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10 **BOARD OF EQUALIZATION**  
 11 **STATE OF CALIFORNIA**

12 In the Matter of the Appeal of: ) **HEARING SUMMARY**  
 13 )  
 14 ) **PERSONAL INCOME TAX APPEAL**  
 15 )  
 16 **KATHY MARSHALL**<sup>1</sup> ) Case No. 444048

	<u>Year</u>	<u>Proposed Assessment</u> <sup>2</sup>
	1995	<u>Penalties</u>
		\$ 6,694.80 <sup>3</sup>
		\$11,033.14 <sup>4</sup>

17 Representing the Parties:

18 For Appellant: Kathy Marshall

19 For Franchise Tax Board: Anne Mazur, Specialist

20 **QUESTIONS:** (1) Whether appellant has demonstrated that the accuracy-related penalty should be  
 21 abated.  
 22 (2) Whether respondent properly determined not to abate interest.  
 23 (3) Whether the Board has jurisdiction to abate any portion of the post-amnesty

24  
 25 <sup>1</sup> Appellant resides in Topanga, Los Angeles County.

26 <sup>2</sup> The FTB should be prepared to provide the accrued interest amount at the time of the oral hearing. According to the Notice  
 27 of Action (NOA) dated March 6, 2008, interest in the amount of \$32,529.37 had accrued through that date.

28 <sup>3</sup> This amount is the accuracy-related penalty.

<sup>4</sup> This amount is the estimated post-amnesty penalty.

1 penalty.

2 HEARING SUMMARY

3 Background

4 Appellant timely filed a California tax return for 1995, reporting adjusted gross income  
5 (AGI) of \$22,465; itemized deductions of \$15,133; taxable income of \$7,332; and zero California tax  
6 after personal and dependent exemption credits. The Internal Revenue Service (IRS) audited appellant's  
7 federal 1995 return and on or about April 2, 2001, imposed additional federal tax based on inclusion of  
8 unreported \$191,918 in capital gain from the sale of appellant's personal residence,<sup>5</sup> adjustments to  
9 itemized deductions and exemptions, and a \$1.00 reduction in self-employment tax. In addition, the IRS  
10 imposed the Internal Revenue Code section 6662 accuracy-related penalty because appellant understated  
11 her tax owed by either \$5,000 or 10 percent of the required amount.

12 Appellant did not inform the FTB regarding the federal change. The IRS report of the  
13 federal change for appellant's 1995 tax year was not received by respondent FTB until April 7, 2006.  
14 Approximately 14 months later, on June 4, 2007, respondent issued a Notice of Proposed Assessment  
15 (NPA) to appellant for \$16,737 in additional California tax, a California accuracy-related  
16 penalty of \$6,694.80,<sup>6</sup> a post-amnesty penalty estimated to be \$11,033.14,<sup>7</sup> plus interest from April 15,  
17 1996. The August 12, 2008 federal Individual Master File (IMF) for appellant states that, on March 5,  
18 2004, the IRS accepted an Offer in Compromise from appellant, but, it does not state whether the offer  
19 was accepted based on doubts as to liability or collectability.

20 Appellant timely protested respondent's NPA, and received a Notice of Action (NOA)  
21 affirming the NPA. Appellant then timely appealed the NOA to this Board.

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23 <sup>5</sup> The tax year in question – 1995 – predates the May 7, 1997 effective date of existing federal and California law that  
24 exempts the first \$250,000 in gain from the sale of a primary residence.

25 <sup>6</sup> Revenue and Taxation Code (R&TC) 19164 permits respondent to impose an accuracy-related penalty based on the Internal  
26 Revenue Code section 6662 provisions. Appellant's unpaid tax exceeded \$5,000 and was 10% or more of the proper amount  
27 for 1995, thus providing a basis for the imposition of R&TC section 19164. In addition, the amnesty statute (section  
28 19164(a)(1)(B)) doubled the accuracy-related penalty from 20% to 40% because the 1995 tax year predates 2003.

<sup>7</sup> Respondent states that when and if its NPA to appellant is upheld by this Board, it will impose the post-amnesty penalty  
created by R&TC sections 19730 to 19738. The post-amnesty penalty is 50% of the interest that accrued on the underpaid  
tax between April 15, 1996 and March 31, 2005.

