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10 **BOARD OF EQUALIZATION**
11 **STATE OF CALIFORNIA**

12 In the Matter of the Appeal of:) **HEARING SUMMARY**
13) **PERSONAL INCOME TAX APPEAL**
14 **BILL KELLS**) Case No. 546539

<u>Year</u>	<u>Tax</u>	<u>Interest to July 6, 2010</u>
2005	\$548.00	\$151.94

15 Representing the Parties:

16 For Appellants: Bill Kells
17 For Franchise Tax Board: Rachel Abston, Legal Analyst

18 **QUESTIONS:** (1) Whether appellant has shown error in the proposed assessment from the Franchise
19 Tax Board (FTB) based on adjustments to appellant’s itemized deductions and
20 Schedule CA adjustments for 2005.
21 (2) Whether appellant has shown error in the FTB’s assessment of interest on the
22 proposed assessment of additional tax due.

23 **HEARING SUMMARY**

24 **Background**

25 Appellant filed his 2005 California income tax return by the extended due date on

1 October 15, 2006. His extension request included a payment of \$67.00. His tax return reported tax due
2 of \$335.00, which payment accompanied the tax return. Because appellant's tax liability was not fully
3 paid by the due date on April 15, 2006, the FTB assessed an underpayment penalty of \$25.16. After
4 applying the tax payments to the tax, penalty, and interest, there was an overpayment of \$32.20. The
5 FTB transferred \$7.05 to pay a balance due for 2003, and then issued a refund to appellant for \$25.39 on
6 December 12, 2006. (FTB Opening Brief, p. 2)

7 Subsequently, the FTB examined appellant's return and determined that appellant
8 improperly subtracted \$4,782 in pension income on Schedule CA (the California adjustments form).
9 The FTB also disallowed \$1,152 in other adjustments made by appellant on Schedule CA.¹ Based on
10 the FTB's adjustments, the FTB issued a Notice of Proposed Assessment (NPA) for \$548 in additional
11 tax, plus applicable interest. Appellant protested, the FTB affirmed the NPA with a Notice of Action
12 (NOA), and this timely appeal followed. Appellant paid \$587.14 on June 9, 2010, during the protest
13 process, which payment is being held by the FTB pending the outcome of this appeal.

14 Contentions

15 Appellant contends, "The amount I have previously paid in this matter is the full and
16 correctly authorized balance." It is not clear whether appellant is referring to the \$587.14 payment on
17 June 9, 2010 or the \$335.00 payment that accompanied the tax return on October 15, 2006. Appellant
18 asserts that the tax due was incorrectly calculated but states that "the correct amount is no longer easily
19 verifiable." Appellant also contends that the estimated interest in the NOA is incorrect and usurious.
20 (Appeal Letter.)

21 The FTB contends that appellant has not demonstrated any error in the FTB's assessment.
22 The FTB asserts that appellant incorrectly subtracted pension income of \$4,782 on Schedule CA and this
23 income was incorrectly excluded from appellant's California taxable income. The FTB contends that
24 appellant has not provided a sufficient explanation for the \$1,152 adjustment to itemized deductions.
25 The FTB maintains that such adjustments to federal itemized deductions are only appropriate when there
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27 ¹ This disallowed deduction for \$1,152 was shown on Line 41 (the "Other adjustments line") in Part II of the Schedule CA
28 form, which part is labeled "Adjustments to Federal Itemized Deductions." To describe the adjustment on Line 41, where the
form says "Specify," appellant wrote: "Legal expenses, CA state courts."

1 is a difference between federal and California tax laws. With regard to the interest assessment, the FTB
2 contends that interest was properly calculated, with interest accrued up to the date appellant's payment
3 was received on June 9, 2010. The FTB contends that there is no apparent reason for interest abatement,
4 the interest rates are set by law, and the interest rates are not usurious. (FTB Opening Brief.)

5 Applicable Law

6 Burden of Proof

7 The FTB's determination is presumed correct and appellant has the burden of proving it
8 to be wrong. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Michael E. Myers*,
9 2001-SBE-001, May 31, 2001.)² In the absence of uncontradicted, credible, competent, and relevant
10 evidence showing an error in the FTB's determinations, they must be upheld. (*Appeal of Oscar D. and*
11 *Agatha E. Seltzer*, 80-SBE-154, Nov. 18, 1980.)

