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7 **BOARD OF EQUALIZATION**

8 **STATE OF CALIFORNIA**

9
10 In the Matter of the Appeal of:) **HEARING SUMMARY**
11) **PERSONAL INCOME TAX APPEAL²**
12 **RICHARD J. EPPING AND**) Case No. 483846
13 **LISA R. EPPING¹**)
14 _____)

15 Year
16 1998

Proposed
Assessment
\$3,174.47

17
18 Representing the Parties:

19 For Appellants: Kenneth Yu, Taxpayer Appeals Assistance Program³

20 For Franchise Tax Board: Anne Mazur, Specialist

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24 ¹ Appellants reside in Orange County, California.

25 ² This appeal was postponed from the February 23, 2010, hearing calendar and rescheduled to the June 15, 2010, hearing
26 calendar to allow appellant's CPA to attend the oral hearing.

27 ³ Appellants submitted their own appeal letter. Kenneth Yu, from the Tax Appeals Assistance Program (TAAP), submitted
28 appellant's Reply Brief. David Rankin, submitted appellants' supplemental reply brief and is listed as the TAAP
representative at the time of this hearing summary.

- 1 QUESTIONS: (1) Whether appellants have met their burden of proof to establish that respondent's
2 NPA for tax year 1998, based on federal audit adjustments, was in error.
3 (2) Whether respondent has abused its discretion in its determination to deny
4 appellant's request for abatement of interest.
5 (3) Whether the Board has jurisdiction to review the FTB's proposed assessment of
6 the post-amnesty penalty and, if so, whether the post-amnesty penalty is
7 unconstitutional.

8 HEARING SUMMARY

9 Background

10 Appellants timely filed a 1998 tax return that reported taxable income of \$107,139 and
11 total tax of \$6,273, which they paid. Subsequently, on February 8, 2006, respondent received a report of
12 an audit of appellants' 1998 and 1999 federal tax returns (RAR) from the Internal Revenue Service
13 (IRS). The RAR showed that the IRS increased taxable income for "Sch-E1-Passive Loss" in the
14 amount of \$27,456 for the 1998 tax year. Based on the RAR, respondent issued a NPA for 1998 which
15 proposed an assessment of additional tax in the amount of \$2,553, plus applicable interest. (Resp.
16 Opening Br., pp. 1-2.).

17 Appellants filed a timely protest dated September 7, 2006, stating that they had not
18 received the most recent RAR. Respondent requested appellants' Individual Master File (IMF) for 1998
19 from the IRS and received the RAR on September 22, 2006. By letter dated April 27, 2007, respondent
20 explained its position on the proposed assessment to appellants and asked appellants whether they still
21 wanted a protest hearing. On May 29, 2007, respondent received appellants' request for a hearing.
22 Respondent again requested appellants' federal account information on July 9, 2007, and received it on
23 July 30, 2007. (Resp. Opening Br., p.2.)

24 At the protest hearing held on October 17, 2007, appellants said that they did not
25 remember the federal audit and did not have a copy of the RAR. Appellants also stated that their
26 accountant believed the losses were disallowed due to income limitations. Appellants provided a copy
27 of their 1998 federal return which showed a loss of \$27,456 for "rental real estate, royalties,
28 partnerships, S corporations, trusts, etc." On an attached Schedule E, appellants claimed losses for two

1 rental properties in the amounts of \$13,137 and \$14,319. On the California Schedule CA for 1998,
2 appellants did not make any adjustment to the losses claimed for the properties on the Schedule E.
3 Appellants stated that they sold one of the properties in 1998, but had not reported a capital gain on the
4 sale because they treated that property as a principal residence. Appellants also questioned respondent's
5 reasons for not reducing the proposed assessment for 1998 by the amount of the reduction in tax for
6 1999, consistent with the IRS's action. (Resp. Opening Br., p.2.)

7 Respondent requested copies of the IMF, RAR and appellants' return from the IRS on
8 September 19, 2007, and requested appellants' federal audit file on February 4, 2008. The IRS
9 responded on March 12, 2008, informing respondent that copies of the RAR and return were no longer
10 available and on May 21, 2008, informing respondent that the audit file was no longer available. By
11 letter dated July 28, 2008, appellants requested interest abatement for the period from April 15, 1999, to
12 the date the NPA was mailed on July 10, 2006, from the date of appellants' protest on September 7,
13 2006, to the protest hearing on October 17, 2007, and from hearing date to June 20, 2008, the date of
14 respondent's letter to appellants informing them of respondent's position on their protest. By letter
15 dated September 16, 2008, respondent notified appellants of its determination to deny the abatement
16 request. On February 5, 2009, respondent issued a Notice of Action (NOA) that affirmed the NPA and
17 included the denial of the request for interest abatement. This timely appeal followed. (Resp. Opening
18 Br., p. 3.)

