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BOARD OF EQUALIZATION

STATE OF CALIFORNIA

In the Matter of the Appeal of:	**HEARING SUMMARY**
	PERSONAL INCOME TAX APPEAL
GREGORY P. HOVIOUS	Case No. 563150

Year	Proposed Assessment
2007	$794

Representing the Parties:

For Appellant: Gregory P. Hovious

For Franchise Tax Board: Janet Butler, Legal Analyst

QUESTION(S): (1) Whether appellant has established error in respondent's proposed assessment which is based on federal information;

(2) Whether respondent abused its discretion in denying interest abatement; and

(3) Whether respondent properly applied appellant and his current spouse's joint 2010 tax refund to his current spouse's separate tax liability.

HEARING SUMMARY

Background

Appellant filed a timely California income tax return (Form 540) for the 2007 tax year,

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claiming head of household (HOH) filing status. On his return, appellant reported federal adjusted gross income (AGI) of $92,453, California adjustments (subtractions) of $1,200, itemized deductions of $32,002, taxable income of $59,251, and tax of $2,093. After applying reported withholding credits of $5,994 and exemption credits of $682, appellant reported an overpayment of $4,583 that respondent refunded on February 22, 2008. (Resp. Op. Br., p. 1, Ex. A & B.)

Subsequently, respondent received information from the Internal Revenue Service (IRS) which indicated that federal adjustments (totaling $4,030) had been made to appellant's federal return for taxable interest of $981, pension income of $17,835, and a rent/royalties adjustment of negative $14,786. The federal report also reflected a federal 10 percent premature distribution tax of $1,784. Based on this information, respondent issued a Notice of Proposed Assessment (NPA) dated March 17, 2010, that applied the federal adjustments, and revised appellant's taxable income to $63,281 (i.e., $59,251 + $4,030) and proposed additional tax of $794 (which includes an increase in regular tax of $349 and a premature distribution tax of $445), plus interest. (Resp. Op. Br., pp. 1-2, Exs. C; Appeal Letter, Attch.)

Appellant protested the NPA, asserting that respondent failed to provide documentation substantiating the additional proposed tax. Appellant also indicated that he was currently disputing the additional tax assessed by the IRS for 2007. Appellant requested respondent to specify the amount and source of income on which respondent's assessment arose. (Resp. Op. Br., p. 2, Ex. D.)

Respondent issued a letter dated November 23, 2010, in which it explained that the CP2000 audit report provided by the IRS reflected the details of the federal adjustments for the 2007 tax year. Specifically, respondent indicated that the federal AGI as accepted by the IRS was $96,483, and the federal AGI reported on appellant's California return was $92,453. Since the difference of $4,030 was equal to the net income adjustments shown on the NPA, respondent found that the NPA was correct. Respondent did not receive a response from appellant. Thereafter, respondent issued a Notice of Action (NOA), dated January 19, 2011, affirming the NPA. Appellant then filed this timely appeal. (Resp. Op. Br., p. 2; Appeal Letter, Attchs.)

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Contentions

Appellant

Appellant contends that the additional income resulted from a stock option cash out during his dissolution of marriage. Appellant states that his former spouse, Kim Hovious, was ordered to pay taxes in the dissolution. Appellant indicates that he will file an amended 2007 return as well as his 2010 return. Appellant states that, between the two returns, his entire tax liability should be eliminated and he should be due a refund. Appellant also requests that all penalties and interest be waived. Appellant then provided a Return Information Notice dated April 11, 2011, for the 2010 tax year indicating that respondent applied a $1,704 credit from appellant's 2010 tax year to another tax year. Based on this notice, appellant contends he does not owe any prior year taxes. (Appeal Letter; Appellant's Addl. Info., Attch.)

In appellant's reply brief, appellant states that he takes little issue with the facts presented in respondent's opening brief. However, with regard to respondent's contention that the $1,704 credit was applied to the 2008 tax year account, appellant contends that respondent has not offered any proof that this occurred. Appellant takes issue with respondent's conclusory statement that the credit was applied to his 2008 tax year account and points to a Notice of State Income Tax Due dated August 29, 2011, for the 2008 tax year which reflects that appellant has a balance due of $6,896.11. Appellant further states that he is currently in negotiations with the IRS over his 2008 tax year liability. Appellant states that the issue with his 2008 tax year liability involves spousal support paid in 2008. (App. Reply Br., p.1, Attchs.)