1           Contentions

2           In her appeal letter, appellant states that she is not contesting the amount of tax, which  
3 she contends arose from her accountant's error, but disputes both the amnesty penalty and the accuracy-  
4 related penalty, and requests an abatement of all interest.<sup>8</sup> In her Protest Letter to respondent, appellant  
5 states: "I incurred this tax liability as I was unable to roll over this gain in the purchase of another  
6 property after my divorce; and due to default of my ex husband on my Alimony and child support  
7 payments." She claims she "never received any notice that I owed any tax until your first notice to me  
8 of 06/04/07 (Notice of Proposed Assessment)" and that "[s]o to receive my first notice 12 YEARS after  
9 the tax liability was incurred (which I was not aware of) with such huge interest and penalties, I feel is  
10 not reasonable."<sup>9</sup> Appellant states that she relied on her accountant, whom she says never told her  
11 during the IRS negotiations that she also owed California tax on the unreported capital gain she  
12 compromised with the IRS.<sup>10</sup>

13           Respondent contends that appellant has neither established error in the federal return  
14 adjustment determination, which is presumptively correct, nor submitted any evidence that the IRS  
15 revised or abated the accuracy-related penalty. In addition, respondent argues that appellant has not  
16 demonstrated good-faith reliance upon the advice of a fully informed and experienced tax professional  
17 so as to permit abatement of the accuracy-related penalty. As for the post-amnesty penalty, respondent  
18 argues that this Board does not have jurisdiction over this penalty until this appeal is resolved and  
19 respondent imposes the final penalty.

20           With regard to interest, respondent argues that appellant has not demonstrated that any  
21 interest accrued due to errors or delays by respondent. Respondent further argues that appellant  
22 contributed to any delay by failing to inform respondent of the federal changes, despite being required to  
23 do so by law. In addition, respondent notes that the statute prohibits the abatement of interest prior to  
24 respondent's first written contact with the taxpayer regarding the deficiency, which occurred here on  
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26 \_\_\_\_\_  
27 <sup>8</sup> Appellant's Protest Letter to FTB, page 2; Appellant's Appeal Letter to this Board, pages 1-2

28 <sup>9</sup> Appellant's Appeal Letter to this Board, page 2.

<sup>10</sup> Appellant's Protest Letter to FTB, page 1; Appellant's Appeal Letter to this Board, pages 1-2.

1 June 4, 2007. Therefore, respondent argues that the majority of interest here may not be abated, even if  
2 the other requirements for interest abatement were satisfied.

3 Applicable Law

4 Federal Determination

5 R&TC section 18622, subdivision (a), requires a taxpayer to either concede the accuracy  
6 of a federal determination, or state where the federal determination is erroneous. The Board has long  
7 held that a Franchise Tax Board deficiency assessment based on a federal audit report is presumptively  
8 correct, and appellant/taxpayer bears the burden of proving error. (*Appeal of Sheldon I. and Helen E.*  
9 *Brockett*, 86-SBE-109, Jun. 18, 1986; *Todd v. McColgan* (1949) 89 Cal.App.2d 509.)

10 Once respondent has met its burden, the assessment is presumed correct and appellant has  
11 the burden of proving it to be wrong. (*Todd v. McColgan, supra; Appeal of Michael E. Myers*, 2001-  
12 SBE-001, May 31, 2001.) Unsupported assertions are not sufficient to satisfy appellant's burden of  
13 proof. (*Appeal of Aaron and Eloise Magidow*, 82-SBE-274, Nov. 17, 1982.) In the absence of  
14 uncontradicted, credible, competent, and relevant evidence showing error in respondent's  
15 determinations, they must be upheld. (*Appeal of Oscar D. and Agatha E. Seltzer*, 80-SBE-154, Nov. 18,  
16 1980.) An appellant's failure to produce evidence that is within her control gives rise to a presumption  
17 that such evidence is unfavorable to her case. (*Appeal of Don A. Cookston*, 83-SBE-048, Jan. 3, 1983.)

18 Accuracy- Related Penalty

19 R&TC section 19164 provides for the imposition of an "accuracy-related penalty"  
20 determined in accordance with Section 6662 of the Internal Revenue Code. Here, the penalty has been  
21 imposed based on a "substantial understatement" of income tax. (Int. Rev. Code, § 6662, subd.(b).)  
22 "Substantial understatement of income tax" means that "the amount of the understatement for the  
23 taxable year exceeds the greater of (i) 10 percent of the tax required to be shown on the return for the  
24 taxable year or (ii) \$5,000. (Int. Rev. Code, § 6662, subd.(d).)