19 **Issue 1. Whether appellants have met their burden of proof to establish that respondent's NPA,**
20 **based on federal audit adjustments, was in error**

21 Contentions

22 Appellants' Contentions

23 In the appeal letter, appellants state that 1998 was "an extraordinary year of having
24 higher than normal income and two rental properties (1 of which were (sic) sold that year)." Appellants
25 contend that the IRS "realized" that the 1998 federal return was in error and made an adjustment to both
26 the 1998 and 1999 returns on April 3, 1991.⁴ Appellants assert that that there was "no change to the
27

28 ⁴ It appears that appellants meant 2001 and not 1991.

1 original 1998 & 1999 tax return refunds/payments” and that “the IRS adjusted for partial rental loss and
2 ‘rightfully’ carryover to 1999 (where the partial rental loss should have been), but no additional tax was
3 paid.” Appellants further assert that even though there was an offset for the rental loss limitation (with
4 the sale of one property accounting for a partial rental loss), the total rental loss should have been
5 allocated to 1998 and 1999 because of the limitation. Appellants state that, in the opinion of their
6 certified public accountant, the losses claimed “would have been a wash by taking the rental loss related
7 to the disposal of the asset and carryover the other rental loss in 1999 based on IRC [section] 469
8 limits.” (Appeal letter, pp. 1-2.)

9 In their reply brief, appellants state that in 2001 the IRS made a retroactive adjustment to
10 their federal 1998 and 1999 returns by increasing their taxable income for the claimed 1998 passive loss
11 in the amount of \$27,456 and by decreasing their taxable income for 1999. Appellants further state that
12 the IRS assessed a liability of \$8,445 from which the IRS deducted \$4,000 for 1998 for the disposed
13 property and deducted \$3,066 as a carryover for 1999. Appellants paid the deficiency amount of
14 \$2,338.39. (App. Reply Br., p.1.)

15 Appellants do not contest the accuracy of the federal audit adjustments but they contend
16 that the 1998 NPA is in error because it does not account for the adjustment decreases made by the IRS
17 for 1998 and 1999. Appellants contend that the NPA reflected only appellants’ adjusted income for
18 1998 and does not consider the valid deductions already made by the IRS. Appellants contend that the
19 doctrine of equitable estoppel requires that an overpayment in a later year should apply to a deficiency
20 in an earlier year so that appellants’ 1998 deficiency should be offset against appellants’ 1999
21 overpayment. Appellants also contend that the duty of consistency and the interests of equity require
22 respondent to make adjustments to the NPA consistent with the adjustments made by the IRS. In this
23 regard, appellants contend that respondent is entitled to two deductions similar to the federal deductions
24 which would reduce appellants’ state tax deficiency for 1998 to \$417.00 (plus applicable interest) and a
25 post-amnesty penalty of \$101.00, for a total deficiency amount of \$1,940.39. (App. Reply Br., pp. 1-2.)

26 In their supplemental brief, appellants argue that the \$4,000 and \$3,066 that the IRS
27 allowed as deductions were suspended passive activity losses which appellants are entitled to deduct as
28 passive loss carryovers of approximately \$1,209 and \$927 against the proposed assessments for 1998

1 and of 1999, respectively. Appellants also argue that the post-amnesty penalty is unconstitutional and
2 invalid as a retroactive levy. However, appellants state that they raise this issue to preserve their
3 “rights” and concede that the Board lacks jurisdictional authority to declare the post-amnesty penalty to
4 be invalid. (App. Supp. Br., pp. 1-2.)

5 Respondent’s Contentions

6 Respondent contends that the NPA was issued timely based on the federal adjustments
7 pursuant to Revenue and Taxation Code (R&TC) section 19060, subdivision (b) which provides in
8 relevant part that an NPA may be issued up to four years from the date the taxpayer or the IRS notifies
9 respondent of a federal change or correction. Respondent contends that the IRS made a final federal
10 determination on June 11, 2001, and under R&TC section 18622, appellants were required to report the
11 federal changes to respondent by December 11, 2001, but failed to do so. Respondent states that the IRS
12 subsequently provided respondent with a copy of the RAR on February 8, 2006, more than six months
13 after the final federal determination and in accordance with R&TC section 19060, subdivision (b), the
14 NPA was mailed on July 10, 2006, within four years of February 8, 2006. (Resp. Opening Br., pp. 4-5.)

15 Respondent further contends that the NPA based on the federal audit adjustments is
16 presumptively correct and appellants have not met their burden of proving it was in error. Respondent
17 states that appellants initially asserted they were unaware of the federal adjustments and did not pay
18 additional tax but the RAR is signed and dated by appellants, which indicates they agreed to those
19 adjustments. In addition, respondent states that appellants’ federal account transcript shows a payment
20 made shortly after the final federal determination. Because appellants have not shown error in the
21 federal adjustment, respondent contends that the \$27,456 increase to appellants’ 1998 California taxable
22 income was proper. (Resp. Opening Br., pp. 5-6.)