12 Taxation of Pension Income

13 California taxes the entire income earned by California residents, in accordance with
14 section 17041 of the Revenue and Taxation Code (R&TC). Pensions are defined as gross income for
15 purposes of taxation according to R&TC section 17071, which incorporates Internal Revenue Code
16 (IRC) section 61 by reference. Distributions from qualified retirement plans must be included in taxable
17 income for California residents, under R&TC section 17501, which incorporates IRC section 408(d).

18 California Adjustments - Schedule CA

19 Schedule CA (540) is used to report adjustments to federal adjusted gross income and
20 federal itemized deductions when income or deductions are treated differently for state and federal tax
21 purposes. The Instructions for Schedule CA (540) for 2005 stated, under "Purpose," "Use this schedule
22 to make adjustments to your federal adjusted gross income and to your federal itemized deductions
23 using California law." The form is not designed to be used by taxpayers to claim additional itemized
24 deductions that were not claimed on the federal tax return if those deductions were treated the same for
25 tax purposes by California and the federal government.

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28 ² Published decisions of the Board, such as *Appeal of Michael E. Myers, supra*, are generally available on the Board's
website: www.boe.ca.gov.

1 Interest

2 Interest is mandatory on unpaid amounts under section 19101 subdivision (a) of the
3 R&TC. The Board does not have the power to waive statutory interest accruing on an unpaid deficiency
4 assessment. (*Appeal of Amy M. Yamachi*, 77-SBE-095, June 28, 1977.) Interest is not a penalty
5 imposed on the taxpayer; it is merely compensation for the use of money after it became due. (*Appeal of*
6 *Audrey C. Jaegle*, 76-SBE-070, June 22, 1976.) Section 19104 of the R&TC allows for the abatement
7 of interest only when (1) the interest is attributable to an unreasonable error or delay committed by the
8 FTB in the performance of a ministerial or managerial act, (2) no significant aspect of the error or delay
9 is attributable to the taxpayer, and (3) the error or delay occurred after the FTB contacted the taxpayer in
10 writing with respect to the deficiency. In this appeal, there has been no allegation and no evidence of
11 any unreasonable error or delay by the FTB, so it appears that the Board has no legal basis to consider
12 interest abatement.

13 Interest Rate

14 Section 19521 of the R&TC generally requires interest rates to be set in accordance with
15 Section 6621 of the IRC, which generally specifies interest rates as three percent above the “Federal
16 short-term rate.” The “Federal short-term rate” is defined by IRC section 1274, subsection (d)(1)(C)(i)
17 as “the average market yield (during any 1-month period selected by the Secretary and ending in the
18 calendar month in which the determination is made) on outstanding marketable obligations of the United
19 States with remaining periods to maturity of 3 years or less.” Thus, as a general matter, interest rates are
20 set at three percent above the yield for short-term federal bonds and U.S. Treasury Bills.³

21 Usury

22 Usury is defined in Article 15 of the California Constitution, with the maximum interest
23 rate generally set at ten percent, with various exceptions. As noted above, the interest rate on tax
24 deficiencies is set by statute (R&TC section 19521). Article 3, section 3.5 of the California Constitution
25 prohibits an administrative agency, such as the Board, from declaring a statute unconstitutional or
26 unenforceable, unless an appellate court made such a determination. There has been no such appellate
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³ The federal rules that determine interest rates contain numerous complications and special provisions that do not appear relevant to the current discussion. For example, there is a different interest rate for overpayments by corporations.

1 court decision concerning the statutes that set the rate of interest.

2 STAFF COMMENTS

3 At the hearing, appellant should be prepared to present evidence to demonstrate an error
4 in the FTB’s assessment. Even if the correct amount is “not easily verifiable,” as appellant contends, the
5 Board needs evidence of an error of some sort to consider overturning the FTB assessment.

6 The FTB should be prepared to show how interest was calculated, perhaps with a chart
7 showing the interest rate and accrued interest for each relevant period. The FTB may wish to show that
8 the rate did not exceed the maximum permissible interest rate under California usury rules.

9 Appellant should demonstrate how interest should have been calculated, consistent with
10 California law, and he should demonstrate any errors committed by the FTB. In particular, if appellant
11 has evidence that the interest rate was usurious, he should provide it. Appellant should cite an appellate
12 court decision declaring California’s interest statutes to be unconstitutional or unenforceable, if such a
13 decision exists.

14 If appellant or the FTB wish to provide additional information and documentation, it
15 should be provided at least fourteen days prior to the hearing to:

Claudia Madrigal, Board of Equalization
Board Proceedings Division
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Sacramento, California 94279-0080

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