25 A taxpayer may be relieved of liability for the accuracy-related penalty if the taxpayer  
26 shows that he or she had reasonable cause for the understatement and acted in good faith. Reliance on  
27 the advice of a qualified tax professional may constitute reasonable cause if that reliance was reasonable  
28 and the taxpayer acted in good faith. (Int. Rev. Code § 6664(c); Treas. Reg § 1.6664-4(a).) To establish

1 good faith reliance on the advice of a competent adviser, a taxpayer must show that he or she provided  
2 the return preparer with complete and accurate information and an incorrect return resulted from the  
3 preparer's mistake. (*Crigler v. Commissioner*, T.C. Memo 2003-93.)

#### 4 Interest Abatement

5 California law imposes interest from the date on which any personal or corporate income  
6 tax is due until the date the entire balance is paid in full. (Rev. & Tax. Code, § 19101, subd. (a).)  
7 Interest is paid, assessed, and collected in the same manner as the underlying tax. (*Id.*, subd. (c).) This  
8 Board has long recognized that the assessment of interest on any unpaid tax is mandatory. (*Appeal of*  
9 *Amy M. Yamachi*, 77-SBE-095, June 28, 1977.) The Board has also recognized that interest is not a  
10 penalty, but is simply compensation to the state for the lost time-value of money received after the due  
11 date. (*Appeal of Alan F. and Rita K. Shugart*, 2005-SBE-001, July 1, 2005.) As such, the law provides  
12 no reasonable cause exception to the imposition of interest. (See *Id.*) R&TC section 19104, subdivision  
13 (b), expressly precludes the abatement of interest accruing prior to the date respondent first contacted the  
14 taxpayer in writing with respect to the deficiency or payment.

15 R&TC section 19104 allows the FTB to abate interest to the extent that interest is  
16 attributable to an error or delay by an employee of the FTB "in performing a ministerial act." (Rev. &  
17 Tax. Code, § 19104, subd. (a));<sup>11</sup> *Appeal of Ernest J. Teichert*, 99-SBE-006, Sept. 29, 1999; *Appeal of*  
18 *Michael and Sonia Kishner*, 99-SBE -007, Sept. 29, 1999; *Appeal of Alan F. and Rita K. Shugart*,  
19 *supra.*) R&TC section 19104, subdivision (a) allows abatement of interest for tax years prior to 1998  
20 only for a "Ministerial act", is defined in United States Treasury Regulation 301.6404-2, subdivision  
21 (b)(2)<sup>12</sup> as a "procedural or mechanical act that does not involve the exercise of judgment or discretion,  
22 and that occurs during the processing of taxpayer's case after all prerequisites to the act, such as  
23 conferences and review by supervisors, have taken place."

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26 <sup>11</sup> Effective for tax years 1998 and thereafter, section 19104 allows interest abatement under specified circumstances for  
27 "managerial acts." The tax year at issue here is 1995.

28 <sup>12</sup> Since section 19104, subd. (a) is modeled after Internal Revenue Code section 6404(e), section 19104, subd. (a) is  
construed by referring to federal regulations and other authority construing IRC section 6404(e); see *Andrews v. Franchise*  
*Tax Board* (1969) 275 Cal.App.2d 653, 658; *Rihn v. Franchise Tax Board* (1955) 131 Cal.App.2d 356, 360.

1                   Post-Amnesty Penalty

2                   R&TC sections 19730 through 19738 set forth the tax amnesty program for taxpayers  
3 subject to the Personal Income Tax Law and the Corporation Tax Law. The amnesty program was  
4 conducted during the two-month period beginning February 1, 2005, and ending March 31, 2005, and  
5 applied to tax liabilities for taxable years beginning before January 1, 2003. If an eligible taxpayer fully  
6 paid the taxpayer's unpaid tax obligations and met all of the other requirements of the amnesty program,  
7 the FTB waived all unpaid penalties and fees imposed, and no criminal action would be brought against  
8 the taxpayer for years subject to the amnesty program.

9                   The amnesty program might be described as employing a "carrot and stick" approach.  
10 On the one hand, the amnesty program provided an opportunity for a taxpayer to identify and pay unpaid  
11 tax obligations and, in return, obtain a waiver of penalties and fees that might otherwise have been  
12 imposed. On the other hand, if a taxpayer underpaid during a period prior to January 1, 2003, and failed  
13 to take advantage of the amnesty program, R&TC section 19777.5 imposes an amnesty penalty.

