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7 **BOARD OF EQUALIZATION**  
8 **STATE OF CALIFORNIA**  
9

10 In the Matter of the Appeals of: ) **HEARING SUMMARY**  
11 ) **PERSONAL INCOME TAX APPEAL**  
12 **VINTON P. CUNNINGHAM AND** ) Case Nos. 447982 and 459821<sup>2</sup>  
13 **BEVERLY F. CUNNINGHAM**<sup>1</sup> )  
14 \_\_\_\_\_ )

	<u>Years</u> <sup>3</sup>	<u>Proposed Assessment</u> <sup>4</sup> <u>Tax</u>	<u>Estimated Amnesty Penalty</u>
	1985	\$2,816.00	\$5,559.09
	1986	\$2,437.00	\$4,296.37

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18 Representing the Parties:  
19 For Appellants: Vinton P. and Beverly F. Cunningham  
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21 <sup>1</sup> Appellants reside in San Diego County.

22 <sup>2</sup> This appeal was originally calendared for the April 28, 2009 Board hearing but was rescheduled to the June 30-July 2, 2009 calendar at appellants' request.

23 <sup>3</sup> The length of time between the years at issue and the filing of this appeal is due to the fact that on August 27, 2007, respondent issued Notices of Proposed Assessments for tax years 1985 and 1986 based on information it received from the Internal Revenue Service in April 2006. In addition, appellants failed to inform respondent of the federal changes.

24 <sup>4</sup> Based on the Notices of Proposed Assessments, accrued interest for the 1985 proposed assessment amounted to \$13,415.19, as of August 27, 2007, and accrued interest for the 1986 proposed assessment amounted to \$10,410.97, as of August 27, 2007. Interest continues to accrue on the unpaid amounts. At the hearing, respondent should be prepared to provide the current amount of accrued interest as of the hearing date for both tax years.  
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1 For Franchise Tax Board: Suzanne L. Small, Tax Counsel III  
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- 3 QUESTIONS: (1) Whether the Franchise Tax Board's (respondent or FTB) 1985 and 1986  
4 proposed assessments are barred by the statute of limitations.  
5 (2) Whether appellants have established error in the 1985 and 1986 proposed  
6 assessments, which are based on federal determinations.  
7 (3) Whether the Board has jurisdiction to review respondent's proposed assessment  
8 of the post-amnesty penalties.

9 HEARING SUMMARY

10 Background

11 1985

12 Appellants filed a 1985 California joint personal income tax return.<sup>5</sup> The Internal  
13 Revenue Service (IRS) subsequently audited appellants' 1985 federal return.<sup>6</sup> (Resp. Opening Br.,  
14 Exhibit B.) Respondent indicates that appellants failed to notify it of any federal determination for the  
15 1985 tax year. (Resp. Opening Br., p. 3.) Based on information it received from the IRS, respondent  
16 disallowed appellants' claimed deduction of \$25,979 for ordinary income loss for the 1985 tax year.  
17 (Resp. Opening Br., p. 2.) On August 27, 2007, respondent issued an NPA for 1985, which increases  
18 appellants' taxable income from \$51,250 to \$77,229 by including disallowed ordinary income loss  
19 deduction of \$25,979. The 1985 NPA proposes additional tax of \$2,816.00 and imposes an estimated  
20 post-amnesty penalty of \$5,559.09, plus interest. (Apps. June 11, 2008, Amended Opening Br.,  
21 Attachment.) Respondent later obtained an IRS Individual Master File (IMF) transcript dated July 21,  
22 2008, for appellants' 1985 federal account. The IMF transcript shows that the IRS made a final  
23 determination for tax year 1985 on August 19, 2002, assessing additional tax of \$10,088.00 plus  
24 interest of \$46,656.67. The IMF transcript also indicates that a \$56,744.67 payment against the entire  
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26 <sup>5</sup> As discussed below, both parties agree that appellants filed 1985 and 1986 joint California returns, although neither party  
27 has retained copies of the returns. (See Apps. June 11, 2008, Amended Opening Br., p. 1 and Apps. July 9, 2008, Opening  
28 Br., p.1; Resp. Opening Br., pp. 5-6.)

<sup>6</sup> It appears from the Individual Master File that appellants filed an amended 1985 federal return that was forwarded to  
examination in 1999.

1 1985 federal deficiency was made on September 8, 2002. (Resp. Opening Br., Exhibit B.)

