

1 (3) Whether the Board has jurisdiction over the post-amnesty penalty.

2 (4) Whether appellant has shown that the entire amount of the interest at issue
3 should be abated.³

4 HEARING SUMMARY

5 Background

6 Appellant filed a timely California resident personal income tax return for 2002. On his
7 return, appellant reported distributions from an Individual retirement Account (IRA) at Union Central in
8 the total amount of \$62,907. One Internal Revenue Service Form (Form) 1099-R for 2002 from Union
9 Central shows a taxable distribution of \$11,282, while a second Form 1099-R for that year from Union
10 Central shows a taxable distribution of \$51,625 (\$11,282 and \$51,625= \$62,907). On California Form
11 (Form) 3805P, which is entitled "Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-
12 Favored Accounts" and was attached to appellant's return, he reported an early distribution of \$11,282
13 but did not report additional tax on that amount. Appellant did not report on Form 3805P either the
14 other early distribution of \$51,625 or additional tax on that amount.

15 Respondent issued a Notice of Proposed Assessment (NPA) on June 5, 2006. The NPA
16 stated that, in accordance with federal adjustments, respondent proposed the assessment of additional tax
17 on the early distribution of \$51,625 in the amount of \$1,291 (2.5 percent x \$51,625= \$1,291). The NPA
18 also stated that respondent proposed the assessment of a post-amnesty penalty of \$62.58 and accrued
19 interest of \$213.97. Respondent did not propose the assessment of additional tax on the early
20 distribution of \$11,282 in its NPA.

21 Appellant protested respondent's NPA on August 2, 2006. In his protest letter, appellant
22 stated that he was entitled to "hardship" consideration because he was forced to withdraw money from
23 his IRA to support himself after the company for which he worked went out of business. Respondent
24 replied to appellant's protest in a letter dated August 16, 2006. In that letter, respondent stated that it
25 would contact appellant when his case was assigned, presumably to a protest hearing officer, and that
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28 ³ As noted in the text below, respondent has agreed that interest in the amount of \$147.25 should be abated for the period from the date it acknowledged receipt of appellant's protest letter (August 16, 2006) through the date it sent correspondence to appellant requesting additional information with respect to the federal adjustments and whether appellant wanted to conduct the protest by mail, over the phone, or with a hearing officer (January 8, 2008).

1 interest would continue to accrue on any unpaid balance during the protest period. Respondent did not
2 contact appellant for approximately 17 months. Appellant filed a Chapter 7 bankruptcy petition on
3 June 5, 2007, and received a discharge in bankruptcy on September 11, 2007.

4 Respondent next contacted appellant by a letter dated January 8, 2008. Respondent
5 acknowledged again in that letter that it had received appellant's protest and asked appellant to provide
6 certain information, including whether he had received a revised report from the Internal Revenue
7 Service reducing or cancelling his federal assessment and what further action he intended to take.
8 Despite acknowledging that it had received appellant's protest, respondent also stated in its letter that it
9 "had not received a response to our letter dated 06/05/06."⁴ Finally, respondent stated that if appellant
10 did not reply to its letter by February 8, 2008, it would conclude that appellant was no longer interested
11 in receiving a protest hearing and affirm its NPA. (Resp. Br, Exhibit D.)

12 Appellant's bankruptcy attorney sent a letter to respondent, dated February 1, 2008, in
13 which he informed respondent of appellant's discharge in bankruptcy and cautioned it against pursuing
14 collection activity against appellant. Respondent states that, because the letter did not contain a request
15 for a protest hearing, respondent issued a Notice of Action (NOA) affirming its NPA. Appellant's
16 timely appeal followed.

17 Contentions

18 In his appeal letter, appellant contends that all the taxes, penalties, and interest at issue
19 should be abated because of respondent's failure to reply to his protest in a timely manner. He also
20 seems to contend that all of those amounts should be abated because he went through bankruptcy to get
21 a "fresh start." In its opening brief, respondent contends that the underlying tax should not be abated
22 because Internal Revenue Code (IRC) section 72(t), as modified by Revenue and Taxation Code
23 (R&TC) section 17085(c)(1) and allegedly further modified by instructions for Form 3805P, does not
24 provide an exception with respect to the additional tax for economic hardship. Respondent also points
25 out that the Board has held in the *Appeal of Robert G. and Jean C. Smith* (82-SBE-082), decided by the
26 Board on October 27, 1981, that it had no jurisdiction to decide whether a tax debt had been discharged
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28 ⁴ The June 5, 2006 letter was the NPA.

