

1 Mai Tran
2 Tax Counsel
3 Board of Equalization, Appeals Division
4 450 N Street, MIC:85
5 PO Box 942879
6 Sacramento CA 95814
7 Tel: (916) 324-8244
8 Fax: (916) 324-2618

6 Attorney for the Appeals Division

7 **BOARD OF EQUALIZATION**

8 **STATE OF CALIFORNIA**

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10 In the Matter of the Appeal of:) **HEARING SUMMARY**
11) **PERSONAL INCOME TAX APPEAL**
12 **IVON PITTI**) **Case No. 688101**
13)

14
15 Year Proposed
16 2008 Assessment
17 \$835

17 Representing the Parties:

18 For Appellant: Ivon Pitti

19 For Franchise Tax Board: Joanna A. Garcia, Senior Legal Analyst

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21 **QUESTIONS:** (1) Whether appellant has demonstrated error in the proposed assessment;
22 (2) Whether interest may be abated.

23 **HEARING SUMMARY**

24 Background

25 Appellant timely filed a 2008 California resident income tax return (Form 540). On the
26 return, appellant reported federal adjusted gross income (AGI) of \$41,544, less California adjustments
27 (subtractions) of \$13,326 and a standard deduction of \$3,692, for a taxable income of \$24,526. Using

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1 the tax rate schedule, appellant reported tax of \$279.¹ After applying exemption credits of \$99 and
2 withholding credits of \$1,136, appellant reported total tax of \$180 and claimed an overpayment of \$956.
3 (Resp. Op. Br., p. 1, Exh. A; App. Reply Br., p. 1, Exh. E.)

4 During the processing of appellant's return, respondent (respondent or FTB) determined
5 that the correct tax should be \$568,² less appellant's personal exemption credit of \$99, for a total tax of
6 \$469. Respondent reduced the claimed overpayment to \$667 (i.e., \$1,136 - \$469) which respondent
7 refunded to appellant on March 27, 2009, along with a Return Information Notice (RIN) to notify
8 appellant of the adjustment. The RIN indicated that respondent made adjustments in accordance with
9 code "TC" and "16".³ (Resp. Op. Br., p. 1-2, Exh. B; App. Reply Br., Exh. C & D.)

10 Respondent subsequently reviewed appellant's return and discovered that appellant did
11 not provide a Schedule CA (540) to substantiate the California adjustments claimed on her California
12 return. Based on this determination, on March 16, 2012, respondent issued a Notice of Proposed
13 Assessment (NPA) which made an adjustment to income of \$13,326 and an adjustment for a health
14 savings account (HSA) deduction of \$1,500 (adjustments totaling \$14,826). The NPA reflected a
15 revised taxable income of \$39,352 (i.e., \$24,526 + \$14,826) and proposed additional tax of \$891, plus
16 applicable interest. (Resp. Op. Br., p. 2, Exh. C; App. Op. Br., Atth.)

17 Appellant protested the NPA, stating that she inadvertently entered \$13,326 in Column B
18 on the Schedule CA California adjustments. Appellant stated that her 2008 withholding of \$1,136
19 covered her entire tax liability of \$837, and her overpaid tax would have been \$299. Appellant also
20 questioned why the FTB refunded appellant \$667 when the FTB had access to appellant's 2008 federal
21 return and when the Schedule CA was missing. Appellant also stated that she should not have to pay
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24 ¹ It appears that appellant miscalculated the tax of \$279 using the tax rate schedule. According to the tax rate schedule for
2008, a taxpayer with taxable income of \$24,526 owes tax of \$268.20 plus 4 percent of the amount of taxable income over
\$16,994 (i.e., \$268.20 + (0.04 x (\$24,526.00 - \$16,994.00)) = \$569.48), for a total tax liability of \$569.48.

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26 ² Based upon a taxable income of \$24,526, the tax table reflects tax of \$568, while tax based on the tax rate schedule is
\$569.48.

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28 ³ According to the corresponding list of explanations, the code "TC" meant appellant incorrectly computed the tax amount on
her return and a change in the tax amount could affect the computation of appellant's schedules. The code "16" meant that
the FTB disallowed appellant's direct deposit refund request because the information needed was missing, invalid, or
illegible.