2           According to respondent, appellants filed a timely protest of the 1985 NPA. (Resp.  
3 Opening Br., p. 2.) Respondent nonetheless issued a Notice of State Income Tax Due dated  
4 November 26, 2007, for tax year 1985, which states that “the proposed assessment for tax year 1985 is  
5 now final and must be paid.” (Apps. June 11, 2008, Amended Opening Br., Attachment.) Respondent  
6 affirmed the 1985 NPA in a Notice of Action (NOA) dated April 14, 2008. (*Ibid.*) Appellants  
7 thereafter filed this timely appeal.

#### 8           1986

9           Appellants filed a 1986 California joint personal income tax return. On April 7, 2006,  
10 respondent received a federal report of Income Tax Examination Changes (RAR) dated August 1,  
11 2002, with respect to appellants’ 1986 federal account, indicating that the IRS disallowed appellants’  
12 claimed deduction of \$22,110 for ordinary income loss for the 1986 tax year. (Resp. Opening Br.,  
13 p. 4, Exhibit A.) The RAR states, “This report reflects changes, based on a Tax Court decision, to  
14 your partnership U.S. Farm Partners EIN: 33-0202577.” (*Ibid.*) Respondent indicates that appellants  
15 failed to notify it of any federal determinations for the 1986 tax year. (Resp. Opening Br., p. 3.) On  
16 August 27, 2007, respondent also issued an NPA for 1985. The 1986 NPA increases appellants’  
17 taxable income from \$59,515 to \$81,625 by including disallowed ordinary income loss deduction of  
18 \$22,110. The 1986 NPA proposes additional tax of \$2,437.00 and imposes an estimated post-amnesty  
19 penalty of \$4,296.37, plus interest. (Apps. July 9, 2008, Opening Br., Attachment.) According to  
20 respondent, appellants filed a timely protest of the 1986 NPA. (Resp. Opening Br., p. 2.) Respondent  
21 affirmed the 1986 NPA in an NOA dated June 9, 2008. (Apps. July 9, 2008, Opening Br.,  
22 Attachment.) Appellants thereafter filed this timely appeal.

#### 23           Appellants’ Contentions

24           Appellants contend that the 1985 and 1986 proposed assessments are barred by the  
25 statute of limitations. Appellants contend that respondent did not issue the 1985 and 1986 NPAs until  
26 twenty years and twenty-one years after they filed their 1985 and 1986 California returns, respectively.  
27 Appellants contend that they have copies of their returns since 1989, but they no longer have copies of  
28 their 1985 and 1986 returns. Furthermore, they contend that the IRS did not impose any penalties

1 when it adjusted their 1985 and 1986 federal accounts. They argue that they have been denied the  
2 opportunity to pursue these matters in a timely fashion, because respondent failed to communicate  
3 with them since they filed their 1985 and 1986 returns. Appellants assert that they are good taxpayers  
4 who have timely reported and paid their California income tax for many years without any  
5 communication from respondent concerning the proposed assessments. Appellants argue that  
6 respondent improperly imposed the post-amnesty penalties for both years, since they did not receive  
7 notification that the amnesty provisions were available to them with respect to these proposed  
8 assessments. Lastly, appellants argue that they are retired seniors over 70 years of age and payment of  
9 the proposed assessments, post-amnesty penalties, and accrued interest would create a significant  
10 financial hardship for them.

#### 11 Respondent's Contentions

12 Respondent contends that both NPAs were timely issue on August 27, 2007, because the  
13 four-year statute of limitations for both tax years only commenced on April 7, 2006, when it received the  
14 1986 RAR from the IRS. Respondent also contends that appellants have not met their burden of  
15 establishing error in the federal actions or the 1985 and 1986 proposed assessments. According to  
16 respondent, appellants were investors in a partnership, U.S. Farm Partners, which was audited by the  
17 IRS. Respondent contends that the IRS disallowed, among other things, items of ordinary income loss  
18 for 1985 and 1986. Respondent argues that appellants have not supported their claim that the IRS  
19 overstated the adjustments. Respondent contends that it properly issued NPAs for 1985 and 1986 in  
20 accordance with Revenue and Taxation Code (R&TC) section 19033 and, where, as here, appellants'  
21 actual returns were no longer available, the court's decision in *John E. Wertin v. Franchise Tax Board*  
22 (1998) 68 Cal.App.4th 961 [*"Wertin"*]). Respondent argues that *Wertin* only applies when the  
23 taxpayer's return is available. Respondent asserts that it destroyed appellants' 1985 and 1986 returns in  
24 accordance with R&TC section 19530<sup>7</sup> and its document retention policy. Respondent states that its  
25 assessments are based on concrete data and are not arbitrary; furthermore, unlike *Wertin*, appellants did  
26 not offer respondent any returns prior to the issuance of the NPAs. Lastly, respondent argues that the  
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28 <sup>7</sup> R&TC section 19530 requires respondent to preserve tax returns for a minimum of three years from the due dates thereof.

