

1 Mai C. 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**

10 In the Matter of the Appeal of:) **HEARING SUMMARY**
11) **PERSONAL INCOME TAX APPEAL**
12 **MEHDI SHAHBAZI AND**) Case No. 575095
13 **FATEMEH R. SHAHBAZI¹**)

Year	Interest
2006	\$4,082.91
2007	\$2,503.13
2008	\$992.01

18 Representing the Parties:

19 For Appellants: Mehdi Shahbazi and Fatemeh R. Shahbazi
20 For Franchise Tax Board: Amanda Vassigh Sigal, Tax Counsel III

22 QUESTION: Whether respondent Franchise Tax Board (respondent/FTB) abused its discretion in
23 denying appellants' request for abatement of interest.

24 ///
25 ///
26 ///

28 ¹ Appellants reside in Santa Clara County.

1 HEARING SUMMARY

2 Background

3 Overview

4 Appellants claimed itemized deductions on their 2006, 2007, and 2008 tax returns for
5 their losses resulting from their rental real estate activities in the years at issue. (Resp. Op. Br., pp. 1-2,
6 Exs. B, H & M.) Respondent disallowed those deductions for the following reasons: (1) appellants'
7 modified adjusted gross income (MAGI) exceeded the threshold for the \$25,000 offset allowance under
8 the active participation provisions pursuant to Internal Revenue Code (IRC) section 469(i); and
9 (2) California does not conform to the rental real estate professional exception allowed to taxpayers for
10 federal purposes pursuant to IRC section 469(c)(7). (Resp. Addl.Br., p. 2.) On appeal, appellants
11 concede proposed assessment of additional tax for each year, but request abatement of interest due to
12 their financial circumstances. (App. Op. Br., p. 1.)

13 2006 Tax Year

14 Appellants filed a timely 2006 joint return on October 15, 2007, in which they reported
15 California AGI of \$315,570.19, itemized deductions of \$262,386.51, and taxable income of \$53,363.68.
16 Tax on that amount, \$1,453, was reduced by exemption credits of \$1,322 for a total tax of \$131.
17 Appellants claimed withholding of \$15,176.55 and a refund of \$15,045.55. (Resp. Op. Br., p. 1, Exs. A
18 & B.)

19 In processing appellants' return, respondent determined appellants failed to account for
20 the AGI limitation in their calculation of exemption credits and reduced appellants' exemption credits
21 from \$1,322 to \$1,106. Respondent revised the refund amount claimed, mailed a Return Information
22 Notice (RIN) and, on November 27, 2007, issued a refund. The refund amount, \$15,497.39, included
23 the overpayment of \$14,829.55 and interest of \$667.84. (Resp. Op. Br., p. 1, Exs. C, D, & E.)

24 After respondent examined appellants' 2006 return, respondent disallowed \$221,573 in
25 rental real estate losses and reduced appellants' claimed itemized deductions by \$13,294. Based on
26 these adjustments, respondent issued a Notice of Proposed Assessment (NPA) on October 19, 2010, in
27 which respondent revised appellants' taxable income to \$288,231.00, resulting in a proposed assessment
28 of additional tax in the amount of \$22,201.00, plus interest of \$3,498.33 for the period April 15, 2007 to

1 April 15, 2009. The NPA also indicated that some of the interest on the additional tax assessment was
2 suspended under Revenue and Taxation Code (R&TC) section 19116. (Resp. Op. Br., pp. 1-2, Ex. F.)

3 2007 Tax Year

4 Appellants filed a timely 2007 joint return on April 15, 2008, in which they reported
5 California AGI of \$166,700, itemized deductions of \$117,393, and taxable income of \$49,307. Tax on
6 that amount, \$1,188, was reduced to zero after applying exemption credits of \$1,364. Appellants
7 claimed withholding of \$19,674 and a refund of \$19,674. (Resp. Op. Br., p. 2, Exs. G & H.)

8 In processing of appellants' return, respondent noted the correct amount of withholdings
9 was \$22,723.43 and therefore, issued a refund of that amount to appellants on May 24, 2008. (Resp. Op.
10 Br., p. 2, Exs. I & J.)

