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

10 In the Matter of the Appeal of: ) **HEARING SUMMARY<sup>2</sup>**  
11 ) **PERSONAL INCOME TAX APPEAL**  
12 **ALI AMIDY AND GUITI NAHAVANDI<sup>1</sup>** )  
13 ) Case No. 524954

	<u>Year</u>	<u>Proposed</u> <u>Assessment</u>
	2004	<u>Tax</u> <u>Penalty<sup>3</sup></u>
		\$111,346.00    \$19,911.40

18 Representing the Parties:

20 For Appellants: Ali Amidy and Guiti Nahavandi  
21 For Franchise Tax Board: Raul A. Escatel, Tax Counsel

23 <sup>1</sup> Appellants reside in Santa Clara County, California.

24 <sup>2</sup> This appeal was originally scheduled for the May 24, 2011 hearing calendar, but appellants failed to respond to the hearing  
25 notice and it was rescheduled to the June 21, 2011 nonappearance consent calendar. At appellants' request, this appeal was  
26 placed back on the oral hearing calendar for the July 26, 2011 hearing calendar but was subsequently postponed due to a  
27 scheduling conflict and rescheduled to the August 23, 2011 oral hearing calendar. Appellants requested a six month  
28 postponement from the August 23, 2011 oral hearing calendar due to an extreme health condition of one of the appellants.  
The additional time requested would allow the appellant time to recover from the health issues and time to retain counsel.  
The postponement request was granted and the matter has been rescheduled to the March 20-22, 2012 Sacramento oral  
hearing calendar.

<sup>3</sup> The penalty amount listed above is an accuracy- related penalty.

- 1 QUESTIONS: (1) Whether respondent correctly determined that appellants failed to provide  
2 sufficient documentation to establish their cost basis in United Food Enterprises,  
3 Inc. (UFE) for purposes of calculating their claimed long-term capital loss from  
4 the sale of their share of UFE in 2004.
- 5 (2) Whether the accuracy-related penalty was properly imposed and whether  
6 appellants have shown reasonable cause for abatement of the penalty.<sup>4</sup>
- 7 (3) Whether the imposition of interest should be waived.<sup>5</sup>

8 HEARING SUMMARY

9 Background

10 Appellants filed California income tax returns for tax years 2003 and 2004.<sup>6</sup> On their  
11 2003 return, appellants claimed a home mortgage interest deduction of \$183,982, as reflected on their  
12 federal Schedule A (Itemized Deductions). (Resp. Opening Br., pp. 1-2, exhibit A, p. 1.) They also  
13 reported the following Internal Revenue Code (IRC) section 1031 (like-kind) exchange: on their 2003  
14 federal Form 8824 (Like-Kind Exchanges), appellants reported the sale on April 4, 2003, of a  
15 commercial building (old property) and the acquisition on July 18, 2003, of a commercial building (new  
16 property).<sup>7</sup> (Resp. Opening Br., exhibit B.) For the old property, they reported a sales price of  
17 \$1,500,000, an adjusted tax basis of \$247,225, and a gain of \$1,252,775. (*Ibid.*) With respect to the  
18 new property, appellants reported a fair market value of \$2,300,000 and a basis of \$1,297,225. (*Ibid.*)

19 On their 2004 return, appellants reported home mortgage interest of \$187,271, as  
20 reflected on their 2004 federal Schedule A. (Resp. Opening Br., pp. 1-2, exhibits A, p. 2.) They also  
21

22 <sup>4</sup> As noted by respondent in its opening brief, appellants only appealed the disallowance of their claimed long-term capital  
23 loss of \$567,509. (Resp. Opening Br., p. 4, exhibit C, p. 1.) In a letter dated October 4, 2010, staff requested that appellants  
24 provide, among other things, any information and/or documentation that would show that the imposition of the accuracy-  
25 related penalty was unwarranted. In their additional brief, appellants request that the accuracy related penalty and interest be  
26 waived but they do not provide any argument or evidence in support of that request. (Apps. Additional Br., p. 1.) In its  
27 additional brief, respondent does not discuss the issues of penalty abatement or interest abatement.

28 <sup>5</sup> See footnote 4, *supra*.

<sup>6</sup> Complete copies of appellants' 2003 and 2004 California income tax returns are not in the file.

<sup>7</sup> According to the 2003 federal Form 8824, on April 4, 2003, appellants both acquired the old property and transferred the  
old property to a third party. (Resp. Opening Br., exhibit B.)