1 in bankruptcy. In addition, respondent points out that appellant has not discharged his California tax
2 liability for 1992 in bankruptcy because that liability had not been “assessed” for purposes of 11 U.S.C.
3 section 507(a)(8)(iii) and other provisions of the federal bankruptcy laws prior to the filing of the
4 bankruptcy petition. Respondent correctly cites *In Re King* (9th Cir. 1992) 961 F.2d 1423 for the
5 proposition that an NPA does not constitute an “assessment” for purposes of section 507(a)(8)(iii) and
6 argues that appellant’s tax liability for 2002 conceivably would not be “assessed” until 30 days after the
7 action of the Board on a petition for rehearing if one is filed in this matter.

8 With regard to the post-amnesty penalty under R&TC section 19777.5, subdivision
9 (a)(2), respondent cites the *Appeal of Nicholas Schillace* (95-SBE-005)(*Schillace*), decided by the
10 Board on August 2, 1995, for the proposition that the Board does not have jurisdiction to determine
11 whether the penalty should be abated. The Board held that in *Schillace* that the Board did not have
12 jurisdiction to determine whether the interest at issue there should be abated because interest was not a
13 “deficiency,” a term that the Board stated was defined under the relevant statute as the amount by which
14 the tax liability of the taxpayer exceeds the amount shown as the tax on the taxpayer’s return.
15 Respondent argues that the post-amnesty penalty is not a “deficiency” for purposes of *Schillace* because
16 the amount of that penalty is only an estimate at present and, as a result, is not included in the amount of
17 the proposed assessment of additional tax that is the subject of the instant appeal. Finally, respondent
18 cites R&TC section 19777.5, subdivisions (e)(1) and (2), for the proposition that once a post-amnesty
19 penalty is assessed as a final liability and has been paid, a taxpayer may file a refund claim only on the
20 limited ground that the amount paid was not properly computed by respondent.

21 With regard to the interest at issue here, respondent quotes federal regulations under the
22 corresponding federal statute to R&TC section 19104 that define “ministerial” and “managerial” acts.
23 R&TC section 19104, subdivision (a), states that respondent may abate any interest on a deficiency or
24 related to a proposed deficiency to the extent that interest is attributable in whole or in part to any
25 unreasonable delay by an officer or employee of respondent (acting in his or her official capacity) in
26 performing a ministerial or managerial act. R&TC section 19104, subdivision (b)(1), provides generally
27 that such an error or delay shall be taken into account only if no significant part of that error or delay can
28 be attributed to the taxpayer involved and after respondent has contacted the taxpayer in writing with

1 respect to that deficiency or payment. Respondent states that, after it examined the period between
2 August 16, 2006, and January 8, 2008, it concluded that an unreasonable delay occurred in the
3 performance of an unspecified ministerial act by one of its employees. It further concluded that the
4 delay occurred after respondent contacted the taxpayer in writing about his deficiency and that no
5 significant aspect of the delay was attributable to appellant. As a result of its conclusions, respondent
6 has agreed to abate interest in the amount of \$147.25 that accrued during the foregoing period.
7 Respondent contends that no additional interest may be abated under R&TC section 19104.

