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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 **RICHARD B. PALLACK**) Case No. 527752¹
13)

14 Year Proposed
15 1993 Assessment
16 \$47,373

16 Representing the Parties:

17 For Appellant: Richard B. Pallack
18 For Franchise Tax Board: Kristen Kane, Tax Counsel

20 QUESTIONS: (1) Whether the Franchise Tax Board (FTB or respondent) issued the Notice of
21 Proposed Assessment (NPA) in a timely manner.
22 (2) Whether Treasury Regulation section 301.9100-3(a) can operate to extend the
23 time period in which appellant could file his disaster loss carryback claim under
24 Revenue and Taxation Code (R&TC) section 17207, subdivision (g).

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28 ¹ This appeal was originally scheduled for an oral hearing on October 23, 2012. At appellant's request, this appeal was rescheduled for an oral hearing on February 26, 2013.

1 (3) If Treasury Regulation section 301.9100-3(a) can operate to extend the time
2 period in which appellant could have filed his disaster loss carryback claim under
3 R&TC section 17207, subdivision (g), has appellant shown that he comes within
4 the provisions of Treasury Regulation section 301.9100-3(a).

5 HEARING SUMMARY

6 Background

7 Appellant did not file a timely 1993 California income tax return. (FTB opening brief
8 (FTB OB) p. 1.) On or about January 1, 1995, the FTB issued a notice, demanding that appellant file a
9 1993 California income tax return or show reasonable cause for not doing so. (*Id.*) When appellant
10 neither filed a return nor demonstrated why a return was not required, the FTB issued a Notice of
11 Proposed Assessment (NPA) on March 13, 1995. (*Id.*) The NPA set forth, among other things, a
12 California taxable income of \$42,888.²

13 Later, appellant filed a 1993 California income tax return on February 10, 1997,
14 reporting, among other things, a disaster loss of \$653,354; federal itemized deductions of \$227,861;
15 California itemized deductions of \$209,861; and a California taxable income of negative \$400,430,
16 which appellant listed as zero in accordance with the instructions for his return. (FTB OB, p. 1 &
17 Ex. B.)

18 Subsequently, on January 5, 2001, the FTB received information³ from the Internal
19 Revenue Service (IRS), stating that the IRS disallowed a disaster loss that appellant claimed on his 1993
20 federal return. (*Id.* p. 1.) In response, the FTB issued a new NPA on March 15, 2001, which increased
21 appellant's California taxable income from negative \$400,430 to a positive \$470,364 by making the
22 following changes: (a) disallowing a casualty loss of \$653,354, (b) disallowing itemized deductions of
23 \$206,585, and (c) disallowing itemized deductions of \$10,855. The NPA listed an additional tax of
24 \$47,373, plus interest. (*Id.* p. 1 & Ex. C.) The NPA set forth a deadline of May 14, 2001, for appellant
25 to file a timely protest. (*Id.*)

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28 ² On appeal, neither appellant nor the FTB provides a complete copy of the NPA. The portion of the NPA that was provided by the FTB does not state how the FTB determined that appellant had a California taxable income of \$42,888 for 1995.

³ The FTB does not specifically state what "information" it received.

1 Appellant filed what appears to be an untimely protest on July 24, 2001, stating that the
2 IRS was reexamining appellant's 1993 federal return. (*Id.* p. 1 & Ex. D.) Subsequently, the FTB sent
3 appellant a letter dated June 5, 2002, notifying appellant that his 1993 California account was being
4 deferred, pending the IRS's reexamination of appellant's 1993 federal return. (*Id.* Ex. E.) Later, the
5 FTB sent appellant a letter dated September 22, 2004, notifying appellant that his 1993 California
6 account was being further deferred, pending the IRS's reexamination of appellant's 1993 federal return.
7 (*Id.* Ex. F.) Afterwards, the FTB sent appellant a letter dated June 2, 2006, requesting an update on the
8 status of appellant's 1993 federal return. (*Id.* Ex. G.)

9 On August 13, 2007, the IRS closed its second review of appellant's 1993 tax return, with
10 no change from its original determination. (FTB Reply Brief (FTB Reply Br.) p. 2 & Ex. N)

11 Subsequently, the FTB sent appellant a letter dated October 21, 2008, requesting an
12 update on the status of appellant's 1993 federal return. In response, appellant sent the FTB a letter dated
13 November 18, 2008, stating that the IRS's proceedings had not yet been completed. (FTB OB, Ex. H,
14 p. 2.)