23 Respondent states that, while appellants’ argument regarding the IRS adjustments is
24 unclear, appellants apparently acknowledge their reporting on the federal and California returns was in
25 error and corrections were not made in a timely manner. Respondent explains that California law
26 conforms to relevant portions of IRC section 469 relating to passive activity losses (PALs) and IRC
27 section 469 allows for the deduction of up to \$25,000 in PALs from rental properties, which is phased
28 out at 50 percent of each dollar by which the taxpayer’s modified adjusted gross income (AGI) exceeds

1 \$100,000. Although respondent was unable to obtain the IRS workpapers for appellants' audit, it
2 appears to respondent the IRS determined that appellants were not entitled to any of the claimed rental
3 loss for 1998 because their modified AGI exceeded \$150,000. On this basis, respondent asserts that the
4 IRS properly increased appellants' taxable income by the amount of the claimed loss from the rental
5 activities reported on the original 1998 federal return. Because California law conforms to IRC section
6 469 in that respect, respondent states that it adjusted appellants' 1998 California taxable income
7 consistent with the IRS adjustments. (Resp. Opening Br., pp. 6-7.)

8 Respondent contends appellants have not shown that the doctrine of equitable estoppel
9 should apply to allow the offset of the 1998 deficiency by an alleged overpayment for 1999.
10 Respondent explains that the government may be estopped from asserting a tax liability against a
11 taxpayer when the government took action upon which the taxpayer relied to his or her detriment.
12 However, respondent asserts that the doctrine may be invoked only when all of the elements of estoppel
13 are present and appellants have made no showing that any of the elements was satisfied.

14 Instead of equitable estoppel, respondent conjectures that appellants intended to argue
15 that the doctrine of equitable recoupment should be applied. Respondent contends that theory of relief
16 fails as well because such an equitable remedy is applicable only when no legal remedy is available and
17 appellants clearly had a legal remedy which they failed to utilize. In that regard, respondent states that
18 appellants failed to timely notify respondent of the federal changes before the statute of limitations for
19 applying such an overpayment expired. Respondent further asserts that appellants' duty of consistency
20 argument also fails because that duty applies only to prevent a taxpayer, and not the government, from
21 changing the treatment of the taxpayer's representations or reporting for tax purposes. (Resp. Reply Br.,
22 pp. 2-3.)

23 Applicable Law

24 Burden of Proof

25 R&TC section 18622 provides that a taxpayer shall either concede the accuracy of a
26 federal determination or state wherein it is erroneous. It is well-settled that a deficiency assessment
27 based on a federal audit report is presumptively correct and the taxpayer bears the burden of proving
28 that the determination is erroneous. (*Appeal of Sheldon I. and Helen E. Brockett*, 86-SBE-109, June 18,

1 1986; *Todd v. McColgan* (1949) 89 Cal.App.2d 509.) Unsupported assertions are not sufficient to
2 satisfy appellants' burden of proof with respect to an assessment based on federal action. (*Appeal of*
3 *Aaron and Eloise Magidow*, 82-SBE-274, Nov. 17, 1982.) In the absence of uncontradicted, credible,
4 competent, and relevant evidence showing that respondent's determinations are incorrect, they must be
5 upheld. (*Appeal of Oscar D. and Agatha E. Seltzer*, 80-SBE-154, Nov. 18, 1980.)

6 Jurisdictional Authority of Board

7 R&TC section 19045 provides that a taxpayer may appeal respondent's action on a
8 protest to this Board. Rule for Tax Appeals (Cal. Code Regs., tit. 18) (RTA) section 5412,
9 subdivision (a)(1) provides that the Board may hear and decide an appeal when "the Franchise Tax
10 Board mails a *Notice of Action* on a proposed deficiency assessment of additional tax, which may also
11 include penalties, fees and interest." Subdivision (b) of RTA section 5412 further specifies that "[t]he
12 Board's jurisdiction is limited to determining the correct amount owed by, or due to, the appellant for
13 the year or years at issue in the appeal."

14 Statute of Limitations on Assessments

15 The statute of limitations on respondent's issuance of a proposed assessment based on
16 federal changes depends on when, or if, it is notified of the federal changes. In general, respondent
17 must issue a proposed assessment within four years of the date the taxpayer filed his or her California
18 return. (Rev. & Tax. Code, § 19057.) Regardless of the general rule, if there are federal changes, and
19 the taxpayer or the IRS notifies respondent within six months of the date the federal changes became
20 final, then respondent must issue a proposed assessment within two years of the date of notification,
21 or within the general four-year period, whichever expires later. (Rev. & Tax. Code, § 19059.) If the
22 taxpayer or the IRS notifies respondent beyond six months from the date the federal changes become
23 final, then respondent must issue a proposed assessment within four years of the date of notification.
24 (Rev. & Tax. Code, § 19060, subd. (b).) The California Supreme Court clarified the specific
25 limitations periods set forth in R&TC section 19060 override the general limitations period set forth
26 in section 19057. (*Ordlock v. Franchise Tax Board* (2006) 38 Cal.4th 897.)

