20 percent state accuracy-related penalty in accordance with
7 the federal accuracy-related penalty on appellant's 2008 tax year that was attributable based upon
8 negligence. Unless one of the exceptions to the penalty is applicable, it appears that respondent
9 properly imposed the accuracy-related penalty.

10 Pursuant to California Code of Regulations, title 18, section 5523.6, if either party has
11 any additional evidence to present, it should be provided to the Board's Board Proceedings Division at
12 least 14 days prior to the oral hearing.⁵

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28 ⁵ Evidence exhibits should be sent to: Khaaliq Abd'Allah, Associate Governmental Program Analyst, Board Proceedings
Division, State Board of Equalization, P.O. Box 942879 MIC:80, Sacramento, California, 94279-0080.