1 reported the sale of their 50 percent interest of UFE, a full-service supermarket in Los Angeles,  
2 California. On their 2004 federal Schedule D (Capital Gains and Losses), appellants claimed a long-  
3 term capital loss of \$567,509 from the March 11, 2004 sale of their 50 percent interest in UFE, which  
4 they acquired on January 31, 2001, resulting from a sale price of \$503,000 and a cost basis of  
5 \$1,070,509. (Resp. Opening Br., p. 2, exhibit C.)

6 Respondent subsequently audited appellants' 2003 and 2004 returns. Pursuant to IRC  
7 section 163, respondent determined that appellants claimed on their 2003 and 2004 returns home  
8 mortgage interest deductions in excess of their statutory limits of \$62,682 and \$63,912, respectively.  
9 (Resp. Opening Br., pp. 1-2.) Respondent thus disallowed the excess home mortgage interest deduction  
10 amounts of \$121,300 (\$183,982 - \$62,682) and \$123,359 (\$187,271 - \$63,912) claimed on appellants'  
11 federal Schedule A for tax years 2003 and 2004, respectively. (*Ibid.*) In a letter dated January 26, 2010,  
12 respondent informed appellants that it reduced the disallowed amount of appellants' mortgage interest  
13 deductions for tax years 2003 and 2004 to \$117,289 and \$122,088, respectively. (Appeal Letter,  
14 Attachment, pp. 8, 12.) For tax year 2003, respondent made a nontaxable adjustment to the basis of the  
15 new property appellants received in a like-kind exchange from \$1,297,225 to \$247,225, which was  
16 required due to a calculation error in appellants' computations. (*Id.*, p. 2, exhibit B.)<sup>8</sup>

17 With respect to appellants' 2004 return, respondent examined and disallowed the claimed  
18 long-term capital loss of \$567,509 due to the sale of appellants' interest in UFE reported on appellants'  
19 federal Schedule D on the ground that appellants failed to provide sufficient evidence to substantiate  
20 their cost basis in UFE. (Resp. Opening Br., p. 2.) During the audit, appellants asserted that there were  
21 no available accounting records establishing appellants' cost basis in UFE. (*Ibid.*) Instead, appellants  
22 provided respondent copies of schedules relating to UFE, a purchase agreement for UFE's assets, bank  
23 statements, deposit slips, and miscellaneous other documents to substantiate their cost basis in UFE.  
24 (*Id.*, exhibits D-H.) In a letter dated May 16, 2008, respondent's auditor informed appellants that the  
25 documentation submitted was insufficient to substantiate the cost basis and there was no indication UFE  
26 ever filed California income tax returns. The auditor proposed disallowing the entire claimed cost basis  
27

28 <sup>8</sup> Respondent explains the calculation error in detail in its additional brief, as well as in a letter to appellants dated January 26, 2010. (Resp. Additional Br., pp. 3-4; Appeal Letter, Attachment.)

1 of \$1,070,509 and assessing an accuracy-related penalty. (*Id.*, exhibit I, p. 1.) The auditor further  
2 stated:

3 In the present matter, the near complete lack of accounting records and/or other  
4 information to substantiate your basis in UFE resulted in an apparent overstatement of  
5 your basis in UFE, which created a substantial understatement of tax due. As a 50%  
6 shareholder of UFE, it is reasonable to infer that you were able to exercise significant  
7 control over UFE, including ensuring the preparation of adequate books and records and  
8 the filing of income tax returns. It appears you were familiar with the proper  
9 accounting/tax obligations of businesses, given your operation of a separate successful  
10 mortgage brokerage business during the same time you had an ownership interest in UFE.

11 (*Ibid.*) The auditor indicated that the proposed assessment would “also include the disallowance of  
12 mortgage interest for 2003 and 2004 and the restatement of deferred gain and basis in the received  
13 property on Form 8824 (Like-Kind Exchanges) for 2003,” which are discussed above. (*Ibid.*)

14 On an unspecified date, respondent issued a Notice of Proposed Assessment (NPA) for  
15 tax year 2003,<sup>9</sup> which disallows an excess home mortgage interest deduction of \$121,300 and makes a  
16 nontaxable adjustment to the basis of the new property appellants received in the like-kind exchange  
17 from \$1,297,225 to \$247,225. (Resp. Opening Br., pp. 1-2.) According to respondent, appellants failed  
18 to timely protest the 2003 NPA. (*Id.*, p. 3.)

