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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 **MARILYN S. KWOLEK**¹) Case No. 518196

	<u>Years</u>	<u>Proposed Assessments</u> ²	<u>Penalties</u> ³
	2004	\$ 935.00	\$ 420.75
	2005	\$12,240.00	\$5,508.00

15 Representing the Parties:

16 For Appellant: Hector C. Perez, Attorney
 17 For Franchise Tax Board: Raul A. Escatel, Tax Counsel

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 22 **QUESTIONS:** (1) Whether appellant has shown that she was entitled to deduct amounts claimed for
 23 charitable contributions for tax years 2004 and 2005.

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 26 ¹ Appellant resides in Contra Costa County, California.

27 ² Appellant provided additional documentation upon the Appeals Division staff's request for further briefing. Respondent
 28 revised its proposed assessment to reduce the additional tax amounts to \$470 for 2004 and \$2,939 for 2005, with a correlating
 reduction of the penalties. The complete breakdown is provided below in the Background section of this hearing summary.

³ The penalties consist of a failure to furnish information penalty and an accuracy-related penalty for both years. The
 complete breakdown is provided below in the Background section of this hearing summary.

1 (2) Whether appellant has shown that the failure to furnish information penalty
2 should be abated.

3 (3) Whether appellant has shown that respondent improperly imposed the accuracy-
4 related penalty for the 2004 and 2005 tax years.

5 HEARING SUMMARY

6 Background

7 Appellant timely filed her 2004 and 2005 returns (Form 540). On her 2004 Form 540,
8 appellant reported \$10,052 in charitable contributions and on her 2005 Form 540 appellant reported
9 \$195,102 in charitable contributions to the University of Iowa. Respondent examined appellant's Forms
10 540 for tax years 2003, 2004 and 2005 for the charitable contributions reported by appellant.
11 Respondent made an initial Information Document Request (IDR) on September 21, 2007, for
12 substantiation of appellant's reported charitable contributions for each of the tax years 2003, 2004 and
13 2005. The IDR specified that appellant provide a list of the charitable organizations receiving the
14 contributions, a copy of each charitable organization's acceptance of the contribution and copies of
15 cancelled checks evidencing the contributions. (Resp. Op. Br., pp. 1-2.)

16 In response to the IDR, appellant provided the following documents: a copy of a
17 statement from the Marilyn S. Kwolek, M.D. Corporation, showing a gift amount of \$95,000 for 2005, a
18 copy of a Schedule K-1 for the 2005 tax year from appellant's Unitrust, a letter to appellant from the
19 University of Iowa Foundation (Foundation) expressing appreciation for the "future support" to the
20 university through the establishment of the Marilyn S. Kwolek Unitrust and a Statement of Gift Intent
21 between State University of Iowa and Marilyn S. Kwolek dated May 5, 2004, "to facilitate the
22 fulfillment of the charitable intentions" of appellant and the Foundation with a gift of approximately
23 \$100,000 from the Unitrust. Appellant did not provide a copy of the Unitrust instrument. (Resp. Op.
24 Br., p. 2 and exhibits F, G, H, and I.)

25 By letter dated April 30, 2008, respondent repeated its request for the items specified in
26 the IDR. The letter also stated that respondent would impose a penalty for failure to furnish the
27 information requested as substantiation for the claimed charitable contributions. When appellant failed
28 to provide the information, respondent sent a final request for information letter dated June 3, 2008,

1 prior to imposing the penalty. In response to respondent's June 3, 2008 letter, appellant informed
2 respondent in a letter dated June 17, 2008, that she was able to provide:

- 3 • "Copies of K-1 (both federal and state) for 2004 wherein the disputed \$36,865 is claimed in
4 line 13 and explained in "G" to consist of different identified items and accompanying
5 correspondence from Rembrandt Venture Partners II, L.P. dated March 31, 2005."
- 6 • "Copies of the Federal Form 4952 Investment Interest Expense Deduction for 2004."
- 7 • A copy of a worksheet for 2005 showing the 2005 K-1 of \$30,832 because appellant's
8 certified public accountant (CPA) was not able to retrieve the Form K-1 from a database.