27 Statute of Limitations on Refunds or Credits

28 With respect to federal adjustments that result in a credit or refund, a claim for such

1 credit or refund may be filed within two years from the date of the final federal determination as
2 defined in R&TC section 18622 or within the period provided in R&TC section 19306, 19307, 19308
3 or 19316, whichever period expires later. (Rev. & Tax. Code, § 19311, subd. (a).) Similarly,
4 respondent is authorized to allow a credit, make a refund or mail a notice of proposed overpayment
5 resulting from a final federal determination within the later of (1) two years from the date of the final
6 federal determination or (2) within the period provided in R&TC section 19306, 19307, 19308 or
7 19316. (Rev. & Tax. Code, § 19311, subd. (b).)

8 The applicable statutory provision here is R&TC section 19306, subdivision (a), which
9 provides that the limitation period is

10 “four years from the date the return was filed (if filed within the time prescribed by
11 Section 18567 or 18604, whichever is applicable), four years from the last day prescribed
12 for filing the return (determined without regard to any extension of time for filing the
13 return), or after one year from the date of the overpayment, whichever period expires
14 later . . .”

15 Doctrine of Equitable Estoppel

16 Equitable estoppel is applied against the government only in rare and unusual
17 circumstances, when all of its elements are present, and its application is necessary to prevent manifest
18 injustice. (See *Appeal of Richard R. and Diane K. Smith*, 91-SBE-005, Oct. 9, 1991.) The four
19 elements of equitable estoppel are: (1) the government agency must be shown to have been aware of the
20 actual facts; (2) the government agency must be shown to have made an incorrect or inaccurate
21 representation to the relying party and intended that its incorrect or inaccurate representation would be
22 acted upon by the relying party or have acted in such a way that the relying party had a right to believe
23 that the representation was so intended; (3) the relying party must be shown to have been ignorant of the
24 actual facts; and (4) the relying party must be shown to have detrimentally relied upon the
25 representations or conduct of the government agency. (*Appeal of Western Colorprint*, 78-SBE-071,
26 Aug. 15, 1978.) Where one of these elements is missing, there can be no estoppel. (*Hersch v. Citizens*
27 *Savings & Loan Assn.* (1983) 146 Cal.App.3d 1002, 1011.) The burden of proving estoppel is on the
28 party asserting estoppel. (*Appeal of Priscilla L. Campbell*, 79-SBE-035, Feb. 8, 1979.)

1 Doctrine of Equitable Recoupment

2 The application of the doctrine of equitable recoupment has been limited to situations
3 wherein a fund of money arising from a single transaction or taxable event has been subjected to tax
4 twice on inconsistent legal theories. In such event, what was mistakenly paid may be recouped against
5 what is correctly due. (*Bull v. United States* (1935)295 U.S. 247, 261; *Stone v. White* (1937) 301 U.S.
6 532; *Rothensies v. Electric Storage Battery Co.* (1946) 329 U.S. 296, 300; *Appeal of Estate of Zebulon*
7 *P. Owings, Deceased, and Mabel J. Owings*, 75-SBE- 008, Jan. 7, 1975.) Further, an underlying
8 inquiry in determining the applicability of the doctrine in favor of the taxpayer is whether the
9 government received monies which in equity and good conscience belong to the taxpayer. (*Bull v.*
10 *United States*, supra at 260; *Boyle v. United States* (3d Cir. 1965) 355 F.2d 233.) However, equitable
11 recoupment is to be applied narrowly so as not to seriously undermine the statute of limitations in tax
12 matters. (*Rothensies v. Electric Storage Battery Co.*, supra at 303.) The Board has determined that it
13 has the authority to apply the doctrine in an appropriate situation. (*Appeals of Wilford and Gertrude*
14 *Winkenbach, et al.*, 75-SBE-081, Dec. 16, 1975.)

15 The doctrine of equitable recoupment is only applicable where “a single transaction
16 constitute[s] the taxable event claimed upon and the one considered in recoupment.” (*Rothensies v.*
17 *Electric Storage Battery Co.*, supra, 329 U.S. at 299; see also *O'Brien v. United States* (7th Cir. 1985)
18 766 F.2d 1038.) A threshold requirement of the doctrine is that it may not be used “to revive an
19 untimely affirmative refund claim, as opposed to offset[ting] a timely government claim of deficiency
20 with a barred claim of the taxpayer.” (*O'Brien v. United States*, supra, 766 F.2d at 1049.) In the *Appeal*
21 *of Frank and Elsie M. Bartlett* (74-SBE-019), decided on May 15, 1974, appellants argued that this
22 Board should apply the doctrine to compel respondent to offset a tax overpayment made in 1963
23 against a 1969 deficiency when the statute of limitations for filing a claim for refund expired. There,
24 the Board held that the doctrine was inapplicable because “the items of income were not derived from a
25 single transaction” in that “the declaration and payment of dividends for each year constituted a single
26 and separate transaction” and “the tax was applied on the basis of income received in each taxable
27 year.”