19 On September 19, 2008, respondent issued an NPA for tax year 2004, which disallows a  
20 mortgage interest deduction of \$123,359 and a claimed UFE cost basis of \$1,070,509. (Resp. Opening  
21 Br., exhibit J.) The 2004 NPA increases appellants’ taxable income from \$95,498 to \$1,289,366.  
22 Because appellants failed to timely protest the 2003 NPA, the parties “formulated a plan for [appellants]  
23 to resolve the 2003 tax year with [their] 2004 tax year.” (Resp. Opening Br., p. 3, fn. 14.) According to  
24 respondent, because the issues for tax years 2003 and 2004 were similar, it abated the tax due for tax  
25 year 2003 and added it to the 2004 NPA, and “[t]he 2003 tax year was analyzed during [appellants’]  
26 protest of the 2004 tax year.” (*Ibid.*) The 2004 NPA proposes additional total tax of \$111,464. (Resp.  
27 Opening Br., exhibit J.) The NPA also imposes an accuracy-related penalty of \$19,911.40. (*Ibid.*)

28 Appellants timely protested the 2004 NPA. (Resp. Opening Br., exhibit K.) In the  
protest letter, appellants only protested the disallowed UFE cost basis of \$1,070,509, which they claimed

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<sup>9</sup> A copy of the 2003 NPA is not in the file, and there is no specific information in the file regarding the 2003 NPA. As discussed below, respondent abated the tax due for tax year 2003 and added it to the 2004 NPA.

1 on their 2004 federal Schedule D. (*Ibid.*) Appellants apparently sent respondent correspondence dated  
2 August 18, 2009, and September 3, 2009, concerning the UFE cost basis issue, which are referenced in  
3 respondent's letter to appellants dated January 26, 2010.<sup>10</sup> (Appeal Letter, Attachment, p. 1.) In its  
4 January 26, 2010 letter, respondent states, "Because no reasonable or credible evidence was provided to  
5 adequately substantiate [appellants'] basis, the entire basis of \$1,070,500 is disallowed." (*Id.*, p. 10.)

6 On February 1, 2010, respondent issued a Notice of Action (NOA), revising the 2004  
7 NPA in response to appellants' protest of the 2004 NPA. The 2004 NOA revised appellants' disallowed  
8 mortgage interest deduction from \$123,359 to \$122,088.<sup>11</sup> The 2004 NOA affirmed the 2004 NPA's  
9 disallowance of the claimed cost basis of \$1,070,509, as well as the imposition of the accuracy-related  
10 penalty of \$19,911.40. The 2004 NOA revised the additional tax from \$111,464 to \$111,346. The 2004  
11 NOA indicates that respondent charged appellants interest on the proposed assessment for the period  
12 April 15, 2005, to April 15, 2007, suspended interest pursuant to R&TC section 19116 for the period  
13 April 16, 2007, to October 3, 2008, and charged interest for the period October 4, 2008, to the present.  
14 (Resp. Opening Br., p. 4, exhibit L; Appeal Letter, Attachment.) This timely appeal followed.

#### 15 Request for Additional Briefing

16 In order to further develop the issues, the Appeals Division requested additional briefing  
17 by letter dated October 4, 2010, in which appellants were requested to provide and to discuss the  
18 following:

19 First, please provide personal banking records and other records, such as corroborating  
20 accounting records from the corporation or other sources, establishing your cost basis in  
[UFE].

21 Second, please provide any information and/or documentation that would show that the  
22 imposition of the accuracy-related penalty was unwarranted.

23 While we are seeking briefing on the issues specified above, you may also address  
24 additional points that may affect the resolution of this appeal.

25 Please discuss any relevant facts or legal authorities and provide any relevant  
26 documentation in support of your answers to the foregoing questions. . . .

27 <sup>10</sup> Copies of appellants' correspondence dated August 18, 2009, and September 3, 2009, are not in the file.

28 <sup>11</sup> In its opening brief, respondent inadvertently stated that the NOA revised the mortgage interest deduction from \$123,259  
to \$122,088. (Resp. Opening Br., p. 4, exhibits J & L.)