11 After respondent examined appellants' 2007 return, respondent disallowed \$220,652 in
12 rental real estate losses and reduced appellants' claimed itemized deductions by \$5,153. Based on these
13 adjustments, respondent issued an NPA on October 19, 2010, in which respondent revised appellants'
14 taxable income to \$275,112.00, resulting in a proposed assessment of additional tax in the amount of
15 \$20,785.00, plus interest of \$1,985.81 for the period April 15, 2008 to October 15, 2009. The NPA also
16 indicated that some of the interest on the additional tax assessment was suspended under R&TC section
17 19116. (Resp. Op. Br., p. 2, Ex. K.)

18 2008 Tax Year

19 Appellants filed a timely 2008 joint return on October 15, 2009, in which they reported
20 California AGI of \$149,559, itemized deductions of \$115,873, and taxable income of \$33,686. Tax on
21 that amount, \$531, was reduced to zero after applying exemption credits of \$1,125. Appellants claimed
22 withholding of \$12,137 and a refund of \$12,137. Respondent issued a refund of that amount to
23 appellants on November 6, 2009. (Resp. Op. Br., p. 2, Exs. L, M & N.)

24 After respondent examined appellants' 2008 return, respondent disallowed \$139,011 in
25 rental real estate losses. Respondent issued an NPA on October 19, 2010, in which respondent revised
26 appellants' taxable income to \$172,697.00, resulting in a proposed assessment of additional tax in the
27 amount of \$10,327.00, plus interest of \$722.39 for the period April 15, 2010 to October 19, 2010.
28 (Resp. Op. Br., pp. 2-3, Ex. O.)

1 Protest

2 Appellants timely protested the NPAs for the years at issue, explaining that they did not
3 use a software program to prepare the returns at issue and they made an honest mistake. Appellants
4 stated that they were willing to pay the additional tax assessments, but request both the interest be
5 waived and a monthly payment arrangement for the taxes owed. (Resp. Op. Br., p. 3, Ex. P.)

6 Upon consideration, in a Notice of Determination Not to Abate Interest issued on
7 May 25, 2011, respondent denied appellants' request for interest abatement because appellants' mistakes
8 on their return were not grounds for which the tax law permits interest abatement. (App. Op. Br.,
9 Attchmt.)

10 Appellants then filed this timely appeal.

11 Contentions

12 Appellants

13 Appellants contend they did not use any software program to prepare their taxes for the
14 years at issue and as a result, they made an honest mistake in their returns. Appellants state that they are
15 willing to pay their fair share of taxes, but request abatement of interest and a monthly payment plan to
16 satisfy their tax liabilities. In support, appellants contend the error was unintentional, they are in the
17 worst economic condition, and they are currently paying the highest tuition to the University of
18 California for their two children. (App. Op. Br., p. 1.)

19 In response to the Board's Appeals Division staff request for additional information
20 regarding their mistakes, appellants stated that shortly after they moved from Texas to California,
21 appellants attended several real estate seminars to learn about investing in real estate and its
22 corresponding tax benefits. Appellants state they learned that if they invest in real estate, all expenses
23 would be tax deductible. Appellants state that they purchased two properties at the highest prices.
24 When they were unable to rent them out for a long period of time, appellants incurred big losses.
25 Appellants explained that when they filed their federal and state returns for the years at issue, appellants
26 deducted the expenses and depreciation of these two real estate properties purchased in 2006.
27 Appellants were later notified that these losses were not deductible for California taxes. Appellants also
28 provided copies of their federal returns for 2006, 2007, and 2008, as requested by the Appeals Division

1 staff. (App. Add. Br., p. 1, Attchmts.)

2 Respondent

3 Respondent contends that its imposition of interest is mandatory, and respondent is not
4 allowed to abate interest except where authorized by law. Respondent asserts appellants' argument that
5 interest should be abated due to inadvertent errors on their returns is a reasonable cause-type argument.
6 Respondent contends that, as there is no reasonable cause exception to the imposition of interest, no
7 interest may be abated in this matter. Respondent further contends appellants have not advanced
8 arguments that would support the abatement of interest in this appeal. Specifically, respondent notes
9 that appellants do not argue that respondent or the Internal Revenue Service committed an error or delay
10 in the performance of a ministerial or managerial act. Respondent asserts that a review of this matter
11 does not reveal any apparent unreasonable errors or delays by respondent in the performance of a
12 ministerial or managerial act. In addition, respondent contends appellants received the benefits of
13 interest suspension for the 2006 and 2007 tax years, pursuant to R&TC section 19116.² (Resp. Op. Br.,
14 pp. 3-4.)