In response to respondent's contention that it properly applied the 2010 overpayment to his current spouse Judy Hovious' 2008 separate tax liability, appellant contends that his current spouse's 2008 separate tax liability was paid in full and points to her online payment receipt. In addition, appellant contends that Revenue and Taxation Code (R&TC) section 19301 and the cases cited by respondent do not provide authority for respondent's actions. Appellant contends that a simple plain English reading of R&TC section 19301, subdivision (a), is applicable to individuals and R&TC section 19301, subdivision (b), provides that overpayments may be credited against amounts due from both taxpayers. Appellant argues that, to support respondent's interpretation, the statute would have to

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read that any overpayment may be credited against the amount then due from both taxpayers or each individual taxpayer. With regard to the cases cited by respondent, appellant contends that these cases do not discuss a joint overpayment applied to an individual liability and respondent did not provide appellant with a pre-deprivation notice or opportunity to object to the offset. Appellant further argues that the applicable statutes discussed the State Controller's authority to do offsets, not respondent's authority. (App. Addl. Br., pp. 1-2.)

In response to the Appeals Division staff's request to provide a copy of the online payment receipt, appellant provided such receipt which shows a payment of $3,320 made on June 9, 2011, to Judy Hovious' 2008 tax year account. Appellant states that the 2010 overpayment is relevant to the 2007 tax liability because respondent should have applied the 2010 overpayment to his 2007 tax liability and thereby satisfying his 2007 tax account balance. Appellant argues that respondent cannot take the 2010 overpayment and apply it to another individual's debt. (App. 2nd Addl. Br., p. 1, Attchs.)

On October 19, 2012, the Board received an additional letter from appellant, which was addressed to respondent, dated October 5, 2012. In that letter, appellant maintains that the 2007 deficiency assessment of $794 should be offset by the two following amounts: First, appellant claims that the June 9, 2011 internet payment of $3,320 should have satisfied Judy Hovious' 2008 tax liability and therefore the $566.33 garnished from Judy Hovious' wages after the internet payment should be applied to appellant's deficiency at issue.[1] Second, appellant claims a refund of $4,013 based on his second amended 2008 return dated May 28, 2011, should satisfy the remaining deficiency.[2] Appellant notes that respondent's discussions of his 2008 tax year account only reference his first amended return for 2008, dated February 28, 2011, and does not discuss his second amended return for 2008, dated May 28, 2011. Appellant also submits copies of the amended federal return and California state return for 2008, dated May 28, 2011, a negotiated check (in the amount of $67,094.54) to his former spouse, Kim Hovious, dated May 13, 2008, a copy of his December 26, 2008 paystub showing wage

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[1]It is unclear why appellant believes the $3,320 payment satisfied Judy Hovious' 2008 tax liability in full. If appellant has any documentation, such as a notice from respondent, to support his position, appellant should provide it at the hearing.

[2] Staff notes respondent already issued two refunds to appellant for the 2008 tax year: $3,641 based on appellant's original 2008 return and $2,756.10 based on appellant's first amended return dated February 28, 2011. (Resp. Addl. Br., p. 2.) Respondent should be prepared to discuss the status of the second amended return dated May 28, 2011.

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garnishment of $19,020 paid to his former spouse in 2008, and the first page of the stipulated judgment relating to appellant's June 26, 2006 separation from his former spouse.[3] (App. 3rd Addl. Br., pp. 1-2, Attchs.)

Respondent

Respondent contends that its proposed assessment is based on federal audit information. Respondent contends that, as these federal changes were not reported on appellant's California return, respondent issued the NPA to include the adjustments in appellant's California taxable income, which resulted in a proposed additional tax of $794. Respondent further contends that a review of appellant's federal account transcript for 2007 does not show that the IRS revised or cancelled the CP2000 assessment. Respondent also notes that the transcript does not show appellant filed an amended 2007 federal return. In addition, respondent provides a corrected California Form 540 tax return and Schedule CA to demonstrate the computation of appellant's revised state tax liability for the 2007 tax year. With regard to appellant's contention that he should have a zero balance due because his overpayment of $1,704 from the 2010 tax year was applied to another tax year, respondent notes that the overpayment was transferred to the 2008 tax year and therefore has no effect on the proposed additional tax for the 2007 tax year. (Resp. Op. Br., pp. 3-4, Exs. F & G.)