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1 Duty of Consistency

2 The duty of consistency was discussed by the Ninth Circuit Court of Appeal in *Ashman v.*
3 *Comm'r* as follows:

4 While it is true that income taxes are intended to be settled and paid annually each year
5 standing to itself, and that omissions, mistakes and frauds are generally to be rectified as
6 of the year they occurred, this and other courts have recognized that a taxpayer may not,
7 after taking a position in one year to his advantage and after correction for that year is
8 barred, shift to a contrary position touching the same fact or transaction. When such a
9 fact or transaction is projected in its tax consequences into another year there is a duty of
10 consistency on both the taxpayer and the Commissioner with regard to it, whether or not
11 there be present all the technical elements of an estoppel.

12 (*Ashman v. Comm'r* (9th Cir. 2000) 231 F. 3d 541, 543.)

13 In *Ashman*, the Ninth Circuit identified the following three elements for meeting the duty
14 of consistency:

15 (1) A representation or report by the taxpayer; (2) on which the Commissioner has relied;
16 and (3) an attempt by the taxpayer after the statute of limitations has run to change the
17 previous representation or to recharacterize the situation in such a way as to harm the
18 Commissioner. If this test is met, the Commissioner may act as if the previous
19 representation, on which he relied, continued to be true, even if it is not. The taxpayer is
20 estopped to assert the contrary.

21 (*Ashman* at 546)

22 STAFF COMMENTS

23 Although respondent raises the issue, appellants have not contested the timeliness of the
24 NPA; staff notes that the NPA was issued timely. Additionally, appellants concede the accuracy of the
25 federal audit adjustments for 1998 but they take the position the 1998 NPA is in error because it does
26 not account for the adjustment decreases made by the IRS for 1998 and 1999. Specifically, appellants
27 assert that the IRS made a deduction of \$4,000 for 1998 for the disposed property and made a deduction
28 of \$3,066 as a carryover for 1999. With respect to the claimed \$4,000 deduction for 1998, there is no
such adjustment on the RAR but the IRS account transcript for 1998 shows a payment of \$4,000 for an
item titled "advance payment of tax owed". Staff believes that appellants may be characterizing this
amount as the "federal deduction" for which a 1998 California adjustment should be made. At the
hearing, appellants should be prepared to present evidence that this item is a federal deduction entitling
them to a corresponding California deduction that reduces appellants' 1998 California income tax

1 liability.

2 Appellants also contend that respondent failed to consider the federal adjustment, i.e. the
3 loss carryover from 1998 that resulted in an overpayment for 1999. However, appellants appear to
4 misunderstand that each tax year is treated separately so that an overpayment occurring in 1999 may not
5 be applied to offset a liability for 1998 unless applicable statutory procedures for crediting such
6 overpayment are followed. Thus, even though appellants contend that the 1998 NPA is erroneous, it
7 appears that the threshold issue presented is whether the Board has jurisdiction to hear and decide
8 appellants' request for a refund or credit for tax year 1999 when respondent has not taken any action for
9 that year which appellants may appeal.

10 In this regard, it appears that, pursuant to R&TC section 19045 and RTA section 5412,
11 the Board does not have jurisdiction to consider the correct tax liability for tax year 1999, as respondent
12 did not issue a NOA for that year. In addition, with respect to any overpayment for 1999 resulting from
13 the federal adjustment for that year, it is clear that R&TC section 19311 contemplates that for that year
14 appellants must have filed a claim for refund or credit or respondent must have issued a notice of
15 overpayment within the prescribed periods of limitation. Here, there is no evidence that either a claim
16 was filed or a notice was issued within those limitations periods. Thus, the failure to comply with those
17 deadlines would appear to preclude the allowance of a credit or refund for tax year 1999.

18 At the hearing, appellants should be prepared to explain why the statute of limitations
19 provided by R&TC section 19311 does not bar their claim for an offset of the proposed assessment for
20 1998 by the alleged overpayment for 1999.

21 Appellants have only made a bare assertion that the doctrine of equitable estoppel is
22 applicable. At the hearing, appellants should be prepared to elaborate on their argument for some form
23 of equitable relief and to provide supporting case law or other authority applying that form of equitable
24 relief to facts similar to those presented here. With respect to appellants' contention that respondent had
25 a duty of consistency, appellants should be prepared to elaborate on the meaning of that duty and to
26 provide supporting authority for applying it to actions taken by a governmental agency.