1 any penalties or interest.⁴ Appellant provided the following documents: (1) Form 5498-SA Employee
2 Health Savings Account Contribution reflecting appellant's HSA contribution of \$1,500; (2) Form 1099-
3 R reflecting that appellant received a retirement distribution of \$5,775.84; (3) Form 1098-E reflecting
4 that appellant paid \$687.89 in student loan interest; (4) Two Forms 5498 reflecting that appellant made
5 Individual Retirement Arrangement (IRA) contributions totaling \$5,000; and (5) Federal Form 8863,
6 Education Credits, claiming an education credit of \$362. (Resp. Op. Br., p. 2, Exh. D; App. Op. Br.,
7 Atth.)

8 In response, respondent sent a letter to appellant, explaining that the FTB needed a copy
9 of appellant's Schedule CA before it could make a determination. When respondent did not receive a
10 copy of appellant's Schedule CA as requested, it issued a Notice of Action (NOA) that revised the NPA.
11 The NOA reflected that the FTB accepted the student loan interest deduction of \$688, removing that
12 amount from the \$13,326 adjustment, resulting in a revised adjustment of \$12,638 (i.e., \$13,326 - \$688),
13 along with the \$1,500 adjustment for the HSA deduction. As a result, the NOA reduced appellant's
14 taxable income to \$38,664 (i.e., \$39,352 (as shown on the NPA) - \$688 (student loan interest)).⁵ The
15 NOA revised appellant's additional tax to \$835 (i.e., \$1,304 (total tax) - \$469 (tax paid with return)).
16 (Resp. Op. Br., p. 2; App. Op. Br., Atth.)

17 Appellant then filed this timely appeal.

18 Contentions

19 Appellant's Opening Brief

20 Appellant disputes the FTB findings that she owes \$961.72 (\$835.00 in additional tax and
21 \$126.72 in interest) based on her HSA contribution of \$1,500. Appellant states that she always mails
22 her returns, including the 2008 federal and California income tax returns. Appellant states that she
23 included her Schedule CA (540) with her California income tax return and does not have a copy of this
24 form. Appellant also questions why the FTB refunded her \$667 when the FTB has access to federal tax
25 returns. Appellant asserts that the FTB has the capability to foresee and anticipate results from any acts
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27 ⁴ No penalties have been imposed in this matter.

28 ⁵ \$24,526 originally-reported taxable income + \$12,638 adjustment + \$1,500 adjustment = \$38,664 revised taxable income.

1 or omissions, such as whether a deduction for the HSA contribution is allowed in California. Appellant
2 also appears to contend that she relied on the instructions to Schedule CA which provide that “Line 25
3 Health Savings Account (HSA) Deduction – Federal law allows a deduction for contributions to an HSA
4 account. California does not conform to this provision. Transfer the amount from column A, line 25, to
5 column B, line 25.” Appellant questions these instructions if California does not allow a deduction for
6 HSA contributions. Appellant also contends that her withholding should cover her entire tax liability.
7 (App. Op. Br. p. 1, Atth.)

8 Respondent’s Opening Brief

9 Respondent states that it issued an NPA based on including the claimed California
10 adjustments of \$13,326 and the deduction for a \$1,500 HSA contribution on appellant’s Schedule CA.
11 Respondent further states that it issued an NOA which revised the NPA to allow appellant’s \$688
12 student loan interest deduction. Respondent contends that appellant has not provided any evidence
13 demonstrating that the proposed additional tax for 2008 is incorrect. (Resp. Op. Br., pp. 2-3.)