With regard to appellant's contention that the Board should waive all interest and penalties on the proposed additional tax, respondent contends that, as taxes are due and payable as of the original due date of the return without regard to extension, R&TC section 19101 provides for the charging of interest on the balance due. Respondent also notes that the Board has held that the imposition of interest is mandatory, citing the Board's decision in the *Appeal of Amy M. Yamachi*, 77-SBE-095, decided on June 28, 1977.[4] Respondent notes that, while interest abatement is available if respondent made an error or delay in its performance of a ministerial or managerial act pursuant to R&TC section 19104, subdivision (a), a review of appellant's case reveals no basis for the abatement of interest. With regard to appellant's request for the abatement of penalties, respondent notes that no

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[3] While the page of the stipulated judgment discusses spousal support and certain issues related to child custody, it does not address the tax responsibilities of appellant and his former spouse.

[4] Board of Equalization cases may be found on the Board's website: www.boe.ca.gov.

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penalties were assessed by the FTB for 2007. Respondent further notes that, as the proposed assessment is based on federal adjustments, appellant has the burden of proof in demonstrating error in respondent's determination, citing R&TC section 18622. Respondent contends that appellant has not met this burden and therefore the California assessment of additional tax plus applicable interest for 2007 is correct. (Resp. Op. Br., pp. 5-6.)

With regard to appellant's contentions that the FTB has not demonstrated that the $1,704 credit from his 2010 tax year account was applied to his 2008 tax year liability, respondent notes that appellant filed a 2010 joint California income tax return with Judy Hovious, his current spouse, in which they reported an overpayment of $1,704. During processing, respondent determined that Judy Hovious had an unpaid balance due for the 2008 tax year. On April 11, 2011, respondent applied the $1,704 overpayment from appellant and Judy Hovious' joint 2010 return to pay the balance owed by Judy Hovious for the 2008 tax year. Respondent contends that overpayments of tax liability on a joint return may be applied to the separate tax liability of the taxpayers who are parties to the joint liability, citing R&TC section 19301. Respondent also notes that there is no injured spouse[5] relief available under California law, citing *Wightman, et al., v. Franchise Tax Board* (1988) 202 Cal. App.3d 966 and *Del Castello v. State of California* (1982) 135 Cal.App.3d 887. As such, respondent contends that it properly applied the 2010 overpayment from the joint return to appellant's current spouse's 2008 separate tax liability. (Resp. Reply Br., pp. 1-3, Exs. H, J, K & I.)

In response to the Appeals Division staff's request to clarify the payment history of appellant's current spouse's separate tax liability for 2008, respondent indicates that it issued an NPA on April 12, 2010, to Judy Hovious. When this notice became final, respondent issued a statement of income tax due notice dated July 13, 2010, reflecting a balance due of $5,242.53. Respondent did not receive any payments and thereafter issued an Income Tax Due Notice dated October 14, 2010, reflecting a balance due of $5,295.64. Since respondent did not receive any payments in response to this notice, it issued a Final Notice before Levy dated December 15, 2010, reflecting a balance due of $5,330.97. Respondent notes that Judy Hovious' account reflects that several payments were made,

[5] Injured spouse situations arise where a joint refund is applied to the separate liability of a spouse. Although federal law provides for injured spouse relief, there is no provision of California providing for recovery as an "injured spouse".

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including the April 4, 2011 credit transfer of $1,704 from her and appellant's joint 2010 return, the June 9, 2011 internet payment of $3,320, and wage garnishments in June and July of 2011, resulting in the satisfaction of the balance due for Judy Hovious' 2008 tax liability and resulting in a $163.61 overpayment which was refunded to her on April 26, 2012. (Resp. Addl. Br., p. 1, Ex. L; Resp. Addl. Corr., pp. 1-2, Exs. P, Q, R & S.)