15 Respondent notes that it generally cannot consider a taxpayer's concern relating to
16 financial hardship until the amount in dispute becomes a final liability. Respondent contends that
17 appellants have not provided sufficient evidence to support interest abatement due to financial hardship
18 pursuant to R&TC section 19112. Respondent further contends that, unlike R&TC section 19104,
19 R&TC section 19112 does not give the Board jurisdiction to review respondent's interest determinations
20 based on a claim of financial hardship. Respondent notes that appellants may request an abatement of
21 interest due to financial hardship by sending their request to respondent's collection advisory team.
22 Respondent also notes that appellants may request an installment agreement and provides appellants
23 with the instructions for doing so. (Resp. Op. Br., pp. 4-5.)

24 In response to the Board's Appeal Division staff's request for additional information,
25 respondent explains its reasons for disallowing the rental real estate losses. Appellants claimed passive
26 rental losses of \$221,573 for 2006 tax year, \$220,652 for 2007, and \$139,011 for 2008. Citing IRC
27

28 ² Respondent notes that, because the NPA for the 2008 tax year was issued prior to the beginning of the suspension period
(18 months from the filing date of appellants' 2008 return), no interest was suspended under R&TC section 19116.

1 section 469(i), respondent contends that losses from passive activities may only be used to offset income
2 from passive activities under federal and California income tax laws. Respondent states that losses from
3 passive activities in excess of income from passive activities are suspended and carried forward to future
4 years until the taxpayer has sufficient income from passive activities to offset the loss or until the
5 taxpayer disposes of the entire interest in the activity in a fully taxable transaction, citing IRC sections
6 469(b) and 469(g). (Resp. Addl. Br., pp. 1-2.)

7 Respondent further explains that a passive activity includes any trade or business in
8 which the taxpayer does not materially participate and any rental activity regardless of participation,
9 citing IRC section 469(c)(1) and (2). Respondent notes that there is an exception to the general passive
10 loss rules which allows taxpayers to deduct up to \$25,000 of passive losses against non-passive income,
11 provided the taxpayer is an active participant in the activity, citing IRC section 469(i). Respondent
12 asserts that this \$25,000 offset is reduced when the taxpayer's MAGI is over \$100,000 and once MAGI
13 exceeds \$150,000, the \$25,000 offset is reduced to zero. Respondent contends that, as appellants'
14 MAGI exceeded \$150,000 for each of the years at issue, appellants were not entitled to claim this offset.
15 Respondent notes that for federal purposes, IRC section 469(c)(7) provides an exception for qualified
16 real estate professionals who materially participate in the rental real estate activity. For those who
17 qualify for this exception, the activity would not be treated as passive and the taxpayer would be entitled
18 to deduct losses from that activity without limit against non-passive income. Respondent states that
19 California does not conform to the real estate professional exception pursuant to IRC section 469(c)(7),
20 and therefore appellants' claimed rental real estate activity losses claimed for the years at issue were
21 properly disallowed. (Resp. Addl. Br., pp. 1-3.)

22 Applicable Law

23 Interest is not a penalty but is merely compensation for the taxpayer's use of the money.
24 (Rev. & Tax. Code, § 19101, subd. (a); *Appeal of Amy M. Yamachi*, 77-SBE-095, June 28, 1977; *Appeal*
25 *of Audrey C. Jaegle*, 76-SBE-070, June 22, 1976.)³ To obtain interest abatement, appellant must qualify
26 under one of the following three statutes: R&TC sections 19104, 19112 or 21012. R&TC section
27

28 ³ Board of Equalization cases may be viewed on the Board's website (www.boe.ca.gov).

