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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 **DAVID SMITH**¹) Case No. 446006
13

		Proposed	
	<u>Year</u>	<u>Assessment</u> ²	
		<u>Tax</u>	<u>Penalty</u> ³
	2005	\$1,213.00	\$303.25

17 Representing the Parties:

18 For Appellant: David Smith

19 For Franchise Tax Board: Mary Yee, Tax Counsel
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21 **QUESTIONS:** (1) Whether appellant has demonstrated error in the underlying tax assessment; and
22 (2) Whether appellant has shown reasonable cause for the abatement of the late filing
23 penalty.

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26 ¹ Appellant resides in Santa Cruz County.

27 ² The FTB should be prepared to provide the accrued interest amounts at the time of the oral hearing.

28 ³ This amount is comprised of a \$303.25 late filing penalty.

1 HEARING SUMMARY

2 Background

3 Appellant has not filed a 2005 California income tax return. Through its Integrated Non-
4 Filer Compliance Program, the Franchise Tax Board (FTB or respondent) obtained computer
5 information from Washington Mutual Bank (Washington Mutual) reporting that appellant paid mortgage
6 interest in 2005 in the amount of \$11,636, which indicated income sufficient to trigger the filing
7 requirement.⁴ Respondent issued a notice demanding that appellant file a return or explain why no
8 return was required. When appellant neither filed a return nor demonstrated why a return was not
9 required, respondent issued a Notice of Proposed Assessment (NPA) on April 9, 2007, based on the
10 information received from Washington Mutual. Appellant timely protested the NPA and requested a
11 protest hearing. On August 14, 2007, respondent acknowledged appellant's protest and informed
12 appellant that in order to make a determination, appellant needed to submit documentation that would
13 verify the sources and amount of funds that enabled him to meet his mortgage obligation and other
14 living expenses during the 2005 tax year.⁵ When appellant did not respond to respondent's August 14,
15 2007 letter, respondent affirmed its assessment in a Notice of Action (NOA) issued on March 19, 2008.
16 Appellant then filed this timely appeal.

17 Contentions

18 Appellant contends that the assessment is arbitrary and baseless because it does not
19 provide evidence that appellant earned sufficient income as a basis for the proposed tax.

20 Respondent contends that appellant should not prevail here because appellant has failed
21 to meet his burden of proof in demonstrating any error in respondent's proposed assessment.
22 Respondent rejects appellant's claim that the proposed assessment is arbitrary and without factual
23 foundation. Respondent contends that the proposed assessment is reasonable and rational because
24 respondent's method of reconstructing appellant's income is based on the inference that appellant earned
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27 ⁴ For the 2005 tax year, respondent estimated appellant's income to be \$46,544 by multiplying the amount of mortgage
28 interest by four (\$11,636 x 4). This calculation is the industry standard, which represents the minimum amount of income an
individual would need to qualify for the mortgage.

⁵ Respondent's brief does not indicate whether an oral protest hearing was conducted.

1 enough income in 2005 to qualify for a mortgage and maintain substantial mortgage payments.

2 Next, respondent contends that the late filing penalty was properly imposed and that
3 appellant has not presented evidence of reasonable cause to support abatement of that penalty.

4 Applicable Law

5 Proposed Assessment

6 Revenue and Taxation Code (R&TC) section 17041 imposes a tax “. . . upon the entire
7 taxable income of every resident of this state . . .” and upon the entire taxable income of every
8 nonresident or part-year resident which is derived from sources in this state.⁶ R&TC section 18501
9 requires every individual subject to the Personal Income Tax to make and file a return with respondent
10 “stating specifically the items of the individual’s gross income from all sources and the deductions and
11 credits allowable” R&TC section 19087, subdivision (a), provides:

12 If any taxpayer fails to file a return, or files a false or fraudulent return
13 with intent to evade the tax, for any taxable year, the Franchise Tax Board,
14 at any time, may require a return or an amended return under penalties of
15 perjury or may make an estimate of the net income, from any available
16 information, and may propose to assess the amount of tax, interest, and
17 penalties due.

18 Respondent’s use of an indirect method of reconstructing appellant’s income is
19 predicated on the assumption that appellant must have had income sufficient to satisfy lending
20 institutions advancing loaned amounts, plus income sufficient to support himself throughout the year.

21 In *Palmer v. Internal Revenue Service* (9th Cir. 1997) 116 F.3d 1309, 1313, the court stated:

22 Where the government’s deficiency determination rests on the reasonable
23 inference that the taxpayers must have had sufficient income to support
24 themselves for years when no income was reported, and statistics are used
25 to reconstruct income, the evidentiary foundation necessary for the
26 presumption of correctness to attach is minimal.

27 If respondent makes a tax assessment based on an estimate of income, respondent’s initial
28 burden is to show why its assessment is reasonable and rational. (*Todd v. McColgan* (1949) 89
Cal.App.2d 509; *Appeal of Michael E. Myers*, 2001-SBE-001, May 31, 2001.)⁷ Federal courts have

27 ⁶ It appears undisputed that appellant resided in California during the 2005 tax year.

28 ⁷ Board of Equalization cases are generally available for viewing on the Board’s website (www.boe.ca.gov).

1 held that the taxing agency need only introduce some evidence linking the taxpayer with the unreported
2 income. (See *Rapp v. Commissioner* (9th Cir. 1985) 774 F.2d 932.)

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

11 Late Filing Penalty

12 California imposes a penalty for the failure to file a return on or before the due date,
13 unless it is shown that the failure is due to reasonable cause and not due to willful neglect. (Rev. & Tax.
14 Code, § 19131.) To establish reasonable cause, the taxpayer "must show that the failure to file timely
15 returns occurred despite the exercise of ordinary business care and prudence, or that cause existed as
16 would prompt an ordinary intelligent and prudent businessman to have so acted under similar
17 circumstances." (*Appeal of Howard G. and Mary Tons*, 79-SBE-027, Jan. 9, 1979.)

18 STAFF COMMENTS

19 Respondent based its assessment on mortgage information from Washington Mutual.
20 The Board has previously concluded that this method of estimating income is rational and reasonable,
21 and thus, it appears that the burden of proof has shifted to appellant in this matter. Appellant may want
22 to provide income information from his loan papers as well as other sources of income to show that the
23 mortgage industry standard of four times the mortgage interest deduction should not be used in this
24 manner. Appellant should further explain how he met his ordinary living expenses (mortgage payments,
25 utilities, food, transportation, insurance, et cet) in the absence of the estimated income. Appellant
26 should provide evidence to substantiate his contentions and rebut the assessment made by respondent.
27 Pursuant to California Code of Regulations, title 18, section 5523.6, appellant should

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1 provide his evidence to the Board Proceedings Division at least 14 days prior to the oral hearing.⁸
2 The parties should also be prepared to discuss whether reasonable cause exists for relief
3 from the late filing penalty.

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28 ⁸ Evidence exhibits should be sent to: Mira Tonis, Appeals Analyst, Board Proceedings Division, State Board of Equalization, P.O. Box 942879 (MIC: 80), Sacramento, California, 94279-0081.