

1 Charles E. Potter, Jr.
2 Tax Counsel
3 Board of Equalization, Appeals Division
4 450 N Street, MIC: 85
5 PO Box 942879
6 Sacramento CA 95814
7 Tel: (916) 324-6592
8 Fax: (916) 324-2618

6 Attorney for the Appeals Division

9 **BOARD OF EQUALIZATION**
10 **STATE OF CALIFORNIA**

12 In the Matter of the Appeal of:) **HEARING SUMMARY²**
13) **PERSONAL INCOME TAX APPEAL**
14 **JON BRYANT ARTZ AND**) Case No. 464509
15 **WENDI A. ARTZ¹**) Adopted:
16 _____)

<u>Year</u>	<u>Proposed Tax</u>	<u>Post-Amnesty Penalty</u>
1999	\$5,494	\$1,041.84

18 Representing the Parties:

19 For Appellants: Lu Artz, P.A., E.A. and Jon Bryant Artz
20 For Respondent: Diane L. Ewing, Tax Counsel III

22 QUESTIONS: (1) Whether appellants have established error in respondent's proposed assessment,
23 which was based on federal adjustments to appellants' 1999 tax year;

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26 ¹ Appellants reside in the City of Los Angeles, Los Angeles County.

27 ² This appeal was originally scheduled for the September 22, 2009 hearing calendar, but due to a failure to respond to the
28 hearing notice, it was subsequently rescheduled to the October 6, 2009 nonappearance consent calendar. Appellants then requested to be placed back on the oral hearing calendar for the February 2010 hearing in Culver City, California.

1 (2) Whether the Board has jurisdiction over the post-amnesty penalty in the context of
2 this appeal.

3 HEARING SUMMARY

4 Background

5 Respondent received a copy of federal income tax changes (Revenue Agent's Report,
6 (RAR)) for the tax year 1999 from the Internal Revenue Service (IRS) dated December 28, 2005. The
7 RAR identified additional capital gain income of \$53,724 from appellants' sale of their personal
8 residence and disallowed deductions of \$8,589 for a total adjustment of \$62,313. These changes
9 increased appellants' federal taxable income to \$101,494, upon which the IRS assessed a federal
10 deficiency of \$12,890. Respondent indicates that appellants did not report these changes to respondent.
11 Accordingly, respondent adjusted appellants' California taxable income by the same amounts included in
12 the RAR and proposed an assessment of \$5,494. Respondent mailed a Notice of Proposed Assessment
13 (NPA) on October 10, 2007, which included additional tax, a post-amnesty penalty, and interest. On
14 November 13, 2007 and December 2, 2007, respondent received protest correspondence from
15 appellants. In reply, respondent sent a letter to appellants on December 26, 2007, requesting appellants
16 to submit documentation that the federal action was still open or that the IRS had revised its actions. On
17 January 4, 2008, respondent received a letter from appellants that an amended California return for 1999
18 had been filed. This amended return reported \$119,201 in federal adjusted gross income (AGI) and
19 \$118,664 in California AGI, \$87,057 in itemized deductions and \$31,607 in California taxable income.
20 Appellants reduced the gain from the sale of the personal residence to \$5,065. After reviewing the
21 amended return, respondent issued a Notice of Action (NOA) affirming the NPA stating that the
22 amended return was inconsistent with the earlier RAR issued by the IRS and proposing a post-amnesty
23 penalty once the tax deficiency assessment became final. This appeal followed.

24 Appellants' Contentions

25 Appellants contend that the home was purchased in Malibu, California in 1985 and was
26 used as a personal residence until July 1998, when it was rented out until September 1999 (the Malibu
27 Home). Appellants indicate that the Malibu Home was sold in September 1999, and that capital gain on
28 the sale, as originally calculated by the IRS, was \$80,303. Appellants state that the IRS conceded some

1 improvement expenses prior to an appeal which appellants were seeking with the U.S. Tax Court.
2 Appellants claim that they incurred expenses of \$75,000 or more in home improvements while they
3 owned the Malibu Home. Appellants admit they have no documentation of these expenses as there were
4 no permits or plans and that they did not know it was necessary to keep documentation regarding home
5 improvements. Appellants therefore contend that respondents' assessment was overstated by not taking
6 into account the additional home improvement costs.