1 21012 is not applicable because there has been no reliance on any written advice requested of
2 respondent. Under R&TC section 19112, interest may be waived for any period for which respondent
3 determines that an individual or fiduciary demonstrates inability to pay that interest solely because of
4 “extreme financial hardship caused by significant disability or other catastrophic circumstance.”
5 However, this section does not provide any authority for the Board to review the FTB’s determination
6 whether to abate interest for extreme financial hardship.

7 Respondent may abate all or a part of any interest on a deficiency to the extent that
8 interest is attributable in whole or in part to any unreasonable error or delay committed by respondent in
9 the performance of a ministerial or managerial act. (Rev. & Tax. Code, § 19104, subd. (a)(1).) Further,
10 an error or delay can only be considered when no significant aspect of the error or delay is attributable to
11 the taxpayer and after respondent has contacted the taxpayer in writing with respect to the deficiency or
12 payment. (Rev. & Tax. Code, § 19104, subd. (b)(1).) There is no reasonable cause exception to the
13 imposition of interest. (*Appeal of Audrey C. Jaegle, supra.*) Furthermore, respondent’s determination
14 not to abate interest is presumed correct, and the burden is on appellants to prove error. (*Appeal of*
15 *Michael E. Myers*, 2001-SBE-001, May 31, 2001.)

16 In the *Appeal of Michael and Sonia Kishner*, 99-SBE-007, decided on September 29,
17 1999, the Board adopted the language from Treasury Regulation section 301.6404-2(b)(2), defining a
18 “ministerial act” as:

19 [A] procedural or mechanical act that does not involve the exercise of judgment or
20 discretion, and that occurs during the processing of a taxpayer’s case after all
21 prerequisites to the act, such as conferences and 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.

22 The Board has not yet adopted a definition for the term “managerial act.” However,
23 when a California statute is substantially identical to a federal statute (such as with the interest
24 abatement statute in this case),⁴ the Board may consider federal law interpreting the federal statute as
25 highly persuasive. (*Appeal of Michael and Sonia Kishner, supra*, (citing *Douglas v. State of California*
26 (1942) 48 Cal.App.2d 835).) In this regard, Treasury Regulation section 301.6404-2(b)(1) defines a
27

28 ⁴ R&TC section 19104, subdivisions (a) and (b)(2)(B), are substantially identical to IRC section 6404 (e) and (h).

1 “managerial act” as:

2 [A]n administrative act that occurs during the processing of a taxpayer’s case involving
3 the temporary or permanent loss of records or the exercise of judgment or discretion
4 relating to management of personnel. A decision concerning the proper application of
5 federal tax law (or other federal or state law) is not a managerial act.

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

14 STAFF COMMENTS

15 Appellants request interest abatement on the basis of their adverse financial situation and
16 their assertion that they made an honest mistake by deducting the losses from income. With respect to
17 their financial situation, R&TC section 19112 provides interest abatement if respondent determines
18 appellants demonstrated an inability to pay due to extreme financial hardship caused by significant
19 disability or other catastrophic circumstance. Here, staff notes that appellants merely state that they are
20 in the “worst economic condition” and paying college tuition for their two children but appellants have
21 not provided any evidence of extreme financial hardship due to any cause. In addition, R&TC section
22 19112 does not grant the Board with authority to review respondent’s denial of interest abatement under
23 such circumstances.

24 The Board does have jurisdiction to consider respondent’s denial of interest abatement
25 under R&TC section 19104. The parties should be prepared at the hearing to address whether there was
26 an unreasonable error or delay in a ministerial or managerial act performed by one of respondent’s
27 employees during the handling of appellants’ protest. Appellants should be prepared to discuss how
28 respondent, in failing to abate interest, exercised its discretion arbitrarily, capriciously, or without sound

1 basis in fact or law. Appellants should also be prepared to explain how the “failure to abate interest
2 would be widely perceived as grossly unfair.” (*Lee v. Commissioner, supra.*) Pursuant to California
3 Code of Regulations, title 18, section 5523.6, if either party has any additional evidence to present, they
4 should provide the evidence to Board Proceedings at least 14 days prior to the oral hearing.⁵

5 ///

6 ///

7 ///

8 Shahbazi_mt

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

26

27

28

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.