1 Board does not have jurisdiction over the post-amnesty penalties imposed for both years.

2 Applicable Law

3 Statute of Limitations on Assessments

4 The statute of limitations on respondent's issuance of a proposed assessment depends  
5 on when, or if, it is notified of the federal changes. In general, respondent must issue a proposed  
6 assessment within four years of the date the taxpayer filed his or her California return. (Rev. & Tax.  
7 Code, § 19057.) Regardless of the general rule, if there are federal changes, and the taxpayer or the  
8 IRS notifies respondent within six months of the date the federal changes became final, then  
9 respondent must issue a proposed assessment within two years of the date of notification, or within the  
10 general four-year period, whichever expires later. (Rev. & Tax. Code, § 19059.) If the taxpayer or the  
11 IRS notifies respondent later than six months from the date the federal changes became final, then  
12 respondent must issue a proposed assessment within four years of the date of notification. (Rev. &  
13 Tax. Code, § 19060, subd. (b).) Finally, if the taxpayer fails to notify respondent of the federal  
14 changes, then respondent may issue a proposed assessment at any time. (Rev. & Tax. Code, § 19060,  
15 subd. (a).) The California Supreme Court has clarified that the specific limitations periods set forth in  
16 section 19060 override the general limitations period set forth in section 19057. (*Ordlock v. Franchise*  
17 *Tax Board* (2006) 38 Cal.4th 897.)

18 Accuracy of Assessments

19 R&TC section 18622 provides that a taxpayer shall either concede the accuracy of a  
20 federal determination or state wherein it is erroneous. It is well-settled that a deficiency assessment  
21 based on a federal audit report is presumptively correct and the taxpayer bears the burden of proving that  
22 the determination is erroneous. (*Appeal of Sheldon I. and Helen E. Brockett*, 86-SBE-109, June 18,  
23 1986; *Todd v. McColgan* (1949) 89 Cal.App.2d 509.) Unsupported assertions are not sufficient to  
24 satisfy appellants' burden of proof with respect to an assessment based on federal action. (*Appeal of*  
25 *Aaron and Eloise Magidow*, 82-SBE-274, Nov. 17, 1982.) In the absence of uncontradicted, credible,  
26 competent, and relevant evidence showing that respondent's determinations are incorrect, they must be  
27 upheld. (*Appeal of Oscar D. and Agatha E. Seltzer*, 80-SBE-154, Nov. 18, 1980.) Appellants' failure to  
28 produce evidence that is within their control gives rise to a presumption that such evidence is

1 unfavorable to their case. (*Appeal of Don A. Cookston*, 83-SBE-048, Jan. 3, 1983.)

2 It is also well established that deductions from gross income are a matter of legislative  
3 grace and the burden is on appellants to show by competent evidence that they are entitled to deductions  
4 claimed. (*Appeal of James C. and Monablance A. Walshe*, 75-SBE-073, Oct. 20, 1975; *New Colonial*  
5 *Ice Co. v. Helvering* (1934) 292 U.S. 435.) Appellants' burden of proof is not overcome by unsupported  
6 allegations. (*Appeal of Gilbert W. Janke*, 80-SBE-059, May 21, 1980.) In order to carry their burden of  
7 proof, appellants must point to an applicable statute and show by credible evidence that the deductions  
8 they claim come within its terms. (*Appeal of Robert R. Telles*, 86-SBE-061, Mar. 4, 1986.)

9 With respect to the unavailability of the returns at issue, prior to 2001, R&TC section  
10 19033 stated in its entirety:

11 If the Franchise Tax Board determines that the tax disclosed by the  
12 taxpayer on an original or amended return, including an amended return  
13 reporting federal adjustments pursuant to section 18622, is less than the  
tax disclosed by its examination, it shall mail notice or notices to the  
taxpayer of the deficiency proposed to be assessed.