1 The parties submitted responsive additional briefs, which are discussed below.

2 Contentions

3 Appellants' Contentions

4 In their appeal letter, appellants contend that on January 31, 2001, they invested  
5 \$1,070,500 in UFE. (Appeal Letter, p. 2.) They also contend that on March 11, 2004, the business was  
6 sold, and they claimed a long-term capital loss.<sup>12</sup> (*Ibid.*) Appellants argue that their submitted  
7 documentation establishes their cost basis of \$1,075,500.<sup>13</sup> (*Ibid.*) In the appeal letter, appellants state  
8 that they do not waive any rights and they reserve "the right to urge new and different matters of  
9 defense." (*Ibid.*)

10 In their additional brief, appellants contend that they have submitted all of their  
11 "investments and deposits" to the UFE account, including "all deposit slips, cancelled checks, and bank  
12 statements" showing the source of the funds prior to their deposit into the account. (Apps. Additional  
13 Br., p. 1.) They also contend that in the last three years they provided all necessary documents, such as  
14 UFE bank statements, cancelled checks, and other requested documents. (*Ibid.*) With respect to the  
15 accuracy-related penalty issue, appellants assert that respondent incorrectly claims they failed to provide  
16 adequate substantiation to support their UFE cost basis. (*Id.*, p. 2.) Appellants contend that they  
17 provided all requested documentation to support their investment in UFE until they sold the business in  
18 2004. (*Ibid.*)

19 Appellants assert that the audit of their tax years 2003 and 2004 accounts has been  
20 ongoing for many years and it was already too late when the auditor requested all of the bank statements  
21 because the bank does not keep all of the statements on file and they need to be ordered in advance.  
22 (Apps. Additional Br., p. 2.) Appellants state:

23 In this entire process, I have provided all the documentation possible that the State Board  
24 of Equalization has requested. I will and have always complied with all requests and  
have always communicated back with the State Board of Equalization.

25 (*Ibid.*) Appellants attached copies of the following documents to their additional brief: 1) a list of  
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27 <sup>12</sup> On the 2004 Schedule D, appellants claimed a UFE sales price of \$503,000, a UFE cost basis of \$1,070,509, and a UFE  
28 long-term capital loss of \$567,509.

<sup>13</sup> See footnote 12, *supra*.

1 appellant-husband's deposit investments to UFE; 2) a breakdown of all deposits with verification of the  
2 funds; 3) bank statements for UFE, including the bank receipts and the source of the funds for January  
3 2001, May 2001, June 2001, July 2001, August 2001, October 2001, May 2002, April 2003, May 2003,  
4 and June 2003; and 4) receipts of all deposits to the landlord for rent payments of \$19,000. (Apps.  
5 Additional Br., pp. 2-3, Attachments.)

6 Appellants concede that several errors were made in the reporting of their mortgage  
7 payments for tax years 2003 and 2004 and they are willing to pay the additional tax due to these errors.  
8 (Apps. Additional Br., p. 1.) They request, however, that the penalties and interest be waived because  
9 they were "unaware of this matter." (*Ibid.*) With respect to the IRC section 1031 like-kind exchange  
10 issue, appellants assert that they are unclear about the calculation error from \$1,297,225 to \$247,225 that  
11 respondent referred to in its opening brief and they require further clarification. (*Ibid.*)

#### 12 Respondent's Contentions

13 Respondent contends that it disallowed appellants' reported loss on their Schedule D for  
14 tax year 2004 because they failed to provide sufficient evidence to substantiate their cost basis of  
15 \$1,070,500 in UFE. (Resp. Opening Br., pp. 4-5.) Respondent asserts that the submitted bank deposit  
16 slips for UFE do not identify the deposits' source, appellants did not provide their personal bank account  
17 records showing that they purportedly deposited the funds into UFE's account or for what purpose such  
18 funds were deposited, and no accounting records were available to verify appellants' purported  
19 investment in UFE. (*Id.*, p. 5.) According to respondent, appellants indicated during the protest stage  
20 that they located UFE's accountant and would be requesting from the accountant information regarding  
21 UFE's operations but no such information has yet been provided to respondent. (*Ibid.*) Respondent  
22 asserts its records indicate that UFE did not file tax returns for tax years 2003 and 2004. (*Ibid.*)  
23 Respondent contends that appellants have not explained why they are unable to substantiate their cost  
24 basis in UFE with documentary evidence and therefore the presumption is that such information would  
25 be unfavorable to them. (*Ibid.*) Respondent claims that the IRS and the FTB provide guidance  
26 regarding record keeping requirements, which appellants did not follow. (*Ibid.*)