14 Respondent contends that appellant’s military retirement income is included in gross
15 income, pursuant to Internal Revenue Code (IRC) section 61, as incorporated by R&TC section 17071.
16 Respondent contends that, as appellant was a California resident in 2008, her military retirement income
17 is taxable to California. Respondent further contends that Schedule CA is used only to report
18 adjustments to federal AGI when that income is taxed differently for state and federal purposes.
19 Respondent explains that the amounts that should have been reported in Column B on the Schedule CA
20 are only the differences between California and federal law. Respondent contends that, because
21 appellant’s reported federal AGI of \$41,544 already included appellant’s subtractions, by listing the
22 \$5,776 in military retirement income, \$5,000 IRA contribution, \$362 education credit, and \$1,500 health
23 savings account deduction in Column B on the Schedule CA, appellant incorrectly subtracted these
24 amounts twice from her California taxable income. Respondent explains that, as corrected, appellant’s
25 federal AGI is \$41,544, and California adjustments are subtractions of \$688 and additions of \$1,500,⁶
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28 ⁶ Respondent notes that the instructions for line 37 of the Schedule CA state “Subtract line 36 from line 22 in columns A, B,
and C.” Because line 22 did not reflect any allowable subtractions, the \$1,500 is then treated as an addition to income and
transferred to line 16 on the Form 540 return. (Resp. Op. Br., p. 3, Exh. F.)

1 resulting in a taxable income of \$38,664 and a total tax liability of \$1,304. Respondent further explains
2 that, as appellant previously paid tax of \$469, the amount of additional tax due is \$835, which is
3 reflected on the NOA. (Resp. Op. Br., p. 3, Exh. G.)

4 Respondent also contends that, during the initial processing of tax returns, FTB
5 employees review a taxpayer's return for only certain purposes, such as checking for mathematical
6 errors and comparing a taxpayer's reported payments against the FTB's records. The FTB does not
7 review tax returns for the correctness of the adjustments to income reported on the return. As such,
8 respondent contends that the FTB's initial processing of appellant's return was not a substantive audit
9 that would reveal whether appellant's adjustments to income were correct. Respondent contends that,
10 after a subsequent substantive audit, respondent issued a timely NPA. Respondent also contends that
11 appellant's withholdings of \$1,136 are not available to be credited towards the additional tax
12 assessment. Respondent explains that appellant's total tax liability as revised was \$469, and appellant
13 was refunded the difference of \$667 (i.e., \$1,136 (original withholding) – \$469 (tax liability as revised)).
14 (Resp. Op. Br., pp. 3-4.)

15 Respondent finally contends that the charging of interest is mandatory if tax is not paid
16 by the original due date or if the FTB assesses additional tax and that assessment becomes due and
17 payable, citing R&TC section 19101. Respondent contends that the Board determined that the
18 imposition of interest is mandatory and that the FTB may not abate interest except where authorized by
19 law, citing the *Appeal of Amy M. Yamachi*, 77-SBE-095, decided by the Board on June 22, 1976.⁷
20 (Resp. Op. Br., pp. 4-6.)

21 Appellant's Reply Brief

22 Appellant contends that, when she received the Notice of Tax Change which reflected the
23 correction of error adjustment codes TC and 16, she had no reason to believe that the FTB did not
24 receive her Schedule CA. Appellant also appears to agree that, if there were no differences between
25 California and federal law in terms of adjustments to income, then the Schedule CA is not required.
26 Appellant questions if the Schedule CA is not required to be filed, how does the FTB compare the
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28 ⁷ Board of Equalization cases may be found on the Board's website: www.boe.ca.gov.

1 correctness of state deductions that taxpayers file against the federal return and Form W-2, Form 1099-
2 R, and other similar documents. Appellant also questions whether the FTB should be responsible and
3 accountable for lost, misplaced, or not scanned documents such as her Schedule CA. Appellant further
4 questions why the FTB does not review tax returns for the correctness of adjustments to income reported
5 on the returns during the FTB's initial processing of the returns when the FTB has access to all of a
6 taxpayer's personal information. Appellant acknowledges that she understands her error in deducting
7 \$13,326 from AGI twice after reading respondent's opening brief. (App. Reply Br., pp. 2-3, Exhs. A-F.)

8 Appellant further contends that she followed the written instructions for the Schedule
9 CA. Appellant notes that she transferred the amount of \$1,500 from column A, line 25 to column B,
10 line 25. Appellant states that she did the following calculation and placed the result in line 37, column
11 B: $\$1,500 - \$0 = \$1,500$. Appellant explains that, since \$1,500 was positive, she transferred \$1,500 onto
12 line 14 of Form 540, side 1. (App. Reply Br., p. 3, Exhs. G-J.)