9 Appellant further states that she contacted the Foundation directly and was informed that additional
10 documentation to substantiate her claimed charitable contributions to the Foundation was currently
11 unavailable due to recent flooding and evacuation at the University of Iowa. (Resp. Op. Br., p. 2 and
12 exhibits J, K, and L.)

13 By letter dated August 26, 2008, respondent notified appellant it received her response to
14 the Audit Issue Presentation Sheet (AIPS) dated July 23, 2008. The letter describes the documents
15 provided by appellant as a copy of a statement which appears to name Marilyn S. Kwolek, M.D.
16 Corporation with a gift of \$95,000 for tax year 2005 and a statement that shows "planned gift" amounts
17 of \$5,000 in 2004 and \$5,000 in 2005. The two documents are described as "Hard Credit Entity Scan."
18 The letter advises appellant that her failure to substantiate the claimed deductions for charitable
19 contributions for the 2004 and 2005 tax years would result in a recommendation that the deductions be
20 denied and that penalties for the failure to furnish information and accuracy-related penalties would also
21 be recommended. By letter dated October 1, 2008, respondent notified appellant that the audit was
22 closed and the examiner would recommend disallowance of the deductions and imposition of the
23 penalties because she failed to provide any further documentation to substantiate the deductions.
24 Notices of Proposed Assessment (NPAs) were issued for tax years 2004 and 2005. (Resp. Op. Br., p. 3
25 and exhibits O & P.) The NPA for 2004 increased appellant's total tax from the reported \$13,116.00 to
26 \$14,051.00 (additional tax of \$935.00) and proposed a \$233.75 failure to furnish information penalty
27 and a \$187.00 accuracy-related penalty. (*Id.* at exhibit O.) The NPA for 2005 increased appellant's
28 total tax from the reported \$4,153 to \$16,393 (additional tax of \$12,240) and proposed a \$3,060 failure

1 to furnish information penalty and \$2,448 accuracy-related penalty. (*Id.* at exhibit P.)

2 Appellant timely protested the NPAs. During the protest, respondent continued to
3 request substantiation but appellant failed to provide additional documentation. Respondent affirmed
4 the NPA's in Notices of Action for both tax years. Appellant filed timely appeals to this Board. (Resp.
5 Op. Br., p. 3.) On appeal, in response to a request from the Appeals Division, appellant provided
6 supporting documentation for a portion of the claimed deductions. Respondent determined appellant's
7 newly provided documents substantiated \$5,000 of the \$10,052 deduction originally reported for 2004,
8 and \$100,000 of the \$195,012 deduction originally reported for 2005. (Resp. Add'l Br.)⁴ Appellant
9 agrees to the \$5,000 and \$100,000 deduction amounts for 2004 and 2005, respectively. (App. Add'l Br.)
10 Respondent revised its proposed assessments based on the documentation as follows:

		Original Amount	Revised Amount	
11	2004			
12		Additional Tax	\$935.00	\$470.00
13		Failure to Furnish Penalty	\$233.75	\$117.50
14		Accuracy-Related Penalty	\$187.00	\$94.00
15	2005			
16		Additional Tax	\$12,240.00	\$2,939.00
		Failure to Furnish Penalty	\$3,060.00	\$734.75
		Accuracy-Related Penalty	\$2,448.00	\$587.80

17 QUESTION (1): Whether appellant has shown that she was entitled to deduct amounts
18 claimed for charitable contributions for tax years 2004 and 2005.

19 STAFF COMMENTS

20 As discussed above, the parties are in agreement as to the correct amount of the allowable
21 deductions based on appellant's substantiation of the \$5,000 and \$100,000 in deductions for 2004 and
22 2005, respectively. Thus, the proper amount of the deductions is no longer in issue.

23 QUESTION (2): Whether appellant has shown that the failure to furnish information penalty
24 should be abated.

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28 ⁴ Respondent submitted an additional brief on March 9, 2011, accepting appellant's evidence substantiating a portion of the
claimed deductions. Respondent submitted a second additional brief on March 14, 2011, providing the revised proposed
assessment amounts, as seen in the following chart.

1 Contentions

2 Appellant's Contentions

3 Appellant contends that the penalties for failure to furnish information requested by
4 respondent imposed for 2004 and 2005 should be abated because appellant provided the necessary
5 information as soon as it was obtained from third parties. Appellant states that she no longer had the
6 assistance of her tax return preparer and relied on another representative who was not familiar with her
7 books and records and requested substantiating documentation from third parties. Appellant notes that
8 among the substantiating documentation was a copy of the check for \$95,000, which was deemed
9 insufficient. (App. Op. Br., pp. 4-5.)