27 In its additional brief, respondent argues that its determination should be upheld because  
28 appellants have not produced "any evidence to prove the funds invested in UFE should be added to

1 UFE's basis" and appellants failed "to prove Respondent's calculation of basis is in error." (Resp.  
2 Additional Br., p. 2.) Respondent contends the copies of documents that appellants submitted with their  
3 additional brief were previously submitted to it during the audit, protest and appeal stages and this  
4 evidence does not establish the identified funds were invested in UFE. (*Id.*, p. 1.) Respondent also  
5 asserts that the submitted documentary evidence does not establish how the funds transferred to UFE  
6 were used or how they increase appellants' adjusted basis in UFE. (*Ibid.*) Citing IRC section 263 and  
7 Treasury Regulation section 1.263(a)-1(b), respondent contends, for example, that "it is unknown  
8 whether the deposits made into UFE's checking account were for expenditures related to UFE that  
9 should be capitalized and added to their adjusted basis or expenses for incidental repairs and  
10 maintenance that are not capital expenditures." (*Id.*, p. 2.) Respondent also contends that under IRC  
11 section 212, appellants' rent payments "are not factored into their investment in UFE," but "are  
12 deductible in the year said payments were made." (*Ibid.*)

13 In its additional brief, respondent asserts that, although appellants did not protest its  
14 nontaxable adjustment to the basis of the new property appellants received in a like-kind exchange from  
15 \$1,297,225 to \$247,225 during its audit of appellants' 2003 account, it would briefly address appellants'  
16 concerns about the relevant adjustments. (Resp. Additional Br., p. 3.) Respondent proceeds to explain  
17 in its additional brief the reasons for the like-kind exchange adjustment. (*Id.*, pp. 3-4.) Because this  
18 nontaxable adjustment made to appellants' 2003 account is not at issue in this appeal, staff will not  
19 discuss respondent's explanation, which is set forth in its additional brief.

20 In its additional brief, respondent does not discuss appellants' request in their additional  
21 brief that the penalty and interest be waived.

## 22 Applicable Law

### 23 Cost Basis

24 R&TC section 18031 provides for the determination of the amount of gain and loss on  
25 disposition of property by reference to Subchapter O of Chapter 1 of Subtitle A of the IRC, which  
26 commences with IRC section 1001. IRC section 1001 provides that gain from the sale of property shall  
27 be the excess of the amount realized over the adjusted basis provided in section 1011 for determining  
28 gain, and the loss from a sale shall be the excess of the adjusted basis provided in section 1011 for

1 determining loss over the amount realized. IRC section 1011(a) provides that “the adjusted basis for  
2 determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be  
3 the basis determined under section 1012.” IRC section 1012 provides that the basis shall be the cost of  
4 the property.

5 IRC section 212 provides that all ordinary and necessary expenses paid or incurred  
6 during the taxable year for the production or collection of income or for the management, conservation,  
7 or maintenance of property held for the production of income is deductible. (Incorporated for California  
8 by Rev. & Tax. Code, § 17201.) This general rule, however, is subject to other provisions of the IRC,  
9 which limit the deductibility of certain expenses that are considered capital in nature.

10 The deductibility of expenses under IRC section 212 is further limited by IRC section  
11 263. (Treas. Reg. § 1.212-1(e).) Thus, any deduction relating to expenses associated with property held  
12 for the production of income must be analyzed in the context of IRC section 263 to determine if those  
13 expenses are deductible under IRC section 212 or whether they must be capitalized and depreciated over  
14 the useful life of the property. IRC section 263(a)(1) provides that no deduction shall be allowed for  
15 “[a]ny amount paid out for new buildings or for permanent improvements or betterments made to  
16 increase the value of any property or estate.”

17 Treasury regulations clarify that amounts paid which add to the value or substantially  
18 prolong the useful life of property are generally considered capital in nature. (Treas. Reg. § 1.263(a)-  
19 1(b).) The cost, acquisition, and construction of buildings are listed as specific examples of capital  
20 expenditures. (Treas. Reg. § 1.263(a)-2)

21 With respect to any assessment determination, respondent has the initial burden of  
22 showing that its assessment was reasonable and rational. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509;  
23 *Appeal of Michael E. Myers*, 2001-SBE-001, May 31, 2001.) Thereafter, respondent’s determination of  
24 an assessment is presumed correct and appellant has the burden of proving it to be wrong. (*Todd v.*  
25 *McColgan, supra; Appeal of Michael E. Myers, supra; Appeal of Ismael R. Manriquez*, 79-SBE-077,  
26 Apr. 10, 1979.) Unsupported assertions are not sufficient to satisfy appellant’s burden of proof. (*Appeal*  
27 *of Aaron and Eloise Magidow*, 82-SBE-274, Nov. 17, 1982.) In the absence of uncontradicted, credible,  
28 competent, and relevant evidence showing error in respondent’s determinations, they must be upheld.