With regard to appellant's 2007 tax year account, respondent notes that appellant self-reported tax of $1,411 and withholding of $5,994 resulting in an overpayment of $4,583, which respondent refunded to appellant. Subsequently, based on federal adjustments, respondent issued the NPA at issue for $794 in additional tax, plus interest. With regard to appellant's 2008 tax year account, respondent notes that appellant self-reported tax of $4,190 and withholding of $7,831 on his original return, resulting in an overpayment of $3,641 which was refunded to appellant. Thereafter, appellant filed an amended 2008 return on March 1, 2011, which increased his tax by $4,666, withholding credit by $6,486, and claimed excess SDI of $694 for an overpayment of $2,514. Respondent processed the amended return and issued the additional refund of $2,756.10 (i.e., $2,514.00 + interest of $242.10) to appellant on June 29, 2011. Respondent notes that, while there is no current balance due or pending assessment for appellant's 2008 tax year, the 2008 return is being reviewed by respondent's audit department based on a federal CP2000 audit report and appellant's amended return. With regard to appellant's 2010 tax year, respondent notes that appellant and Judy Hovious filed a joint return reporting tax of $5,104 and withholding of $6,808, resulting in an overpayment of $1,704, which was applied to Judy Hovious' 2008 separate tax liability on April 4, 2011. (Resp. Addl. Br., p. 2, Exs. M, N & O; Resp. Addl. Corr., pp. 2-4, Ex. U.)

Applicable Law

Accuracy of Assessment

R&TC section 18622, subdivision (a), provides that a taxpayer shall either concede the accuracy of a federal determination or state wherein it is erroneous. R&TC section 18622, subdivision (b), also provides that when a taxpayer files an amended federal return, he is required to file a California amended return within six months of the amended federal return if the change in the return increases the amount of the taxpayer's tax liability. It is well-settled that a deficiency assessment based

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on a federal audit report is presumptively correct and the appellant bears the burden of proving that the determination is erroneous. (*Appeal of Sheldon I. and Helen E. Brockett*, 86-SBE-109, June 18, 1986; *Todd v. McColgan* (1949) 89 Cal.App.2d 509.) Unsupported assertions are not sufficient to satisfy an appellant's burden of proof with respect to an assessment based on federal action. (*Appeal of Aaron and Eloise Magidow*, 82-SBE-274, Nov. 17, 1982.)

Early Distribution Tax

Internal Revenue Code (IRC) section 72 governs distributions from qualified retirement plans. R&TC section 17085 conforms to, but modifies, IRC section 72. IRC section 72(t)(1) provides that, if a taxpayer receives an early distribution from a qualified retirement plan, the taxpayer's tax shall be increased by an amount equal to 10 percent of the portion of the amount that is includible in gross income unless the distribution falls within a specified exception. Those exceptions include, but are not limited to, distributions made on or after the date on which the employee attains age 59-1/2; distributions made to the employee to the extent such distributions do not exceed amounts paid for medical care; distributions to unemployed individuals for health insurance premiums; and distributions from certain plans for first home purchases. (Int.Rev. Code, §§ 72(t)(2)(A)(i), 72(t)(2)(A)(v), 72(t)(2)(B), 72(t)(2)(D), 72(t)(2)(F).) R&TC section 17085, subdivision (c)(1), modifies the 10 percent early distribution tax to a 2.5 percent early distribution tax.

Interest Abatement

Under California law, taxes are due and payable as of the original due date of the taxpayer's return without regard to the extension to file the return. (Rev. & Tax. Code, § 18567 subd. (b).) If tax is not paid by the original due date, or if respondent assesses additional tax and that assessment becomes due and payable, R&TC section 19101 requires the charging of interest on the resulting balance due. Interest is mandatory and respondent is not allowed to abate interest except where authorized by law. (*Appeal of Amy M. Yamachi*, *supra*; *Appeal of Audrey C. Jaegle*, 76-SBE-070, June 22, 1976.) Interest is not a penalty, but is simply compensation for a taxpayer's use of money after the due date of the tax. (*Appeal of Audrey C. Jaegle*, *supra*.) Moreover, there is no reasonable cause exception to the imposition of interest. (*Appeal of Audrey C. Jaegle*, *supra*.)