15 On October 14, 2009, the FTB received a copy of appellant's federal transcript, showing
16 that (i) the IRS's reexamination of appellant's 1993 federal return was final and (ii) the IRS's
17 reexamination of appellant's 1993 federal return resulted in no change from the IRS's original
18 determination. (*Id.* p. 2 & E. & I.)

19 On February 16, 2010, the FTB issued a Notice of Action (NOA), affirming the NPA.
20 (*Id.* p. 2 & Ex. J.) The NOA listed an additional tax of \$47,373, plus interest of \$99,989. In response,
21 appellant filed this timely appeal.

22 Contentions

23 Appellants' Appeal Letter

24 Appellant asserts that the FTB affirmed the NPA without ever discussing the merits of
25 the NPA with him. In addition, appellant asserts that (i) he "never had the opportunity to challenge the
26 merits in court" and (ii) he never received a determination from the IRS for federal purposes. Appellant
27 concludes with the assertion that he has full and complete proof to substantiate that the casualty loss
28 should be allowed.

1 Appellant’s Opening Brief

2 Appellant asserts that, due to the 1994 Northridge earthquake in California (the
3 Northridge earthquake), he suffered significant damage and a decline in value on several properties,
4 including his retail store and his personal residence. (Appellant’s opening brief (App. OB), p. 1.)
5 Appellant also asserts that he never received a determination on the merits of the case from the IRS for
6 federal purposes. (*Id.* pp. 1-2.)

7 Appellant contends that the most direct evidence of the decline in value of the applicable
8 properties is set forth in his property tax bills, which appellant provides copies of with his appeal brief,
9 including appellant’s own summary. (*Id.* p. 2.) Appellant asserts that the applicable property tax bills
10 establish “a loss in fair market value due to the earthquake for the commercial properties of at least
11 \$965,523 . . .”, which appellant argues is considerably less than the \$653,354 loss he claimed on his
12 return. (*Id.* pp. 2-3.) (Emphasis in original.) In addition, appellant asserts that various seismic repair
13 bids (copies of which are attached to his opening brief) indicate damages totaling \$1,274,939 and that
14 the loss he claimed on his return is less than the repair bills. (*Id.* pp. 2-3.)

15 As for the loss on appellant’s personal residence, appellant asserts that the property tax
16 bills are not a reliable indicator of the property’s value due to the application of Proposition 13.
17 (*Id.* p. 3.) Thus, apparently instead of relying on his property tax bills to establish the value of his
18 personal residence, appellant provides a structural repair estimate, listing repair costs of \$358,449. (*Id.*)
19 Appellant asserts that the estimate of \$358,449 is more than the structural repair of \$146,682 that
20 appellant listed on his return. (*Id.*) Furthermore, appellant states that estimates of his personal property
21 losses total \$61,821. Appellant contends, however, that due to appeal page limitations, he was not able
22 to attach evidence of his personal property losses. (*Id.*) Appellant asserts that the estimate of \$61,821 is
23 more than the personal property loss of \$47,000 that appellant claimed in his return.

24 The FTB’s Opening Brief

25 *The federal determination*

26 The FTB asserts that an FTB determination which is based on a federal audit is presumed
27 correct and appellant has the burden of proving error, citing *Appeal of Sheldon I. and Helen E. Brockett*,
28 86-SBE-109, decided on June 18, 1986. (FTB OB, p. 2.)

1 The FTB contends that the IRS determined that appellant was not entitled to claim a
2 disaster loss carryback under Internal Revenue Code (IRC) section 165(i) because the loss was not
3 timely claimed. (*Id.*) In addition, the FTB asserts that, when the issue was reconsidered by the IRS, the
4 IRS reexamination resulted in no change to its original assessment. (*Id.*)

5 *Appellant failed to timely elect a carryback under California law*

6 The FTB contends that the election to carryback appellant's loss (from 1994 (i.e., the
7 earthquake damages) to 1993) is invalid because the election does not meet the requirements under
8 R&TC section 17207, subdivision (g), which sets out timing restrictions that apply to the loss carryback.
9 (*Id.* pp. 3-4.) The FTB asserts that, if appellant wanted to utilize the disaster loss carryback, then
10 appellant needed to elect the carryback treatment on his original or amended 1993 return and file that
11 return on or before October 15, 1995, which was the due date of a California 1994 return (including
12 extension granted under California Code of Regulations section 18567). The FTB states that appellant
13 filed his 1993 California return on February 10, 1997, which the FTB asserts is well after the October
14 15, 1995 deadline. (*Id.*)

15 Appellants' Reply Brief

16 *Background facts, as alleged by appellant*

17 Appellant asserts that in 1994 a large earthquake hit the Los Angeles area, which is a
18 matter of public record, with the epicenter in Northridge and very close to Sherman Oaks and most of
19 appellant's properties. Appellant asserts that the extent of his losses is evidenced by the tax bills and
20 loss/repair estimates attached as exhibits to his opening brief. (Appellant's reply brief (App. Reply Br.)
21 p. 1.)