13 In summary, appellant contends that the RIN did not state anything specific about the
14 FTB not receiving her Schedule CA and that the FTB should have made corrections during the initial
15 processing of her return. Appellant states that the FTB should revise its written instructions to prevent
16 confusion. Appellant also appears to contend that the FTB incorrectly refunded her \$667 which resulted
17 in additional tax and interest to appellant. (App. Reply Br., p. 3.)

18 Applicable Law

19 Proposed Assessment

20 R&TC section 17041 imposes a tax “. . . upon the entire taxable income of every resident
21 of this state . . .” and upon the entire taxable income of every nonresident or part-year resident which is
22 derived from sources in this state. IRC 61, as incorporated by R&TC section 17071, provides that gross
23 income is all income from whatever source derived.

24 The FTB's determination to assess additional tax is presumed correct and an appellant
25 has the burden of proving it to be wrong. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of*
26 *Ismael R. Manriquez*, 79-SBE-077, Apr. 10, 1979.) Unsupported assertions are not sufficient to satisfy
27 an appellant's burden of proof. (*Appeal of Aaron and Eloise Magidow*, 82-SBE-274, Nov. 17, 1982.) In
28 the absence of uncontradicted, credible, competent, and relevant evidence showing error in the FTB's

1 determinations, such proposed assessments must be upheld. (*Appeal of Oscar D. and Agatha E. Seltzer*,
2 80-SBE-154, Nov. 18, 1980.) An appellant's failure to produce evidence that is within her control gives
3 rise to a presumption that such evidence is unfavorable to her case. (*Appeal of Don A. Cookston*, 83-
4 SBE-048, Jan. 3, 1983.)

5 Deductions

6 Deductions are a matter of legislative grace and the burden of proving the right to the
7 deduction falls upon the taxpayer. (*New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435; *Appeal of*
8 *Franklin E. and Barbara R. Walker*, 84-SBE-139, Sep. 12, 1984.) To carry the burden of proof, the
9 taxpayer must point to an applicable statute and show by credible evidence that the deductions claimed
10 come within its terms. (*Appeal of Robert R. Telles*, 86-SBE-061, Mar. 4, 1986.)

11 Student Loan Interest

12 IRC section 221, incorporated into California law by R&TC section 17024.5, provides
13 taxpayers with a deduction for student loan interest paid up to \$2,500.

14 Health Savings Account Contributions

15 IRC section 106(d) generally provides that HSA contributions are excluded from federal
16 gross income. However, for California purposes, R&TC section 17131.4 provides that section 106(d) of
17 the Internal Revenue Code, relating to contributions to health savings accounts, shall not apply.

18 Interest Abatement

19 Interest is not a penalty but is merely compensation for the taxpayers' use of the money.
20 (Rev. & Tax. Code, § 19101, subd. (a); *Appeal of Amy M. Yamachi*, 77-SBE-095, June 28, 1977;
21 *Appeal of Audrey C. Jaegle*, 76-SBE-070, June 22, 1976.) To obtain interest abatement, an appellant
22 must qualify under one of the following three statutes: R&TC sections 19104, 19112, or 21012.
23 R&TC section 21012 does not appear applicable here because there has been no reliance on any written
24 advice requested of respondent. Under R&TC section 19112, interest may be waived for any period for
25 which respondent determines that an individual or fiduciary demonstrates an inability to pay that
26 interest solely because of extreme financial hardship caused by significant disability or other
27 catastrophic circumstance. This statute does not appear to provide any authority for the Board to
28 review the FTB's determination whether to abate interest for extreme financial hardship.