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1 **Issue 2. Whether appellants have shown that respondent abused its discretion by denying**
2 **appellants' request for abatement of interest.**

3 Contentions

4 Appellants' Contentions

5 In the appeal letter, appellants do not directly contest the imposition of accrued interest
6 but they present a chronological activity summary of the following periods.

- 7 • The period from 1999 to 2006, during which they state that they received “no letters on
8 information from IRS or FTB”.
- 9 • The period from 2006 to 2007 which they describe as a one year period from the submission of
10 their protest letter until the protest hearing date.
- 11 • The period from 2007 to 2008 which they describe as an eight month period during which
12 respondent requested information from the IRS and apparently provided a written record of the
13 protest hearing.

14 (Appeal Letter, p.2.)

15 In the reply brief, however, appellants appear not to question the imposition of accrued interest. They
16 argue only that the additional tax liability for 1998 should be reduced to “\$417.00 plus applicable
17 interest, plus the post-amnesty penalty of \$101.00.” (App. Reply Br., p.2.)

18 Respondent's Contentions

19 Respondent contends that appellants have not met the statutory requirements that allow
20 abatement of interest and this Board has authority to decide only whether respondent's determination not
21 to abate interest was an “abuse of discretion”. Respondent contends appellants have not met their
22 burden of proving by clear and convincing evidence that respondent abused its discretion. (Resp.
23 Opening Br., p. 7.)

24 According to respondent, appellants contend that interest should be abated based on (1)
25 the long period of time from the filing of the original return until the issuance of the NPA based on the
26 federal determination and (2) the length of the period from the filing of the protest until the protest
27 hearing and thereafter until appellants received respondent's first letter stating respondent's position.
28 With respect to the first period, respondent contends that R&TC section 19104, subdivision (b) provides

1 that interest may not be abated prior to the date of the first written contact by respondent concerning the
2 deficiency. Thus, any interest that accrued prior to the issuance of the NPA may not be abated.

3 With respect to the second period, respondent contends that interest may only be abated
4 for error or delay that is attributable to a ministerial or managerial act by respondent. Respondent
5 contends that there was no unreasonable error or delay in the performance of a ministerial or managerial
6 act during the period of approximately 13 months from the receipt of appellants' protest to the date of
7 the protest hearing. Respondent notes that during this period there were requests for information from
8 the IRS, correspondence between appellants and respondent, the transfer and assignment of appellants'
9 protest and the protest hearing itself. Respondent contends that any delay attributable to prioritizing and
10 organizing workloads are not acts for which interest may be abated and there is no evidence to suggest
11 that appellants' file was lost or misplaced.

12 Finally, respondent contends that there was no unreasonable error or delay by respondent
13 after the protest hearing when respondent was attempting to obtain additional information regarding the
14 federal audit from the IRS. Respondent further contends that the time spent during the protest
15 determining facts and applying the law is a discretionary act and not either a ministerial act or a
16 managerial act. Respondent further contends that the length of the period from the federal audit
17 determination until the issuance of the NPA was attributable to appellants because they failed to notify
18 respondent about the federal audit results for the 1998 year in 2001. .

19 Applicable Law

20 Interest

21 Interest is not a penalty but is merely compensation for the taxpayer's use of the money.
22 (Rev. & Tax. Code, § 19101, subd. (a); *Appeal of Amy M. Yamachi*, 77-SBE-095, June 28, 1977; *Appeal*
23 *of Audrey C. Jaegle*, 76-SBE-070, June 22, 1976.) In order to obtain interest abatement, appellant must
24 qualify under one of the following three statutes: R&TC sections 19104, 19112 or 21012. R&TC
25 section 21012 is not applicable because there has been no reliance on any written advice requested of
26 respondent. R&TC section 19112 requires a showing of extreme financial hardship caused by
27 significant disability or other catastrophic circumstance, which appellants have not alleged. Therefore,
28 appellants' request for interest abatement must be addressed under the provisions of R&TC section

1 19104.

2 Respondent may abate all or a part of any interest on a deficiency to the extent that
3 interest is attributable in whole or in part to any unreasonable error or delay committed by respondent in
4 the performance of a ministerial or managerial act. (Rev. & Tax. Code, § 19104, subd. (a)(1).) There is
5 no reasonable cause exception to the imposition of interest. (*Appeal of Audrey C. Jaegle, supra.*)
6 Further, an error or delay can only be considered when no significant aspect of the error or delay is
7 attributable to appellant and after respondent contacted appellant in writing with respect to the
8 deficiency or payment. (Rev. & Tax. Code, § 19104, subd. (b)(1).) Respondent’s first written contact
9 with appellant concerning the proposed deficiency assessment was on July 10, 2006.