7 In a letter dated November 3, 2009, to this Board with a copy to respondent, appellants
8 provided declarations from three individuals made under penalty of perjury (the Declarations). Mel
9 Profit declared that appellants made numerous improvements, but did not provide a dollar amount
10 estimate. Jack Pritchett declared that he has been a real estate agent in Malibu for 36 years and actually
11 sold appellants' Malibu House in 1999. Mr. Pritchett states that appellants made numerous
12 improvements (master bedroom expansion, substantial landscaping, installed skylights, refurbished the
13 wood floors). Mr. Pritchett states that the Malibu House seemed new and fresh when his company listed
14 it for sale and estimated the total improvements would have cost somewhere in the range of \$90,000 to
15 \$120,000.³ Finally, Terry Adamson stated that she has lived in the area of the Malibu House for over 24
16 years and personally knows appellants and is familiar with the Malibu House. Ms. Adamson confirmed
17 the various improvements identified by Mr. Pritchett, but also stated that appellants completely
18 remodeled the kitchen as well.

19 With respect to the post-amnesty penalty, appellants have not raised any specific
20 arguments, but asserted in their original appeal letter that they were appealing all amounts shown on
21 respondent's NOA. Respondent appears to have interpreted appellants' broad statement to mean that
22 appellants were appealing the application of the post-amnesty penalty to the Board.

23 Respondent's Contentions

24 Respondent claims that appellants have presented no evidence to respondent that the IRS
25 subsequently revised its original RAR dated December 28, 2005. Respondent states that appellants'
26 amended return conflicts with the RAR provided by the IRS, and that since no additional evidence, other
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28 ³ Board staff notes that Mr. Pritchett did not provide individualized estimates on the specific improvements he listed.

1 than an amended return has been provided, appellants have not satisfied their burden of proof that the
2 IRS's original RAR was incorrect.⁴ Respondent indicates that the only mention of claimed home
3 improvement costs have already been taken into account by the IRS in its original RAR. According to
4 respondent, the Counsel Settlement Memorandum and Transmittal (Settlement Memorandum), attached
5 to the RAR (which was provided to respondent by the IRS) indicates that of the original \$83,724 in
6 capital gains related to the Malibu Home identified by the IRS, the IRS allowed \$30,000 in home
7 improvement costs. According to the Settlement Memorandum, IRS counsel stated that appellants
8 originally sought \$122,500 in improvements, but were only able to substantiate a portion of them. IRS
9 counsel recommended, based on the hazards of litigation, a partial (24.5 percent) concession of the
10 \$122,500 in improvements, which resulted in an allowance of \$30,000 in improvements. Based on the
11 Settlement Memorandum, respondent reasons that the remaining \$53,724 reported in the RAR already
12 included \$30,000 in home improvement costs allowed by the IRS.

13 Respondent states that in order to confirm that the IRS had not subsequently revised
14 appellants' federal adjustments for 1999, respondent requested and obtained a copy of appellants' 1999
15 Individual Master File transcript (IMF) from the IRS. Respondent states that the IMF as of
16 December 16, 2008, shows that the IRS had not revised appellants' 1999 account since the December
17 2005 settlement was signed and the RAR issued. The taxable income amount of \$101,494 and
18 deficiency amount of \$12,890 on the IMF are identical to the amounts on the RAR previously issued.
19 Respondent indicates the IMF also shows that the federal action is final and subsequent entries show
20 both the examination and litigation have closed. Respondent's position appears to be that whatever
21 settlement the taxpayer may have worked out with the IRS, if any, prior to appealing the RAR to the
22 U.S. Tax Court, the IRS ultimately assessed appellants \$53,724 in additional capital gains and \$8,589 in
23 disallowed expenses. Respondent contends that it has merely followed the IRS's recalculation of capital
24 gains and disallowed expenses as reported by the IRS on the original RAR.

25 Respondent contends that the post-amnesty penalty amount shown on the NOA is an
26 estimated amount, is not part of the deficiency amount and will be recomputed and imposed if and when
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⁴ Since the briefing period was closed at the time appellants forwarded the Declarations to the Board in November 2009, respondent has not had an opportunity yet to respond to the Declarations.

1 the proposed deficiency assessment becomes a final assessment and the final deficiency amount exceeds
2 any prepayments made before the end of the amnesty period. (*See* Rev. & Tax. Code, § 19777.5, subds.
3 (a) and (d).) Since the proposed deficiency before the Board has not yet become final, the Board does
4 not have jurisdiction to consider the post-amnesty penalty in the context of this appeal. Respondent
5 contends that once the post-amnesty penalty is assessed as final and has been paid, a taxpayer may then
6 file a limited refund claim if the penalty was not properly computed by respondent. (Rev. & Tax. Code,
7 § 19777.5, subd. (e)(1) and (2).)