1 Under R&TC section 19104, respondent may abate all or a part of any interest on a
2 deficiency to the extent that interest is attributable in whole or in part to any unreasonable error or delay
3 committed by respondent in the performance of a ministerial or managerial act.⁸ (Rev. & Tax. Code,
4 § 19104, subd. (a)(1).) An error or delay can only be considered when no significant aspect of the error
5 or delay is attributable to the appellant and after respondent has contacted the appellant in writing with
6 respect to the deficiency or payment. (Rev. & Tax. Code, § 19104, subd. (b)(1).) There is no reasonable
7 cause exception to the imposition of interest. (*Appeal of Audrey C. Jaegle, supra.*)

8 The Board's jurisdiction in an interest abatement case is limited by statute to a review of
9 respondent's determination for an abuse of discretion. (Rev. & Tax. Code, § 19104, subd. (b)(2)(B).)
10 To show an abuse of discretion, the appellant must establish that, in refusing to abate interest,
11 respondent exercised its discretion arbitrarily, capriciously, or without sound basis in fact or law.
12 (*Woodral v. Commissioner* (1999) 112 T.C. 19, 23.) Interest abatement provisions are not intended to
13 be routinely used to avoid the payment of interest, thus abatement should be ordered only "where
14 failure to abate interest would be widely perceived as grossly unfair." (*Lee v. Commissioner* (1999)
15 113 T.C. 145, 149.) The mere passage of time does not establish error or delay that can be the basis of
16 an abatement of interest. (*Id.* at p. 150.)

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20 ⁸ In the *Appeal of Michael and Sonia Kishner*, 99-SBE-007, decided on September 29, 1999, the Board adopted the language
21 from Treasury Regulation section 301.6404-2(b)(2), defining a "ministerial act" as:

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

24 The Board has not yet adopted a definition for the term "managerial act." However, when a California statute is substantially
25 identical to a federal statute (such as with the interest abatement statute in this case), the Board may consider federal law
26 interpreting the federal statute as highly persuasive. (*Appeal of Michael and Sonia Kishner, supra*, (citing *Douglas v. State of
California* (1942) 48 Cal.App.2d 835.)) In this regard, Treasury Regulations section 301.6404-2(b)(1) defines a "managerial
act" as:

27 [A]n administrative act that occurs during the processing of a taxpayer's case involving the temporary or
28 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.

1 STAFF COMMENTS

2 It appears that appellant may have misread the directions to the Schedule CA. As such,
3 to reconstruct appellant's 2008 filing, Board staff offers the following. On her 2008 federal return,
4 appellant reported wage income of \$42,956 and pensions and annuities income (her military pension) of
5 \$5,776, for a gross income of \$48,732. Appellant then claimed the following adjustments to her gross
6 income, totaling \$7,188, to arrive at an adjusted gross income of \$41,544: (1) a health savings account
7 deduction of \$1,500; (2) an IRA deduction of \$5,000; and (3) a student loan interest deduction of \$688.
8 Appellant's 2008 federal adjusted gross income is illustrated as follows:

9	Wage income		\$42,956
10	Pension income		<u>5,776</u>
	Gross Income		\$48,732
11	Adjustments to Gross Income:		
12	HSA Deduction	\$1,500	
13	IRA Deduction	5,000	
	Student Loan Int. Deduction	<u>688</u>	(7,188)
14	Federal Adjusted Gross Income		<u>\$41,544</u>

15 As mentioned above, California does not comply with the federal statute relating to the
16 deductibility of health savings account contributions. As such, appellant's California return should have
17 reflected the add back of the HSA deduction and should have appeared as follows:

18	Federal Adjusted Gross Income		\$41,544
19	California adjustments:		
20	Additions:		
	HSA Deduction	<u>\$1,500</u>	<u>1,500</u>
21	California Adjusted Gross Income		\$43,044
22	Standard Deduction		(3,692)
23	California Taxable Income		<u>\$39,352</u>

24 Respondent, however, included an additional adjustment on the NOA: the allowance of
25 student loan interest in the amount of \$688, resulting in a California taxable income of \$38,664 (i.e.,
26 \$39,352 - \$688). In doing so, respondent mistakenly allowed appellant this adjustment to gross income
27 twice, such that appellant's tax liability is less than it should be for 2008.

28 With regard to interest abatement, in accordance with R&TC section 19104, appellant

1 should be prepared demonstrate an unreasonable error or delay by the FTB in the performance of a
2 ministerial or managerial act, arising to an abuse of discretion.

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