22 Appellant contends that he relied on professional accountants to advise him of the
23 necessary requirements for reporting casualty losses. (*Id.*) Appellant asserts that the process of
24 establishing the loss amounts and gathering the substantiating documentation was a daunting task.
25 (*Id.*, p. 2.) Appellant contends that, as a result of the earthquake, the majority of information on his
26 computers was lost and his paperwork was thrown all over the premises. (*Id.*)

27 In addition, appellant asserts that as a result of the earthquake, his clothing store business
28 "dried up", as most of his clientele were affected by the earthquake and were not shopping for new suits.

1 Appellant asserts that his business never recovered and was eventually closed. (*Id.*)

2 Appellant asserts that for the period of 1994 through 1996, there was an extreme shortage
3 of qualified licensed building contractors who, even if you could find one to take your call, would
4 schedule an appointment to see you within 3 to 6 months and then would not show up. (*Id.* p. 3.)
5 Furthermore, appellant contends that he was not able to get a contractor to give him a repair estimate
6 until June 1, 1996. (*Id.*)

7 *Appellant's legal argument*

8 Appellant asserts that the IRS should have allowed him to report the casualty loss, per
9 Treasury Regulation section 301.9100-3(a), which appellant contends provides an extension for late
10 disaster loss elections where a taxpayer acted reasonably and in good faith. (*Id.*) Furthermore, appellant
11 asserts that Treasury Regulation section 301.9100-3(b) provides that a taxpayer will be deemed to have
12 acted reasonably and in good faith if (1) the taxpayer failed to make the election because of intervening
13 events beyond the taxpayer's control, or (2) the taxpayer relied on a qualified tax professional and the
14 tax professional failed to make or advise the taxpayer to make the election. (*Id.* pp. 3-4.)

15 As to the facts at hand, appellant argues that he has met both of the tests in Treasury
16 Regulation section 301.9100-3(b) for showing reasonable cause and good faith, in that (1) the
17 earthquake and its aftermath were beyond his control, and (2) he relied upon his tax professional to
18 advise him regarding the tax rules related to a disaster loss. (*Id.* p. 4.) In addition, appellant asserts that
19 granting the requested relief would put the FTB in no worse position than had the election been timely
20 made, thus satisfying the requirement of Treasury Regulation section 301.9100-3(c). (*Id.*)

21 In addition, appellant asserts that the facts in Private Letter Ruling (PLR) 9534016 are
22 substantially identical to the facts at hand and, in PLR 9534016, the IRS granted relief under Treasury
23 Regulation section 301.9100-3. (*Id.*)

24 The FTB's Reply Brief

25 *The Treasury regulation only applies to a federal disaster loss election*

26 The FTB contends that the time for making a federal disaster loss election (as specified in
27 Treasury Regulation section 1.165-1) can be extended for good cause under Treasury Regulation section
28 301.9100-3(a). In comparison, the FTB contends that the time for making a California disaster loss

1 election (as specified in R&TC section 17207, subdivision (a)(15)) cannot be extended for good cause
2 under Treasury Regulation section 301.9100-3(a).

3 *Even if the Treasury regulation were applicable, appellant has not shown reasonable*
4 *cause and good faith*

5 The FTB asserts that the IRS agent assigned to review appellant's audit expressly found
6 that (i) appellant did not establish reasonable cause for the late filing, and (ii) the PLR cited by appellant
7 above did not apply to appellant's tax matter. (*Id.* pp. 4-5.)