10 In the *Appeal of Michael and Sonia Kishner*, 99-SBE-007, decided on September 29,
11 1999, this Board adopted the language from Treasury Regulation section 301.6404-2(b)(2), defining a
12 “ministerial act” as:

13 [A] procedural or mechanical act that does not involve the exercise of judgment or
14 discretion, and that occurs during the processing of a taxpayer’s case after all
15 prerequisites to the act, such as conferences and review by supervisors, have taken place.
16 A decision concerning the proper application of federal tax law (or other federal or state
17 law) is not a ministerial act.

18 This Board has not yet adopted a definition for the term “managerial act.” However,
19 when a California statute is substantially identical to a federal statute (such as with the interest
20 abatement statute in this case),⁵ we may consider federal law interpreting the federal statute as highly
21 persuasive. (*Appeal of Michael and Sonia Kishner, supra*, (citing *Douglas v. State of California* (1942)
22 48 Cal.App.2d 835.)) In this regard, Treasury Regulations section 301.6404-2(b)(1) defines a
23 “managerial act” as:

24 [A]n administrative act that occurs during the processing of a taxpayer’s case involving
25 the temporary or permanent loss of records or the exercise of judgment or discretion
26 relating to management of personnel. A decision concerning the proper application of
27 federal tax law (or other federal or state law) is not a managerial act.

28 Respondent’s determination not to abate interest is presumed correct, and the burden is
on appellant to prove error. (*Appeal of Michael E. Myers*, 2001-SBE-001, May 31, 2001.) This Board’s

⁵ Revenue and Taxation Code section 19104, subdivisions (a) and (b)(2)(B) are substantially identical to Internal Revenue Code section 6404 (e) and (h).

1 jurisdiction in an interest abatement case is limited by statute to a review of respondent's determination
2 for an abuse of discretion. (Rev. & Tax. Code, § 19104, subd. (b)(2)(B).) To show an abuse of
3 discretion, appellant must establish that, in refusing to abate interest, respondent exercised its discretion
4 arbitrarily, capriciously, or without sound basis in fact or law. (*Woodral v. Commissioner* (1999) 112
5 T.C. 19, 23.) Interest abatement provisions are not intended to be routinely used to avoid the payment of
6 interest, thus abatement should be ordered only "where failure to abate interest would be widely
7 perceived as grossly unfair." (*Lee v. Commissioner* (1999) 113 T.C. 145, 149.) The mere passage of
8 time does not establish error or delay that can be the basis of an abatement of interest. (*Id.* at p. 150.)

9 STAFF COMMENTS

10 As stated above, even though the NPA was issued approximately seven years after the
11 original 1998 return was filed, it was timely issued as provided by R&TC section 19060. Thus, any
12 interest that accrued during that period prior to the issuance of the NPA may not be abated because the
13 NPA was respondent's first written notification to appellants. Regarding the period after the issuance
14 of the NPA, the Appeals Division notes that respondent received the IMF from the IRS on September
15 22, 2006, but did not contact appellants concerning their request for a protest hearing until seven
16 months later on April 27, 2007. Secondly, the period from the protest hearing on October 17, 2007, to
17 the date of the NOA was almost 16 months. Respondent contends that there was no unreasonable
18 error or delay by respondent after the protest hearing because respondent was attempting to obtain
19 additional information regarding the federal audit from the IRS. Respondent further contends that the
20 time spent during the protest determining facts and applying the law is a discretionary act and not
21 either a ministerial act or a managerial act for which interest may be abated. At the hearing, both
22 parties should be prepared to discuss whether the seven-month period or the 16-month period
23 constituted unreasonable delay and, if so, whether that delay was attributable to the performance of a
24 managerial act.

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1 **Issue 3. Whether the Board has jurisdiction to review the FTB's proposed assessment of the**
2 **post-amnesty penalty and, if so, whether the post-amnesty penalty should not be applied because**
3 **it is unconstitutional.**

4 Contentions

5 Appellants' Contentions

6 In their supplemental brief, appellants argue that the post-amnesty penalty is
7 unconstitutional. According to appellants, the post-amnesty penalty violates their substantive due
8 process rights because it operates as a retroactive levy and violates their procedural due process rights by
9 denying them a prior post-payment right of review except for computational error. In addition,
10 appellants contend that R&TC section 19777.5 is void for vagueness. However, appellants state that
11 they raise this issue to preserve their "rights" and concede that the Board lacks jurisdictional authority to
12 declare the post-amnesty penalty to be invalid. (App. Supp. Br., pp. 1-2.)

13 Respondent's Contentions

14 Respondent does not discuss the post-amnesty penalty in its opening or reply brief. We
15 note that appellants raised the issue for the first time in their supplemental brief and Board staff stated in
16 its letter dated November 13, 2009, that briefing was completed upon the filing of appellants'
17 supplemental brief.