10 Furthermore, appellant contends respondent has not shown any negligence or disregard of
11 any rules or regulations, and asserts that a mere failure to substantiate a claimed deduction does not give
12 rise to this penalty. (App. Reply Br., p. 5.) Appellant asserts she relied on her CPA to file her tax
13 returns, and did not provide information requested because she believed her CPA already provided it.
14 Appellant provided some additional documentation during briefing and contends respondent could have
15 attained some of the information on its own, such as determining whether the University of Iowa was
16 flooded in 2008. (*Id.* at pp. 5-6.) With the submission of additional documentation, appellant's
17 representative states the evidence was timely received by appellant, but only recently received by the
18 representative.⁵ (App. Supp. Br., p. 1.)

19 Respondent's Contentions

20 Respondent provides a timeline of its requests for information from appellant.
21 Respondent indicates it requested substantiating documentation for her claimed deductions on
22 September 21, 2007, April 30, 2008, and June 3, 2008; with the final request indicating a penalty would
23 apply if appellant did not respond by providing the requested information. (Resp. Op. Br., exhibit E,
24 J & K.) Respondent states appellant contacted respondent on June 18, 2008, asserting the University of
25 Iowa experienced flooding that prevented her from retrieving the requested information. Respondent
26 asserts, however, that this alleged flooding did not begin until seven months after the initial request for
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⁵ The provided documentation includes a letter from the university affirming the amounts donated, dated July 1, 2010, and a grantor trust agreement, dated December 27, 2003. (App. Supp. Br., exhibits.)

1 information, and appellant still did not provide any of the requested documentation until August 10,
2 2010 (the date of appellant's supplemental brief on this appeal). (Resp. Add'l Br., p. 3.) Respondent
3 notes that prior to this date, appellant provided a ledger showing two payments of \$2,500 made to the
4 University of Iowa in 2004 (Resp. Op. Br., exhibit T) and a copy of a check for \$95,000 made to the
5 University of Iowa in 2005 (*Id.* at exhibit U), but asserts these documents failed to substantiate the
6 deductions. (Resp. Op. Br., pp. 5-6.)

7 Respondent clarifies its position upon further briefing, stating it imposed a penalty for
8 failure to furnish information requested in writing, and not a penalty for failure to file a return upon
9 notice and demand (i.e., a demand penalty). Respondent asserts that while both are options under
10 R&TC section 19133, the latter has additional requirements in accordance with Regulation 19133,
11 subdivision (b), which do not apply to the penalty proposed here. (See Cal. Code Regs., tit. 18, § 19133,
12 subd. (b).) Respondent asserts that appellant's difficulty in acquiring information or documents does not
13 constitute reasonable cause. Respondent contends the penalty is properly assessed since appellant failed
14 to furnish information upon request and has not shown that such failure was due to reasonable cause and
15 not willful neglect. (Resp. Add'l Br., pp. 2-3.)

16 Applicable Law

17 R&TC section 19133 authorizes respondent to impose a penalty on any taxpayer failing
18 or refusing to furnish information requested in writing by respondent, or failing or refusing to make and
19 file a return upon notice and demand by respondent.⁶ The penalty may be abated if the taxpayer's
20 failure to provide the information is due to reasonable cause and not willful neglect. (Rev. & Tax. Code,
21 § 19133.)

22 A taxpayer bears the burden of showing reasonable cause for abatement of the penalty.
23 (Appeal of Kerry and Cheryl James, 83-SBE 009, Jan. 3, 1983.) Further, reasonable cause means such
24 cause as would prompt an ordinarily intelligent and prudent businessperson to so act under similar
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26 ⁶ To impose a demand penalty, Regulation 19133(b) provides an additional requirement that an individual taxpayer failed to
27 file a return for a previous tax year after receiving a demand for tax return during the four-taxable-year period preceding the
28 taxable year at issue. Since respondent has not issued a demand in this appeal, and asserts this penalty is a failure to furnish
information penalty and not a demand penalty, that regulation does not come into play. (Cal. Code Regs., tit. 18, § 19133,
subd. (b).)