8 In his reply brief, appellant continues to take the position that there should be an
9 economic hardship exception to the imposition of additional tax on the early distributions from
10 appellant's IRA even if there is not a specific statutory exception for economic hardship. Appellant
11 cites no authority in support of his position, but his argument appears to be equitable in nature. In
12 addition, appellant argues that his tax liability for 2002 should be treated as having been discharged in
13 bankruptcy because that tax liability allegedly would have actually been discharged in bankruptcy if the
14 finality of his appeal had not been retarded by the unreasonable delay in the performance of a ministerial
15 act that has been acknowledged by respondent. In the alternative, appellant argues that no additional tax
16 should be imposed because he allegedly had a reasonable and good faith belief that his tax liability had
17 been discharged in bankruptcy. Again, appellant cites no authority in support of his positions. Finally,
18 appellant makes a number of arguments that the post-amnesty penalty imposed on appellant is
19 unconstitutional. Appellant states that it is making the constitutional arguments "in order to preserve
20 Appellant's rights." (App. Reply Br., p. 4.) Appellant does not specify what those rights are or what
21 their relationship is to his constitutional arguments. In any event, however, appellant concedes that the
22 Board does not have jurisdiction over the issue whether the post-amnesty penalty is constitutionally
23 valid. Appellant does not address in his reply brief whether interest, in addition to the interest that
24 respondent now has agreed to abate, should be abated.

25 In its reply brief, respondent reiterates its position that appellant's tax liability for 2002
26 was not discharged by his bankruptcy because his appeal was not final (and the tax therefore not
27 assessed) prior to the filing of his bankruptcy petition. Respondent also argues that the sole remedy for
28 its unreasonable delay in the performance of a ministerial act is the abatement of interest under R&TC

1 section 19104. In addition, respondent points out that the Board in the *Appeal of Aimor Corporation*
2 (83-SBE-221), decided on October 26, 1983, and other cases noted that section 3.5 of Article III of the
3 California Constitution prevents the Board from declaring that statutory provisions are unconstitutional
4 or determining that they unenforceable unless an appellate court has already made such a determination.
5 Finally, respondent points out in those cases that the Board has a well established policy of abstention
6 from deciding constitutional issues in an appeal involving the proposed assessment of additional tax.

7 In its final brief, appellant cites 11 U.S.C section 507(a)(7)(A)(ii) and 523(a)(1)(A) for
8 the proposition that taxes which are measured by income or gross receipts and assessed 240 days before
9 the filing of a bankruptcy petition are dischargeable in bankruptcy. Appellant points out that he filed his
10 bankruptcy petition on June 5, 2007, and that under the foregoing statutes his deficiency would have had
11 to been assessed by October 8, 2006, to be dischargeable in bankruptcy. He further points out that the
12 period between August 16, 2006, the date on which respondent first abated interest, and October 8,
13 2006, is 53 days. He alleges that such a period of approximately two months might have been sufficient
14 for his deficiency to have become assessed under those statutes. For that reason, respondent essentially
15 argues that the appropriate remedy for respondent's unreasonable delay in performing a ministerial act is
16 not merely the abatement of interest but also the abatement of the additional tax and the post-amnesty
17 penalty; however appellant cites no authority in support of his argument.

18 Law

19 R&TC section 17085 incorporates by reference, with certain modifications, IRC section
20 72. R&TC section 17085, subdivision (c)(1), provides in pertinent part that the applicable rate used in
21 assessing the additional tax under IRC section 72(t) is 2.5 percent rather than the federal rate. IRC
22 section 72(t)(1) provides that if any taxpayer receives any from a qualified retirement plan, the
23 taxpayer's tax for the taxable year in which such amount is received shall be increased by an amount
24 equal to 10 percent of the portion of such amount that is includible in gross income. IRC section
25 72(t)(2) enumerates exceptions to the application of additional tax stated in section 72(t)(1), including
26 distributions made on or after the date on which the employee attains age 59.5. The enumerated
27 exceptions in IRC section 72(t)(2) do not include an exception for economic hardship. The
28 modifications of IRC section 72(t) by R&TC section 17085 also do not include an exception for

1 economic hardship.

