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7 **BOARD OF EQUALIZATION**
8 **STATE OF CALIFORNIA**

10 In the Matter of the Appeal of:) **HEARING SUMMARY**
11) **PERSONAL INCOME TAX APPEAL**
12 **MICHAEL B. LOZADA**¹) Case No. 578331

	<u>Year</u>	<u>Proposed</u>
	2007	Assessment
		\$1,559

16 Representing the Parties:

17 For Appellant: Michael B. Lozada
18 For Franchise Tax Board: Dawn Casey, Staff Service Analyst

20 QUESTION: Whether appellant has demonstrated error in the assessment, which was based upon
21 federal adjustments.

22 HEARING SUMMARY

23 Background

24 Appellant and his wife filed a timely 2007 California resident income tax return,
25 reporting, among other things, a federal adjusted gross income (AGI) of \$46,728 and a California
26 taxable income of \$11,741. (FTB opening brief (OB), Ex. A.) After taking into account personal
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28 ¹ Appellant filed a joint return with his spouse, Myrna A. Lozada. However, only appellant filed the appeal letter (AL); thus, all future references shall refer to appellant in the singular.

1 exemption credits, appellant and his wife reported a tax liability of zero. (*Id.*)

2 Later, the FTB received “information”² showing that the Internal Revenue Service (IRS)
3 made the following adjustments to their 2007 federal return, which increased their federal AGI by
4 \$15,358, from \$46,728 to \$62,086: (a) pension income of \$15,000, (b) interest of \$69, and (c) taxable
5 dividends of \$289. (FTB OB, p. 2 & Ex. B.) In addition, the IRS assessed a 10 percent premature
6 distribution tax of \$6,278. (*Id.*)

7 On July 29, 2010, the FTB issued a Notice of Proposed Assessment (NPA) that
8 conformed to the federal adjustments “a-c” above by adding \$15,358 to appellant’s 2007 California
9 taxable income, which increased the California taxable income from \$11,741 (as self-reported) to
10 \$27,099. (*Id.* Ex. C.) The NPA included a California 2.5 percent premature distribution tax of
11 \$1,559.00 (based upon a pension distribution of \$62,378), which resulted in an additional tax owed of
12 the same amount (i.e., \$1,559.00), plus interest of \$207.24. (*Id.*)

13 Appellant timely protested the NPA, arguing that the IRS and the FTB were both
14 imposing a 10 percent premature distribution tax, for a total of 20 percent, and requesting that the
15 California proposed assessment be recalculated. (*Id.* p. 2 & Ex. D.) In addition, along with his protest
16 letter, appellant provided a copy an IRS Notice CP22A, dated October 19, 2009. (*Id.*)

17 In a letter dated March 24, 2011, the FTB stated that the NPA was issued based on a
18 federal CP2000 audit report. (FTB OB, p. 2 & Ex. E.) The FTB also stated that, for California tax
19 purposes, the premature distribution tax is 2.5 percent of \$62,378 (i.e., the total pension distribution
20 amount), for a total of \$1,559. (*Id.*) In addition, the FTB stated that information from the IRS did not
21 show that the IRS’s assessment had been canceled or reduced and, therefore, it was the FTB’s position
22 that the NPA was correct. (*Id.*)

23 In response, appellant mailed the FTB a letter dated April 6, 2011, wherein appellant
24 stated that (1) he incorrectly reported the \$15,000 (i.e., adjustment “a” above) as a personal loan on his
25 federal return, and (2) the California additional tax in the NPA should be recalculated to be 2.5 percent
26 of \$15,000, which totals \$375. (FTB OB, p. 2 & Ex. F.) Appellant’s letter did not discuss adjustments
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28 ² On appeal, the FTB refers to a federal audit report (Form CP2000) dated June 16, 2011.

1 “b” and “c” above. (*Id.* Ex. F.)