Pursuant to R&TC section 19104, respondent may abate interest accrued on a deficiency

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when the aggrieved taxpayer identifies an unreasonable error or delay which (1) occurred after respondent contacted the taxpayer in writing about the particular deficiency or overpayment underlying the disputed interest; (2) is not significantly attributable to the taxpayer; and (3) is attributable to a ministerial or managerial[6] act performed by respondent. (*Appeal of Michael and Sonia Kishner*, 99-SBE-007, Sept. 29, 1999; see also Rev. & Tax. Code, § 19104, subds. (a)(1) & (b)(1).)

Respondent's determination not to abate interest is presumed correct, and the burden is on an appellant to prove error. (*Appeal of Michael E. Myers*, 2001-SBE-001, May 31, 2001.) The Board's jurisdiction in an interest abatement case is limited by statute to a review of respondent's determination for an abuse of discretion. (Rev. & Tax. Code, § 19104, subd. (b)(2)(B).) To show an abuse of discretion, an appellant must establish that, in refusing to abate interest, respondent exercised its discretion arbitrarily, capriciously, or without sound basis in fact or law. (*Woodral v. Commissioner* (1999) 112 T.C. 19, 23.)

R&TC section 19301

Under California law, any overpayment of a tax liability "may be credited against any amount then due from the taxpayer and the balance shall be refunded to the taxpayer." (Rev.& Tax. Code § 19301, subd. (a).) With respect to joint returns, "the amount of the overpayment may be credited against the amount then due from both taxpayers and the balance shall be refunded to both taxpayers in the names under which the return was paid." (Rev. & Tax. Code §19301, subd. (b).)

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[6] In the *Appeal of Michael and Sonia Kishner* (99-SBE-007), decided September 29, 1999, this Board adopted the language from Treasury Regulation section 301.6404-2 (b)(2), which defines a "ministerial act" as:

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

Further, as we did in the *Appeal of Michael and Sonia Kishner*, we turn to Treasury Regulation section 301.6404-2 (b)(1) for the definition of a "managerial" act. The regulation defines a managerial act as:

> [A]n administrative act that occurs during the processing of a taxpayer's case involving the temporary or permanent loss of records or the exercise of judgment or discretion relating to management of personnel. A decision concerning the proper application of federal tax law (or other federal or state law) is not a managerial act. Further, a general administrative decision, such as the IRS's decision on how to organize the processing of tax returns or its delay in implementing an improved computer system, is not a managerial act for which interest can be abated . . . .

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STAFF COMMENTS

Respondent's proposed assessment is based on federal adjustments, consisting of unreported interest income of $981, pension income of $17,835, and a rent/royalties adjustment of negative $14,786. With regard to appellant's contention that the unreported income is attributable to his former spouse and his former spouse is responsible for taxes pursuant to a dissolution agreement, appellant should be prepared to substantiate this claim with documentation. Appeals Division staff notes that the IRS Wage and Income Transcript indicates that the payers listed appellant as the recipient of the funds. (Resp. Op. Br., Ex. E.)

With regard to appellant's interest abatement request, appellant should be prepared to demonstrate how respondent abused its discretion in denying interest abatement. Both parties should be prepared to discuss whether appellant has shown that respondent committed an unreasonable delay or error in the performance of a ministerial or managerial act while processing appellant's account.

Appellant disputes respondent's application of appellant and his current spouse's 2010 joint tax refund of $1,704 to his current spouse Judy Hovious' 2008 separate tax liability rather than to appellant's 2007 separate tax liability. Respondent issued the NPA to appellant for the 2007 tax year on March 17, 2010. Respondent issued the NPA to Judy Hovious for the 2008 tax year on April 12, 2010. Appellant should be prepared to provide authority supporting his argument that the joint refund should not have been applied to his current spouse's separate tax liability. Respondent may wish to explain its procedures regarding offsets. Notwithstanding the provisions of R&TC section 19301, respondent may wish to explain why it applied the $1,704 joint refund to Judy Hovious' 2008 tax liability rather than appellant's 2007 tax liability when it appears that appellant's 2007 liability existed prior to Judy Hovious' 2008 liability.

Pursuant to California Code of Regulations, title 18, section 5523.6, if either party has any additional evidence to present, they should provide their evidence to the Board Proceedings Division at least 14 days prior to the oral hearing.[7]

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[7] Evidence exhibits should be sent to: Claudia Madrigal, Appeals Analyst, Board Proceedings Division, State Board of Equalization, P.O. Box 942879 MIC:80, Sacramento, California, 94279-0080.