1 (*Appeal of Oscar D. and Agatha E. Seltzer*, 80-SBE-154, Nov. 18, 1980.)

2 Accuracy-related Penalty

3 R&TC section 19164, which incorporates the provisions of IRC section 6662, provides  
4 for an accuracy-related penalty of 20 percent of the applicable underpayment. The penalty applies to the  
5 portion of the underpayment attributable to negligence or disregard of rules and regulations or to any  
6 substantial understatement of income tax. (Int.Rev. Code, § 6662(b).) The IRC defines “negligence” to  
7 include “any failure to make a reasonable attempt to comply” with the provisions of the code.  
8 (Int.Rev. Code, § 6662(c).) The term “disregard” is defined to include any “careless, reckless, or  
9 intentional disregard.” (*Ibid.*) There is a “substantial understatement of income tax” when the amount  
10 of the understatement for a taxable year exceeds the greater of ten percent of the tax required to be  
11 shown on the return, or \$5,000. (Int.Rev. Code, § 6662(d)(1).) An accuracy-related penalty shall not be  
12 imposed as to any portion of an underpayment as to which appellants show there is reasonable cause and  
13 they acted in good faith. (Rev. & Tax. Code, § 19164, subd. (d); Int.Rev. Code, § 6664(c)(1); Cal. Code  
14 Regs., tit. 18, § 19164, subd. (a).) Treasury Regulation section 1.6664-4(b)(1) provides in relevant part:

15 The determination of whether a taxpayer acted with reasonable cause and in good faith is  
16 made on a case-by-case basis, taking into account all pertinent facts and circumstances.  
17 . . . Generally, the most important factor is the extent of the taxpayer’s effort to assess  
18 the taxpayer’s proper tax liability. Circumstances that may indicate reasonable cause and  
19 good faith include an honest misunderstanding of fact or law that is reasonable in light of  
20 all the facts and circumstances, including the experience, knowledge and education of the  
21 taxpayer. . . .

19 Interest Abatement

20 Taxes are due and payable as of the original due date of the taxpayer’s return (without  
21 regard to extension). When a tax is not paid by the original due date or if respondent assesses additional  
22 tax that becomes due and payable, the law provides that interest will be charged on the resulting balance  
23 due, compounded daily. (Rev. & Tax. Code, § 19101.) Interest is also mandatory with respect to the  
24 imposition of an accuracy-related penalty pursuant to R&TC section 19164. (Rev. & Tax. Code,  
25 § 19101, subd. (c)(2)(B).) We have determined that respondent’s imposition of interest is mandatory  
26 and respondent is not authorized to abate interest except where authorized by law. (*Appeal of Amy M.*  
27 *Yamachi*, 77-SBE-095, June 28, 1977.) Moreover, interest is not a penalty imposed on the taxpayer and  
28 there is no reasonable cause exception to the imposition of interest. It is simply compensation for the

1 use of money. (*Appeal of Audrey C. Jaegle*, 76-SBE-070, June 22, 1976.)

2 To obtain interest abatement, appellants must satisfy the requirements of one of the  
3 following three statutes: R&TC sections 19104, 19112 or 21012. It does not appear that any of the  
4 exceptions authorized by law are present in this appeal. R&TC section 19104 provides that respondent  
5 may abate interest only when (1) the interest is attributable to any unreasonable error or delay committed  
6 by respondent in the performance of a ministerial or managerial act, (2) no significant aspect of the error  
7 or delay is attributable to the taxpayer, and (3) the error or delay occurred after respondent has contacted  
8 the taxpayer in writing with respect to the deficiency. (Rev. & Tax. Code, § 19104, subs. (a)(1) &  
9 (b)(1).) R&TC section 19112 requires a showing of extreme financial hardship caused by “significant  
10 disability or other catastrophic circumstance.” which appellants have not alleged. Lastly, R&TC section  
11 21012 is not applicable because there has been no reliance on any written advice requested of  
12 respondent.