2 R&TC section 19730 provides that respondent shall administer a tax amnesty program
3 for taxpayers. R&TC section 19731 provides in pertinent part that the tax amnesty program shall be
4 conducted during a two-month period beginning February 1, 2005, and ending March 31, 2005,
5 inclusive, or during a timeframe ending no later than June 30, 2005, under section 19733. R&TC
6 section 19732, subdivision (a)(1), provides generally for a waiver of all unpaid penalties and fees for
7 each taxable year for which tax amnesty is allowed but only to the extent of the amount of any penalty
8 or fee that is owed as a result of previous nonreporting or underreporting of tax liabilities or prior
9 nonpayment of any taxes previously assessed or proposed to be assessed for that taxable year. R&TC
10 section 19733 defines the requirements for those taxpayers seeking tax amnesty. R&TC section
11 19777.5, subdivision (a)(2), states that, for amounts that are due and payable on the last day of the
12 amnesty period, there shall be added to the tax for each taxable year for which amnesty could have been,
13 but was not, requested an amount equal to 50 percent of the accrued interest beginning on the last date
14 prescribed by tax for payment of the tax and ending on the last day of the amnesty period specified in
15 section 19731. R&TC section 19777.5, subdivision (d), provides that provisions relating to deficiency
16 assessments shall not apply to the assessment or collection of the post-amnesty penalty. R&TC section
17 19777.5, subdivision (e)(1), provides generally that a taxpayer may not file a claim for refund for any
18 amount paid in connection with the post-amnesty penalty, except as provided in subdivision (2). R&TC
19 section 19777.5, subdivision (e)(2), provides that a taxpayer may file a claim for any amounts paid to
20 satisfy the post-amnesty penalty on the grounds that the amount of the penalty was not properly
21 computed by respondent.

22 R&TC section 19104, subdivision (a), states that respondent may abate any interest on a
23 deficiency or related to a proposed deficiency to the extent that interest is attributable in whole or in part
24 to any unreasonable delay by an officer or employee of respondent (acting in his or her official capacity)
25 in performing a ministerial or managerial act. R&TC section 19104, subdivision (b)(1), provides
26 generally that such an error or delay shall be taken into account only if no significant part of that error or
27 delay can be attributed to the taxpayer involved and after respondent has contacted the taxpayer in
28 writing with respect to that deficiency or payment. California Code of Regulations, title 18, section

1 19053 provides in pertinent part that, in the absence of respondent's regulations and unless otherwise
2 specifically provided, in cases in which the California Bank and Corporation Tax Law conforms to the
3 Internal Revenue Code (IRC), regulations under the IRC shall insofar as possible govern the
4 interpretation of conforming California statutes.

5 Treasury Regulation section 301.6404-2(b)(1) defines a "managerial act" as follows:

6 Managerial act means an administrative act that occurs during he
7 processing of a taxpayer's case involving the temporary or
8 permanent loss of records or the exercise of judgment or discretion
9 relating to management of personnel. A decision concerning the
10 proper application of federal tax law (or other federal or state law)
11 is not a managerial act. Further, a general administrative decision,
12 such as the IRS's decision on how to organize the processing of tax
13 returns or its delay in implementing an improved computer system,
14 is not a managerial act for which interest can be abated under
15 paragraph (a) of this section.

16 Treasury Regulation section 301.6404-2(b)(2) defines a "ministerial act" as follows:

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

24 STAFF COMMENTS

25 Staff notes that petitioner's Chapter 7 bankruptcy petition was filed prematurely in order
26 for his 2002 taxes to be dischargeable due to appellant's protest of the NPA. The effect of protesting the
27 NPA is to prevent the tax from going final, being assessed, and potentially being dischargeable in
28 bankruptcy. (See generally *In Re King* (9th Cir. 1992) 961 F.2d 1423.) The choice to protest a proposed
assessment and the timing of the filing of a bankruptcy petition are entirely within the debtor's control.
Accordingly it does not appear that the delayed protest process is related to appellant's decisions to both
protest the NPA and file a bankruptcy petition prior to the tax being final and assessed, and the waiting
periods having expired (e.g., the tax must have been assessed 240 days prior to the filing of the
bankruptcy petition), in order to successfully discharge his 2002 tax. Appellant should clarify at the
hearing what his contentions are regarding the proper treatment of his tax liability for 2002 as the result
of his bankruptcy and provide supporting authority. Appellant should also clarify whether he still

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contends that the remaining amount of the interest at issue should be abated, and on what basis.

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