8 Applicable Law

9 Revenue and Taxation Code (RTC) section 18622, subdivision (a) provides that when the
10 IRS makes a change or correction to a taxpayer's federal account that results in an increase in the amount
11 of state tax payable, the taxpayer must either concede the accuracy of the federal determination or state
12 wherein the federal change is erroneous. A state deficiency assessment that is based on a federal report
13 is presumptively correct and the taxpayer bears the burden of proving error. (*Appeal of Sheldon I. and*
14 *Helen E. Brockett*, 86-SBE-109, June 18, 1986.) Absent uncontradicted, credible, competent and
15 relevant evidence showing that respondent's determinations are incorrect, respondent's proposed
16 assessment must be upheld. (*Appeal of Oscar D. and Agatha E. Seltzer*, 80-SBE-154, Nov. 18, 1980.)

17 In 2004, California enacted an amnesty program administered by respondent for taxable
18 years prior to January 1, 2003. Taxpayers that did not participate in amnesty were subject to amnesty
19 penalties with respect to any new and existing penalties for amnesty-eligible years. The post-amnesty
20 penalty is imposed on amounts that become due and payable after the amnesty period (which ended
21 March 31, 2005) and is equal to 50 percent of the interest computed under R&TC section 19101 on the
22 tax underpayment for the period beginning on the last date prescribed by law for the payment of the tax
23 and ending on March 31, 2005.

24 Due to the application of subdivisions (d) and (e) of R&TC section 19777.5, the Board
25 only has jurisdiction to review respondent's imposition of the post-amnesty penalty in a single
26 circumstance: where a taxpayer paid the post-amnesty penalty, then filed a refund claim asserting that
27 the amount of the penalty was improperly calculated.

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1 STAFF COMMENTS

2 *The Tax Deficiency*

3 It appears that appellants believe respondent has underestimated appellants' basis in the
4 Malibu Home, by failing to allow for additional home improvement costs. Appellants believe this
5 resulted in an erroneous assessment by respondent. However, respondent appears to be relying solely on
6 additional taxable gain amounts as calculated and provided by the IRS in appellants' federal account.
7 Respondent has not re-audited appellants to independently determine what appellants basis in the
8 Malibu Home was at the time of sale. It appears respondent attempted to understand the IRS's
9 conclusions (reasoning that \$83,724 in capital gains identified by the IRS at audit was ultimately
10 reduced by an allowed amount of \$30,000 in home improvement costs) which resulted in the final
11 federal capital gains income of \$53,724. Whatever additional give-and-take that may have occurred in a
12 purported pre-trial settlement between appellants and the IRS with respect to the entire 1999 federal
13 return, according to the IMF provided by respondent, it appears to Board staff that an additional amount
14 of capital gains of \$53,724 and disallowed expenses of \$8,589 occurred at the federal level. Appellants
15 have not provided any evidence that the IRS's deficiency was reduced, but instead argue that the
16 California deficiency should be reduced based on facts that were not audited by respondent.

17 Therefore, since the IRS's determination that respondent relied on is presumptively
18 correct, appellants should be prepared at the oral hearing to demonstrate that the IRS's determination
19 was subsequently reduced or is incorrect. In addition to the Declarations already provided (which Board
20 staff presumes may represent new evidence of the incorrectness of the federal determination), appellants
21 should provide as an exhibit for the oral hearing a detailed list of each claimed improvement that
22 includes information as to the contractors utilized, estimated cost of materials and third-party labor costs
23 at least 14 days prior to the hearing date.⁵ In addition, once respondent has had an opportunity to review
24 the Declarations, respondent should be prepared at the oral hearing to discuss the probative value of the
25 Declarations. Finally, it may be worthwhile for appellants to explain at the oral hearing whether the
26 information provided in the Declarations was provided to the IRS earlier, and if not, then why appellants
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28 ⁵ This exhibit should be sent to Claudia Madrigal, Board Proceedings Division, Board of Equalization. P. O. Box 942879
MIC: 80, Sacramento, CA 94279-0080. (See Cal. Code Regs., tit. 18 § 5523.6, subd. (b).)

1 failed to do so.

2 *The Post-amnesty Penalty*

3 Appellants have not paid the post-amnesty penalty and are protesting a deficiency related
4 NOA, rather than appealing a denial of a refund claim. Since no refund is at issue in this appeal, at the
5 oral hearing, appellants should be prepared to explain why the Board has jurisdiction over the
6 application of the post-amnesty penalty in the context of this deficiency appeal.

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