18 Applicable Law

19 Income Tax Amnesty Program

20 In 2004, the Legislature enacted Senate Bill 1100 (Stats. 2004, Ch. 226) adding Revenue
21 and Taxation Code (R&TC) sections 19730 through 19738, which set forth the provisions for the
22 income tax amnesty program whereby taxpayers who paid tax and interest liabilities were granted relief
23 from most penalties, including the penalty for late filing of the return. The tax amnesty program was
24 conducted during a two-month period from February 1, 2005, through March 31, 2005, inclusive and
25 applied to tax liabilities for taxable years beginning before January 1, 2003. (Rev. & Tax. Code,
26 § 19731.) R&TC section 19733, subdivision (a) provides, in relevant part, that the amnesty program
27 applied to any taxpayer under the following conditions:

- 28
- The taxpayer was eligible to participate and filed an application electing to participate in the

1 program during the period specified in R&TC section 19731.

- 2 • For any taxable year eligible for the tax amnesty program where the taxpayer filed a return but
3 underreported tax liability on that return, the taxpayer filed an amended return for that year
4 within 60 days after the conclusion of the tax amnesty period.

5 R&TC section 19777.5, subdivision (a), imposes the post-amnesty penalty for each
6 taxable year for which amnesty could have been requested. R&TC section 19777.5 generally provides
7 that the post-amnesty penalty will be imposed in an amount equal to 50 percent of interest accrued on
8 unpaid tax as of the last day of the amnesty period (March 31, 2005). The post-amnesty penalty is
9 imposed in addition to any other applicable penalties. Under the statutory provisions, respondent has no
10 discretion to determine whether the post-amnesty penalty should be imposed. In addition, the amnesty
11 provisions limit the Board's review of respondent's imposition of the post-amnesty penalty. Subdivision
12 (e)(2) of R&TC 19777.5 grants the Board jurisdiction to review respondent's imposition of the post-
13 amnesty penalty in a single circumstance: where a taxpayer paid the post-amnesty penalty and filed a
14 refund claim asserting that respondent failed to "properly compute" the amount of the penalty which
15 claim was denied by respondent.

16 STAFF COMMENTS

17 It does not appear to staff that this Board has jurisdiction to review whether respondent
18 properly imposed the post-amnesty penalty. At the hearing, both parties should be prepared to discuss
19 whether the Board has such jurisdiction. Appellants should be prepared to discuss whether they
20 participated in the amnesty program and, if not, the reasons for not participating. Furthermore,
21 appellants should be prepared to discuss why the post-amnesty penalty should not apply.

22 Subsection (c) of Article III, section 3.5 of the California Constitution precludes the
23 Board from refusing to enforce a California statute on the basis that federal law or federal regulations
24 prohibit the enforcement of the California statute, unless an appellate court has made a determination
25 that the enforcement of the statute is prohibited by federal law or federal regulations. In addition, the
26 Board has a well-established policy of abstention from deciding constitutional issues in appeals
27 involving proposed assessments of additional tax. (*Appeal of Aimor Corp.*, 83-SBE-221, Oct. 26, 1983.)
28 This policy is based upon the absence of any specific statutory authority that would allow the FTB to

1 obtain judicial review of a decision in such cases and the Board’s belief that judicial review should be
2 available for questions of constitutional importance. (*Appeals of Fred R. Dauberger, et al.*, 82-SBE-082,
3 March 31, 1982.) Moreover, the Board held in *Appeal of Walter R. Bailey*, 92-SBE-001 (February 20,
4 1992) that “due process is satisfied with respect to tax matters so long as an opportunity is given to
5 question the validity of a tax at some stage of the proceeding.”

6 Furthermore, this Board has determined that a taxpayer’s disagreement with the law
7 should be directed to the Legislature, which is charged with formulating the law, rather than to those
8 who are charged with enforcing the law as it is written. (*Appeal of Thomas C. and Donna G. Albertson*,
9 84-SBE-002, Jan. 17, 1984; *Appeal of Chester A. Rowland*, 75-SBE-071, Oct. 21, 1975; *Appeal of*
10 *Samuel R. and Eleanor H. Walker*, 73-SBE-020, Mar. 27, 1973.)

11 In addition, the Board’s Rules for Tax Appeals, Chapter 4, section 5412, subdivision (b),
12 provides that the Board does not have jurisdiction to consider any of the following: 1) whether a
13 California statute or regulation is invalid or unenforceable under the federal or California constitution,
14 unless a federal or California appellate court has already made such a determination; and 2) whether the
15 appellant is entitled to a remedy for the FTB’s actual or alleged violation of any substantive or
16 procedural right, unless the violation affects the adequacy of a notice, the validity of an action from
17 which a timely appeal was made, or the amount at issue in the appeal. (Cal. Code Regs., tit. 18, div. 2.1,
18 § 5412, subd. (b).) It thus appears that the Board does not have jurisdiction to determine whether
19 respondent violated appellant’s due process rights under the federal or California constitutions or
20 whether R&TC section 19777.5 is unconstitutional.

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