14 In 1998, the Court of Appeal construed the foregoing language, along with the definition of "deficiency"  
15 in R&TC section 19043, to require that "where a taxpayer's return is available, the FTB may not assess  
16 or collect a deficiency without relying on the return." (*Wertin*, 68 Cal.App.4th 961, *supra*.)<sup>8</sup>

17 In 2000, the Legislature amended R&TC section 19033 in light of the holding in *Wertin*.  
18 The first section of the legislation states, "It is the intent of the Legislature that the amendments made by  
19 this act is [sic] to clarify the power of the Franchise Tax Board to issue deficiency assessments after the  
20 holding in [*Wertin*]." (Ch. 414, Stats. 2000, § 1.) The second section of the legislation added a new  
21 subdivision to R&TC section 19033 to expressly allow respondent to use "electronically stored return  
22 data" in the determination of a deficiency. (Rev. & Tax. Code, § 19033, subd. (b) ; Ch. 414, Stats. 2000,  
23 § 2.) The amendments apply to NPAs issued on or after January 1, 2001. (Rev. & Tax. Code, § 19033,  
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26 <sup>8</sup> In *Wertin*, the court held that respondent could not issue a notice of deficiency without relying on an *available* tax return.  
27 Unlike the present appeal, the plaintiff in *Wertin* had offered a tax return to the FTB. In *Wertin*, the plaintiffs maintained that  
28 they had already filed the return and it was in the FTB's possession. The plaintiffs also told the FTB that they would retrieve  
their copy of the return from storage with sufficient advance notice if the FTB did not have their return. *Wertin* does not  
support the proposition that respondent may not make a deficiency determination in the absence of a tax return.

1 subd. (d).)<sup>9</sup>

2 Post-amnesty Penalties

3 R&TC sections 19730 through 19738 set forth the tax amnesty program for taxpayers  
4 subject to the Personal Income Tax Law and the Corporation Tax Law. The amnesty program was  
5 conducted during the two-month period beginning February 1, 2005, and ending March 31, 2005, and  
6 applied to tax liabilities for taxable years beginning before January 1, 2003. If an eligible taxpayer fully  
7 paid the taxpayer's unpaid tax obligations and met the other requirements of the amnesty program,  
8 respondent waived all unpaid penalties and fees imposed, and no criminal action would be brought  
9 against the taxpayer for years subject to the amnesty program. R&TC section 19777.5 generally  
10 provides that, for each tax year for which amnesty could have been requested by the taxpayer, the  
11 amnesty penalty will be imposed in an amount equal to 50 percent of interest accrued on unpaid tax as  
12 of the last day of the amnesty period (March 31, 2005). The amnesty penalty is imposed in addition to  
13 any other applicable penalties.

14 The amnesty provisions give respondent no discretion to determine whether the amnesty  
15 penalty should be imposed and provide no exceptions for taxpayers who may have acted in good faith or  
16 had reasonable cause for failing to participate in the amnesty program. In addition, the amnesty  
17 provisions strictly limit the Board's ability to review respondent's imposition of the amnesty penalty.  
18 Subdivision (d) of R&TC section 19777.5 states, "Article 3 (commencing with Section 19031), (relating  
19 to deficiency assessments) shall not apply with respect to the assessment or collection of [the amnesty  
20 penalty]." Article 3 sets forth the procedure for a taxpayer to protest a proposed assessment. Thus,  
21 subdivision (d) of R&TC section 19777.5 provides that a taxpayer may not contest the assessment of the  
22 amnesty penalty by respondent under the protest procedures that are applicable to deficiency  
23 assessments. Because the protest provisions are not applicable to the amnesty penalty, there is no action  
24 by respondent for the Board to review under R&TC section 19045 when a taxpayer challenges the  
25 assessment of the amnesty penalty in a deficiency proceeding. Even if the Board did have jurisdiction to  
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28 <sup>9</sup> R&TC section 19033 was subsequently amended again to require that the notice of proposed deficiency described in  
subdivision (a) shall be mailed in a manner that includes a postmark. (Ch. 281 (A.B. 1360), Laws 2007, effective January 1,  
2008, and applicable to notices of deficiencies proposed to be assessed issued on or after January 1, 2008.)