14                   The amnesty provisions give the FTB 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 of the FTB's imposition of the amnesty penalty.

18                   Subdivision (d) of R&TC section 19777.5 provides that a taxpayer may not contest the  
19 assessment of the amnesty penalty by the FTB under the protest procedures that are applicable to  
20 deficiency assessments. Because the protest provisions are not applicable to the amnesty penalty, there  
21 is no FTB action on a protest for the Board to review under R&TC section 19045. Thus, R&TC  
22 section 19045 does not provide the Board with authority to review the FTB's imposition of the amnesty  
23 penalty where the penalty has not been paid (i.e., in the context of an unpaid assessment).

24                   Subdivision (e) of R&TC section 19777.5 severely limits the ability of taxpayers to file a refund claim  
25 with respect to the imposition of the amnesty penalty by providing that "[n]otwithstanding Chapter 6  
26 [which commences with section 19301 and includes section 19324], a taxpayer may not file a claim for  
27 refund or credit for any amounts paid in connection with [the amnesty penalty,] except as provided in  
28 paragraph 2." Paragraph 2 states that a taxpayer may file a claim for refund for any amounts paid to

1 satisfy the amnesty penalty “on the grounds that the amount of the penalty was not properly computed  
2 by the Franchise Tax Board.” In sum, due to the application of subdivisions (d) and (e) of R&TC  
3 19777.5, it appears that the Board only has jurisdiction to review the FTB’s imposition of the amnesty  
4 penalty in a single circumstance: where a taxpayer paid the amnesty penalty, filed a refund claim  
5 asserting that the FTB failed to properly compute the amount of the penalty and this refund claim was  
6 denied by the FTB.

7 STAFF COMMENTS

8 Respondent based its revised assessment on information from the federal audit report,  
9 which found that appellant failed to report \$191,918 in capital gain income from the pre-1997 sale of a  
10 primary residence. The Board has previously concluded that federal audit determinations are  
11 presumptively correct, and that appellant bears the burden of contradicting them with specific, credible  
12 evidence. To date, appellant has conceded that the tax amount is correct. At the hearing, appellant  
13 should either confirm that she concedes the amount of tax, or, if she wishes to contest the amount of tax,  
14 be prepared to provide evidence of error in the federal adjustment relied on by respondent or in  
15 respondent’s determination.

16 With respect to the accuracy-related penalty, the parties should be prepared to discuss  
17 whether appellant had reasonable cause for the understatement and acted in good faith. Appellant  
18 should be prepared to discuss, and provide any supporting evidence regarding, the circumstances  
19 surrounding her failure to report the capital gain income on her original tax return.<sup>13</sup> Respondent should  
20 be prepared to address appellant’s arguments regarding her divorce and her former husband’s failure to  
21 pay alimony and child support, and her statement that the understatement resulted from an oversight of  
22 her accountant. If appellant received erroneous advice in the preparation of this return, she should be  
23 prepared to demonstrate that in failing to report the capital gain she reasonably relied in good faith upon  
24 the judgment of an experienced tax advisor, who received all necessary and accurate information from  
25 her.

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28 <sup>13</sup> Pursuant to California Code of Regulations, title 18, section 5523.6, appellant should, if possible, provide any evidence to the Board Proceedings Division at least 14 days prior to the oral hearing. Evidence exhibits should be sent to: Mira Tonis, Appeals Analyst, Board Proceedings Division, State Board of Equalization, P.O. Box 942879, Sacramento, California, 94279-0081.

1           With regard to interest abatement, only interest accrued after June 5, 2007 may be abated,  
2 and such interest may be abated only if appellant demonstrates error or delay by respondent in  
3 performing a ministerial act, and that no part of the delay in payment is caused by appellant. In this  
4 connection, staff notes that appellant was aware of the final federal determination on or about April 2,  
5 2001, but never reported it to the FTB.

6           Finally, appellant has not paid the post-amnesty penalty and is protesting the NPA and  
7 NOA issued by respondent, rather than appealing the denial of a refund claim. In the opinion of staff,  
8 due to subdivisions (d) and (e) of R&TC section 19777.5, the Board does not have jurisdiction to review  
9 any contention that the FTB should not impose the post-amnesty penalty, because the penalty has not  
10 been paid. Staff also notes that appellant has not asserted that the FTB failed to properly compute the  
11 amount of the penalty.

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