2 In reply, the FTB sent appellant and his wife a letter dated June 16, 2011, wherein the
3 FTB stated that (1) information from the IRS did not show that the IRS’s assessment had been canceled
4 or reduced, and (2) it was the FTB’s position that the NPA was correct. (*Id.* p. 2 & Ex. G.) In addition,
5 the letter stated that, if the IRS changed its position and issued a revised audit report, the FTB should be
6 provided with a copy of the IRS’s revised audit report. (*Id.*)

7 Subsequently, appellant sent the FTB a certified letter dated July 16, 2011,³ asserting:

8 As indicated on the attached document from the IRS, the IRS has assessed me and
9 (sic) additional \$6,238.00 classified as “IRS Other tax”. This is not an income tax
10 but an IRA early distribution penalty (10% penalty or tax for early withdrawal of
11 IRA before age 60) as explained on the IRS letter attached. As far as my Federal
12 Income tax was concerned, they disallowed my personal loan of \$15,000.00.
13 Hence my gross income became \$62,378 instead of \$47,378 (see line 16b), which
14 resulted in my having to pay \$1,559.00 to the IRS.

15 Using Turbo Tax 2007, I have recalculated my California State return. As
16 indicated on the State return, the new gross income of \$62,378 increased my tax
17 from \$117 to \$397, however this was still below my California personal
18 exemption of \$482. (AL, p. 1, attachment.)

19 Later, the FTB affirmed the NPA in a Notice of Action (NOA) dated July 26, 2011. (See
20 exhibits attached to the AL.) The NOA proposed an additional tax of \$1,559.00, plus interest of
21 \$277.41. In response, appellant filed this timely appeal. (*Id.*)

22 Contentions

23 Appellant

24 Appellant’s argument on appeal is somewhat unclear. It appears, however, that appellant
25 might be making an argument similar to the argument he made at protest. On appeal, appellant states
26 that he recalculated his tax using Turbo Tax and his deductions are greater than his tax. Specifically,
27 appellant states in part:

28 . . . I used Turbo Tax 2007 to recalculate my tax based on IRS disallowing my
\$15,000 loan I claimed on my return ****

. . . My IRA distribution was my sole source of income for 2007.

. . . instead of a salary, I used my IRA. My tax for 2007 was calculated and my

³ The letter is dated July 16, 2011, but the Post Office’s certification is dated July 18, 2011. On appeal, the FTB does not state whether it has records indicating that it ever received appellant’s letter dated July 16, 2011.

1 deductions was (sic) greater my (sic) tax. Since I did not have any withholding
2 tax, I did not get any refund. (AL, p. 1.)

3 The FTB

4 The FTB contends that its proposed assessment correctly conforms to the IRS's
5 adjustments (i.e., items "a-c" above). (FTB OB, p. 3.) In support, the FTB refers to the federal audit
6 report (Form CP2000) dated June 16, 2011, and the federal account transcript dated August 12, 2011.
7 (FTB OB, pp. 3-4 & Exs. B & H.)

8 The FTB states that R&TC section 18622 requires a taxpayer to concede the accuracy of
9 the federal changes or to state wherein the changes are erroneous. (*Id.* p. 4.) Also, the FTB states that
10 deficiency assessments based on federal adjustments to income are presumed to be correct and the
11 taxpayer bears the burden of proving that the FTB's determination is erroneous. (*Id.*, citing *Appeal of*
12 *Donald G. and Franceen Webb*, 75-SBE-061, Aug. 19, 1975.)⁴ The FTB argues that appellant failed to
13 provide evidence showing the IRS adjustments, and the California assessment based thereon, were made
14 in error; thus, the FTB contends that appellant failed to carry his burden of proving error. (*Id.* p. 5.) The
15 FTB also states that, in contrast to federal law, which imposes an early distribution tax of 10 percent,
16 California imposes an early distribution tax of only 2.5 percent. (*Id.* p. 4.) The FTB concludes that
17 adjustments "a-c" were properly imposed and appellant has not otherwise shown error in the NOA. (*Id.*
18 p. 5.)