13 Respondent’s determination not to abate interest is presumed correct, and the burden is  
14 on appellants to prove error. (*Appeal of Michael E. Myers, supra.*) The Board’s jurisdiction in an  
15 interest abatement case is limited by statute to a review of respondent’s determination for an abuse of  
16 discretion. (Rev. & Tax. Code, § 19104, subd. (b)(2)(B).) To show an abuse of discretion, appellants  
17 must establish that in refusing to abate interest respondent exercised its discretion arbitrarily,  
18 capriciously, or without sound basis in fact or law. (*Woodral v. Commissioner* (1999) 112 T.C. 19, 23.)  
19 Interest abatement provisions are not intended to be routinely used to avoid the payment of interest, thus  
20 abatement should be ordered only “where failure to abate interest would be widely perceived as grossly  
21 unfair.” (*Lee v. Commissioner* (1999) 113 T.C. 145, 149.)

## 22 STAFF COMMENTS

23 The parties should be prepared to explain how the tax due from appellants’ 2003 tax year  
24 account was abated and then added to the 2004 NPA as discussed above.

25 Appellants should be prepared to discuss in detail how the documentation they have  
26 provided establishes a cost basis in UFE in the amount of \$1,070,500 as reported on their 2004 return.  
27 Appellants should explain whether the claimed cost basis is due to an initial investment in UFE at the  
28 time of purchase or whether it also includes additional infusions of funds on the part of appellants.

1 Appellants should be prepared to demonstrate, with respect to each alleged transfer of funds to UFE that  
2 they have included in their tax basis, whether the transfer (a) was from their funds and (b) was made as a  
3 capital contribution or to fund UFE (rather than as another type of transfer such as, perhaps, a loan or the  
4 repayment of a loan). To the extent appellants made loans to UFE, both parties should be prepared to  
5 discuss whether the loans were repaid and the tax implications of the loans and any subsequent  
6 repayment or cancellation of the loans. Appellants should be prepared to discuss why UFE did not file  
7 tax returns for tax years 2003 and 2004 and why there are no accounting records to provide in support of  
8 appellants' contentions.

9           The FTB should be prepared to clarify its argument that "it is unknown whether the  
10 deposits made into UFE's checking account were for expenditures related to UFE that should be  
11 capitalized and added to their adjusted basis or expenses for incidental repairs and maintenance that are  
12 not capital expenditures." (Resp. Additional Br., p. 2.) It appears to staff that the critical question in  
13 determining appellants' tax basis in their UFE stock is: did appellants transfer the funds as an  
14 investment or capital contribution to UFE, rather than as some other type of transfer? If appellants  
15 actually contributed funds to UFE (and the funds were actually held or used by UFE rather than being  
16 intermingled with personal expenses or expenses of other businesses), then it appears to staff that it is  
17 irrelevant whether UFE used the funds for current expenses (such as utility bills) or for capitalized  
18 expenditures such as the acquisition of property (such as a new store). Respondent should be prepared  
19 to discuss these issues and, if necessary, clarify its argument.

20           Appellants should state whether they are requesting abatement of the accuracy-related  
21 penalty. If so, they should be prepared to discuss whether there was reasonable cause for and whether  
22 they acted in good faith with respect to the underpayment of tax.

23           Appellants should state whether they are requesting abatement of the interest. If so, they  
24 should be prepared to discuss the statutory authority that entitles them to interest abatement. Appellants  
25 do not allege that the interest was attributable to any unreasonable error or delay by respondent that  
26 occurred after respondent contacted appellants in writing with respect to the deficiencies as required by  
27 R&TC section 19104. We also note that appellants have not alleged extreme financial hardship caused  
28 by "significant disability or other catastrophic circumstance" as required by R&TC section 19112 and

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have not alleged any reliance on any written advice requested of respondent as required by R&TC section 21012.

In the event appellants have any additional evidence to submit in support of their claimed cost basis in UFE, or their request for abatement of the accuracy-related penalty or abatement of interest, they should submit it to the Board and respondent at least 14 days prior to the hearing date.<sup>14</sup>

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<sup>14</sup> Exhibits should be submitted to Claudia Madrigal, Board Proceedings Division, Board of Equalization, P.O. Box 942879 MIC: 80, Sacramento, CA 94279-0080.