1 review respondent's imposition of an amnesty penalty in a deficiency appeal, the amnesty provisions do  
2 not provide a reasonable cause exception or any similar exception to the imposition of the amnesty  
3 penalty.

4 Subdivision (e)(2) of R&TC section 19777.5 grants the Board jurisdiction to review  
5 respondent's imposition of the amnesty penalty in a single circumstance: where a taxpayer paid the  
6 amnesty penalty, filed a refund claim asserting that respondent failed to "properly compute" the amount  
7 of the penalty and respondent denied this refund claim.

#### 8 STAFF COMMENTS

##### 9 Statute of Limitations

10 Appellants did not inform respondent of the federal changes for either 1985 or 1986 and  
11 it is not clear that the IRS notified respondent of the federal changes for 1985; assuming it did not, it  
12 appears that FTB timely issued the proposed assessment under R&TC section 19060, subdivision (a)  
13 (issued at any time). Respondent appears to assume it was notified by the IRS of the federal adjustments  
14 to 1985 at the same time as 1986 based on its receipt on April 7, 2006, of the 1986 RAR. Assuming this  
15 is correct, the proposed assessment for 1985 issued on August 27, 2007, would also appear to be timely  
16 issued under R&TC section 19060, subdivision (b) (within four years of the IRS notification of the  
17 federal changes on April 7, 2006). It also appears that respondent timely issued the proposed assessment  
18 for 1986 on August 27, 2007, within four years of the IRS notification of the federal changes on April 7,  
19 2006.

20 If appellants contend that they did in fact inform respondent of the federal changes, then  
21 they should submit evidence supporting this contention to respondent and the Board at least 14 days  
22 prior to the hearing date.<sup>10</sup>

##### 23 Accuracy of Assessments

24 With respect to the proposed assessments themselves, appellants have not yet shown  
25 error in the proposed assessments or the federal determinations on which they are based. Should  
26 appellants wish to contest the additional tax assessments for either or both years, then they should be  
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28 <sup>10</sup> Exhibits should be submitted to: Mira Tonis, Board Proceedings Division, Board of Equalization. P. O. Box 942879  
MIC: 80, Sacramento, CA 94279-0081

1 prepared to provide and discuss evidence substantiating their claimed ordinary business loss deductions  
2 for 1985 and 1986. Any documentary evidence supporting appellants' position should be submitted to  
3 the Board and respondent at least 14 days prior to the hearing date.<sup>11</sup> Respondent should be prepared to  
4 discuss the information it obtained from the IRS prior to issuing the 1985 NPA, which caused it to  
5 disallow ordinary income loss in the amount of \$25,979. (Resp. Opening Br., p. 2.) It appears to staff  
6 that the 1985 IMF transcript dated July 21, 2008, does not reflect such an adjustment. (Resp. Opening  
7 Br., Exhibit B.) The 1986 RAR, however, shows that the IRS disallowed \$22,110 of ordinary income  
8 loss deductions. (*Id.*, Exhibit A.)

9           It appears that under R&TC section 19033, subdivision (b)(1), which supersedes the  
10 *Wertin* decision, respondent may examine electronically-stored return data in lieu of the original  
11 California returns. Respondent should be prepared to discuss at the hearing whether it used electronic  
12 return data when it determined the 1985 and 1986 proposed assessments.

#### 13           Post-Amnesty Penalties

14           There appears to be no statutory mechanism for the Board to review respondent's  
15 proposed assessment of the post-amnesty penalties at this time. (See Rev. & Tax. Code, § 19777.5.)  
16 Although respondent has indicated that it may impose post-amnesty penalties, the post-amnesty  
17 penalties are not part of the tax deficiencies in this appeal and will not be calculated and imposed unless  
18 and until the proposed deficiency assessments become final and the final deficiency amounts exceed any  
19 prepayments made before the end of the amnesty period. If the amnesty penalties become final  
20 liabilities and are paid, then appellants could potentially file claims for refund if they assert that the  
21 penalties were not properly computed by respondent. (Rev. & Tax. Code, § 19777.5, subs. (e)(1) &  
22 (2).) For these reasons, it appears that appellants' contention that the post-amnesty penalties should not  
23 be imposed is premature and cannot be considered by the Board in this appeal.

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25 Cunningham\_lf

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27 <sup>11</sup> Staff notes that respondent argues that appellants have not supported their claim that the IRS overstated the adjustments,  
28 but there is no indication in the record that appellants are making that specific argument.