1 circumstances. (*Appeal of Elmer R. and Barbara Malakoff*, 83-SBE 140, June 21, 1983.) Without
2 evidence to the contrary, respondent's penalty determinations are presumed correct. (See *Appeal of*
3 *Robert Scott*, 83-SBE-094 Apr. 5, 1983.)

4 Generally, a taxpayer's inability to provide a timely response to a notice and demand, or
5 furnish requested information because of lack of necessary information or documents, is not considered
6 reasonable cause. (*Appeal of William T. and Joy P. Orr*, 68-SBE-010, Feb. 5, 1968.) The fact that tax
7 information is lost, lacking, inaccurate, or difficult to obtain is insufficient to meet the taxpayer's burden
8 of establishing reasonable cause. (*Appeal of Stephen C. Bieneman*, 82-SBE-148, July 26, 1982; *Appeal*
9 *of Elmer R. and Barbara Malakoff*, *supra*; *Appeal of Roger W. Sleight*, 83- SBE-244, Oct. 26, 1983.)
10 Complexity of the tax law which leads to a delay in computing tax liability, and therefore a delay in
11 responding to a notice and demand or request for information, is not reasonable cause. (*Appeal of Philip*
12 *C. and Anne Berolzheimer*, 86-SBE-172, Nov. 19, 1986; *Appeal of Roger W. Sleight*, *supra*.)

13 STAFF COMMENTS

14 The information requested by respondent that gave rise to this penalty was a list of the
15 charitable organizations receiving the contributions, a copy of an acceptance of the contributions by the
16 organizations, and copies of cancelled checks evidencing the contributions. (Resp. Op. Br., exhibit E.)
17 Appellant provided other documentation that appellant apparently believed was sufficient to support the
18 claimed charitable contributions request for information. (See Resp. Op. Br., exhibits T & U.) In
19 response to respondent's further requests, appellant explained that she tried to obtain information from
20 the charitable organization but was informed that a natural disaster prevented the staff of the
21 organization from responding to her request. (App. Op. Br., p. 6.) Appellant also seems to argue that
22 she acted reasonably by providing the information to respondent as soon as it was made available to her
23 by the third party. (App. Supp. Br.)

24 Although appellant asserts that she made efforts to obtain the requested information from
25 the Foundation, she has not presented any evidence of those efforts, such as written correspondence
26 from the Foundation. On the other hand, appellant provided some information in response to
27 respondent's first request that respondent determined was insufficient to establish entitlement to the
28 claimed deductions. On that basis, the Appeals Division notes that respondent could have simply

1 disallowed the deductions rather than continuing to request the information and imposing the penalty
2 when appellant failed to furnish it. Respondent should be prepared to explain its rationale for imposing
3 the penalty. Since the parties are now in agreement with the partially allowed deduction amount and the
4 substantiation thereof, there is no longer any information request still pending.

5 QUESTION (3): Whether appellant has shown that respondent improperly imposed the
6 accuracy-related penalty for the 2004 and 2005 tax years.

7 Contentions

8 Appellant's Contentions

9 Appellant argues that she made a reasonable attempt to comply with California law and
10 exercised ordinary care in the preparation of her tax returns by hiring a CPA and by disclosing all
11 relevant facts to her return preparer. In addition, she asserts that she maintained adequate records as
12 evidenced by the \$95,000 statement on the general ledger of her S corporation. Appellant further argues
13 that there is no substantial understatement of tax and appellant's return position was not "blatantly
14 incorrect." (App. Op. Br., pp. 5-6.)

15 Respondent's Contentions

16 Respondent states that the accuracy-related penalty was imposed based on respondent's
17 determinations that there was a substantial understatement of tax⁷ and negligence since appellant failed
18 to make a reasonable attempt to comply "with the provisions of the code for a return position that seems
19 'too good to be true' under the circumstances." (Resp. Op. Br., pp. 7-8; See also Treas. Reg.,
20 § 1.666-3(b)(1)(ii).) Respondent also states that the penalty includes any failure by the taxpayer to keep
21 adequate records or to substantiate items properly.