19 In addition, the FTB asserts that R&TC section 17501 incorporates Internal Revenue
20 Code (IRC) section 408(d), which provides that any amount paid or distributed out of a retirement plan
21 is included in the gross income of the taxpayer when received, in accordance with IRC section 72. Next,
22 the FTB asserts that, because California law (i.e., Rev. & Tax. Code, § 17081) incorporates IRC section
23 72, California residents who receive distributions from a retirement plan must include the paid or
24 distributed amounts in taxable income for California purposes. (*Id.* p. 4.)

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28 ⁴ Board of Equalization cases are generally available for viewing on the Board's website (www.boe.ca.gov).

1 Applicable Law

2 Federal Adjustments

3 A taxpayer must report federal changes to income or deductions to the FTB within six
4 months of the date the federal changes become final. (Rev. & Tax. Code, § 18622, subd. (a).) The
5 taxpayer must concede the accuracy of the federal changes or prove that those changes, and any
6 California deficiency assessment based thereon, are erroneous. (Rev. & Tax. Code, § 18622, subd. (a);
7 *Appeal of Sheldon I. and Helen R. Brockett*, 86-SBE-109, June 18, 1986; *Appeal of Aaron and Eloise*
8 *Magidow*, 82-SBE-274, Nov. 17, 1982.) Unsupported assertions are not sufficient to satisfy an
9 appellant’s burden of proof. (*Appeal of Aaron and Eloise Magidow, supra.*) In the absence of
10 uncontradicted, credible, competent, and relevant evidence showing that the FTB’s determination is
11 incorrect, the proposed assessment must be upheld. (*Appeal of Oscar D. and Agatha E. Seltzer*, 80-
12 SBE-154, Nov. 18, 1980.)

13 Pension Income

14 R&TC section 17071 incorporates IRC section 61, which defines “gross income”,
15 including subdivisions (a)(9) and (a)(11) of the statute, as including “all income from whatever source
16 derived” including annuities and pensions. R&TC section 17501 incorporates IRC section 72 and IRC
17 section 408(d), to include any pension distribution into gross income.

18 Premature Distribution from a Retirement Plan

19 IRC section 72(t)(1) imposes a 10 percent additional tax (in addition to income taxes
20 otherwise imposed) on early withdrawals from Individual Retirement Accounts (IRA’s), qualified
21 retirement plans, and annuities, with stated exceptions, including an exception for a distribution made on
22 or after the date the individual attains age 59 1/2. R&TC section 17085, subdivision (c)(1), adopts and
23 modifies IRC section 72(t)(1) such that the additional tax/penalty is 2.5 percent for California purposes.

24 STAFF COMMENTS

25 Page 6 of IRS audit report includes an itemization of some of the adjustments to the
26 federal return, including that appellant’s and his wife’s taxable retirement income for 2007, based upon
27 a Form 1099-R issued by National Financial Services LLC, totaled \$62,378. This amount is the basis
28 for the 2.5 percent California premature distribution penalty made by respondent (i.e., \$62,378 x 2.5

1 percent = \$1,559). (Form CP 2000; FTB OB, Ex. D.) Appellant's and his wife's regular tax assessment
2 was offset, and reduced to zero, by personal and dependent exemption credits, such that respondent's
3 assessment of the premature distribution penalty is the sole basis of respondent's proposed assessment.
4 At the oral hearing, appellant should be prepared to show error in the IRS adjustments or in the
5 California assessment based thereon. Pursuant to California Code of Regulations, title 18, section
6 5523.6, if appellant desires to provide any additional evidence for the Board's consideration, appellant
7 should provide such evidence to the Board Proceedings Division at least 14 days prior to the oral
8 hearing.⁵

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12 Lozada, Michael_wjs

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⁵ 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.