8 In addition, the FTB contends that the facts set forth in PLR 9534016 are distinguishable
9 to the facts for the matter at hand because (i) the federal disaster loss election is found in a regulation
10 (i.e., Treasury Regulation section 1.165-1) and is not codified in a statute, as is California's disaster loss
11 election (which is provided for in R&TC section 17207, subdivision (g), and (ii) the taxpayer in PLR
12 9534016 filed a timely return and, thus, was not using "hindsight" in making his election, which is
13 proscribed by Revenue Procedure 92-85 section 5.01(5) as not being a reasonable cause for purposes of
14 making an election. (*Id.*) In comparison, the FTB asserts that appellant chose not to file his 1993
15 California return until 1997, which allowed him hindsight when making his election, which shows a lack
16 of good faith. (*Id.*)

17 Appellant's Supplemental Brief

18 Appellant contends that he has an excellent business reputation and the FTB's arguments
19 of "bad faith" have no basis whatsoever. (Appellant's Supplemental Brief (App. Supp. Br.) pp. 1-2.)

20 Appellant asserts that the facts of this appeal show that he meets (not just one but) both of
21 the tests set forth in Treasury Regulation section 301.9100-3(a), in that (1) the earthquake and its
22 aftermath were beyond his control, and (2) he relied on his tax professional to advise him regarding the
23 appropriate tax rules related to casualty losses. (*Id.* p. 2.)

24 Appellant also asserts that "[disaster carry back losses is governed by Regulations not
25 California Tax Rev. Code Section 17207 subdivision (g) . . ." (*Id.*) Finally, appellant asserts that "my
26 CPA advisors feel that the statute of limitations for the State of California to pursue this [proposed
27 assessment] have expired." (*Id.*)

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1 **QUESTION (1): Whether the FTB issued the NPA in a timely manner.**

2 Applicable Law

3 In general, the FTB must issue an NPA within four years of the date the taxpayer filed his
4 or her California return. (Rev. & Tax. Code, § 19057.) However, there are special statutes of
5 limitations when federal adjustments are involved.

6 A taxpayer is required to report federal changes to income or deductions to the FTB
7 within six months of the date the federal changes become final. (Rev. & Tax. Code, § 18622.) If the
8 taxpayer complies with that requirement, the FTB may issue the NPA within two years of the date of
9 notification, or within the general four-year period, whichever expires later. (Rev. & Tax. Code,
10 § 19059.) If the taxpayer notifies the FTB more than six months after the date the federal changes
11 became final, then the FTB may issue the NPA within four years of the date of notification. (Rev. &
12 Tax. Code, § 19060, subd. (b).) Finally, if the taxpayer fails to notify the FTB of the federal changes,
13 then the FTB may issue the NPA at any time. (Rev. & Tax. Code, § 19060, subd. (a); *Ordlock v.*
14 *Franchise Tax Board* (2006) 38 Cal.4th 897.)

15 STAFF COMMENTS

16 As noted above, the FTB received information⁴ from the IRS on January 5, 2001,
17 showing that the IRS disallowed a disaster loss that appellant claimed on his 1993 federal return.
18 Appellant has not provided any evidence to show that he notified the FTB of this federal adjustment
19 prior to January 5, 2001. Here, the FTB issued an NPA on March 15, 2001. Based on the foregoing, it
20 appears to staff that the FTB issued the NPA in a timely manner.

21 **QUESTION (2): Whether Treasury Regulation section 301.9100-3(a) can operate to extend the**
22 **time period in which appellant could file his disaster loss carryback claim under**
23 **Revenue and Taxation Code (R&TC) section 17207, subdivision (g).**

24 Applicable Law

25 A personal casualty loss is a loss of property, not connected with a trade or business and
26 not covered by insurance, which is deductible if caused by fire, storm, shipwreck, or other casualty.
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⁴ The FTB does not specifically state what “information” it received.

1 (Int.Rev. Code, § 165(h)(3)(B).) Although IRC section 172 allows for carrybacks, R&TC section
2 17276, subdivision (c), states that net operating loss (NOL) carrybacks shall not be allowed. Thus, for
3 California purposes, a NOL generally may only be carried forward.

4 There is an exception to the California NOL carryback prohibition that may apply if a
5 taxpayer incurs certain disaster losses. (Rev. & Tax. Code, § 17207, subd. (d).) If a taxpayer's loss
6 qualifies as a disaster loss and satisfies the requirements of IRC section 165(i) and R&TC section 17207,
7 the taxpayer may elect to deduct the loss from the previous year's income.