22 Respondent asserts that appellant attempts to show there was reasonable cause for the
23 understatement and that she acted in good faith by arguing she could not rely on her former return
24 preparer and was compelled to employ another tax representative who was not familiar with her books
25 and recordkeeping. (Resp. Op. Br., pp. 8-9.) Respondent further states that appellant has not disclosed
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28 ⁷ Respondent asserts in its opening brief that the accuracy-related penalty was proper for 2005 under the substantial
understatement of income tax theory. Respondent has not retracted this assertion; however, since respondent subsequently
revised its proposed assessments, it appears this theory no longer applies.

1 the information she provided to the return preparer upon which the deductions were claimed.
2 Respondent asserts that appellant has only claimed the preparer must have made a mistake or there were
3 errors made by the computer on which the return was prepared. Respondent concludes that appellant
4 has not established that she acted in good faith and that the understatement was due to reasonable cause.
5 (*Id.* at p. 9.)

6 Respondent further contends that appellant was negligent in failing to maintain adequate
7 books and records to substantiate her reported charitable contributions for 2004 and 2005. Respondent
8 contends that such a failure constitutes negligence for which the penalty may be imposed. Respondent
9 contends that appellant has not established that she exercised ordinary care and, hence, was negligent in
10 this regard. In addition, respondent asserts that where a deduction is claimed, but is clearly incorrect,
11 the accuracy-related penalty should be imposed. (Resp. Op. Br., p. 10.)

12 Applicable Law

13 R&TC section 19164, which incorporates the provisions of IRC section 6662, provides
14 for an accuracy-related penalty of 20 percent of the applicable underpayment. The penalty applies to
15 the portion of the underpayment attributable to negligence or disregard of rules and regulations or to
16 any substantial understatement of income tax. (Int.Rev. Code, § 6662(b).) The IRC defines
17 “negligence” to include “any failure to make a reasonable attempt to comply” with the provisions of
18 the code. (*Id.* at § 6662(c).) The term “disregard” is defined to include any “careless, reckless, or
19 intentional disregard.” (*Ibid.*) There is a “substantial understatement of income tax” when the amount
20 of the understatement for a taxable year exceeds the greater of ten percent of the tax required to be
21 shown on the return, or \$5,000. (*Id.* at § 6662(d)(1).) An accuracy-related penalty shall not be
22 imposed as to any portion of an underpayment as to which appellant shows there is reasonable cause
23 and she acted in good faith. (Rev. & Tax. Code, § 19164, subd. (d); Int.Rev. Code, § 6664(c)(1); Cal.
24 Code Regs., tit. 18, § 19164, subd. (a).) Respondent’s imposition of the penalty for negligence is
25 presumed correct. (*Appeal of Robert and Bonnie Abney*, 82-SBE-104, June 29, 1982.)

26 STAFF COMMENTS

27 Using the revised proposed assessments respondent provides on appeal, it is clear that
28 neither understatement reaches the minimum amount required to be considered substantial, and therefore

1 the accuracy-related penalties at issue here may be imposed only for negligence or disregard of the rules
2 and regulations. Since respondent's imposition of the penalties carries a presumption of correctness,
3 appellant has the burden of showing reasonable cause for the understatement and that she acted in good
4 faith. Appellant should be prepared to provide legal support for her contention that the accuracy-related
5 penalty should only apply when a taxpayer's return position is "blatantly incorrect".

6 The parties should be prepared to discuss appellant's reliance on her CPA and whether it
7 was reasonable to claim the originally reported deductions given the fact that the parties now agree the
8 properly supported deduction amounts are approximately one-half of those originally claimed. (See
9 Treas. Reg., § 1.6662-3(b)(1)(ii).) Both parties should be prepared to discuss appellant's maintenance of
10 records and documents surrounding the claimed deductions, and whether there was a lack of ordinary
11 care that constitutes negligence. (See Treas. Reg., § 1.6662-3(b)(1).) Appellant is a professional
12 physician and sole shareholder of a professional corporation in her name. The Board should take into
13 account appellant's education and business experience when determining the issue of negligence.
14 (*Sutor v. Commissioner* (1951) 17 T.C. 64, 69.) The parties should be prepared to discuss whether
15 appellant's agreement with respondent's determination that she is entitled to the partial deduction
16 amounts on appeal, has any bearing on whether the understatement of tax was attributable to negligence.
17 (See App. Add'l Br.)

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