8 Timing of the disaster area loss election

9 Under federal law, the time deadline for making the disaster area loss election is provided
10 by federal regulation. Specifically, Treasury Regulation section 1.165-11(e) provides, in part, that a
11 disaster area loss must be made on or before the later of (1) the due date for filing the income tax return
12 (determined without regard for any extension of time granted the taxpayer for filing the income tax
13 return) for the taxable year in which the disaster actually occurred, or (2) the due date of filing the
14 income tax return (determined with regard to any extension of time granted the taxpayer for filing such
15 return) for the taxable year immediately preceding the taxable year in which the disaster actually
16 occurred.

17 Under California law, the time deadline for making a disaster area loss election is
18 provided by a California statute. Specifically, R&TC section 17207, subdivision (g), provides that a
19 disaster area loss for the Northridge earthquake (among others various disasters listed in R&TC section
20 17027, subdivisions (a)(15) to (a)(39)) must be made on a return or on an amended return filed on or
21 before the due date of the return (determined with regard to the extension) for the taxable year in which
22 the disaster occurred.

23 Extension of time to file a disaster area loss election

24 Under Treasury Regulation section 301.9100-1(c), the IRS—in exercising its
25 discretion—may grant a reasonable extension of time to file a federal disaster area loss election.
26 Treasury Regulation section 301.9100-3 provides the standards that the IRS will use to determine when,
27 among other things, the IRS may grant an extension of time to make a federal disaster area loss

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1 election.⁵ Treasury Regulation section 301.9100-3 only applies, however, when the time deadline for
2 filing an election is set forth by a “regulatory election”⁶ and is not set forth by statute:

- 3 (a) In general. Requests for extensions of time for regulatory elections that do not meet the
4 requirements of § 301.9100-2 must be made under the rules of this section. Requests for
5 relief subject to this section will be granted when the taxpayer provides the evidence
6 (including affidavits described in paragraph (e) of this section) to establish to the satisfaction
7 of the Commissioner that the taxpayer acted reasonably and in good faith, and the grant of
8 relief will not prejudice the interests of the government. (Emphasis added.)

9 Accordingly, a taxpayer might be able to obtain an extension of time to make a federal disaster area loss
10 election from the IRS under the standards set forth in Treasury Regulation section 301.9100-3, as the
11 time for making a federal disaster area loss election is provided by a regulation (i.e., Treasury
12 Regulation section 1.165-11(e)) —not a statute. In comparison, a taxpayer cannot obtain an extension of
13 time to make a California disaster area loss election from the FTB under the standards set forth in
14 Treasury Regulation section 301.9100-3, as the time for making the California disaster area loss election
15 is provided by a statute (i.e., R&TC section 17207, subdivision (g)).

14 STAFF COMMENTS

15 Appellant apparently filed his disaster area loss election after the time deadline provided
16 for in R&TC section 17207, subdivision (g). It appears that appellant is not entitled to an extension of
17 time to file his disaster area loss election under Treasury Regulation section 301.9100-3 because the
18 time deadline for California purposes is set by statute. Accordingly, staff is of the opinion that
19 appellant’s disaster area loss election was late for California purposes, as appellant filed his election in
20 1997 (which was after the October 15, 1995 deadline—i.e., the due date of appellant’s 1994 California
21 return [determined with regard to the extension]).

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25 ⁵ Under Treasury Regulation section 301.9100-3, requests for relief will be granted when the taxpayer provides evidence to
26 establish that the taxpayer acted reasonably and in good faith, and granting relief will not prejudice the interests of the
27 government.

28 ⁶ A “regulatory election” is defined in Treasury Regulation section 301.9100-1(b) as “an election whose due date is
prescribed by a regulation published in the Federal Register, a revenue ruling, a revenue procedure, notice, or announcement
published in the Internal Revenue Bulletin . . .”

1 **QUESTION (3): If Treasury Regulation section 301.9100-3(a) can operate to extend the time**
2 **period in which appellant could have filed his disaster loss carryback claim under**
3 **R&TC section 17207, subdivision (g), has appellant shown that he comes within**
4 **the provisions of Treasury Regulation section 301.9100-3(a).**

5 Applicable Law

6 The applicable law is set forth under Question 2 above.

7 STAFF COMMENTS

8 As noted above, staff is of the opinion that (i) appellant filed his California disaster area
9 loss election after the deadline specified in R&TC section 17207, subdivision (g), and (ii) Treasury
10 Regulation section 301.9100-3 cannot extend the deadline for filing a California disaster area loss
11 election, as the California deadline is provided by statute. Accordingly, the factors set forth in Treasury
12 Regulation section 301.9100-3 (such as reasonable cause and good faith) do not provide a basis for
13 extending the California statutory deadline.

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