

**OFFICE OF TAX APPEALS  
STATE OF CALIFORNIA**

In the Matter of the Appeal of: ) OTA Case No. 18011113  
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**KYLE G. LARSEN** ) Date Issued: July 25, 2018  
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**OPINION**

Representing the Parties:

For Appellant: Kyle G. Larsen

For Respondent: Natasha S. Page, Tax Counsel IV

T. STANLEY, Administrative Law Judge: Pursuant to California Revenue and Taxation Code section 19324,<sup>1</sup> Kyle Larsen (appellant) appeals an action by the Franchise Tax Board (FTB or respondent) in denying appellant’s claim for refund in the amount of \$543.61 for the 2014 tax year.<sup>2</sup>

Appellant waived his right to an oral hearing and therefore the matter is being decided based on the written record.

**ISSUES**

1. Did appellant have taxable income from a California source that required him to file a 2014 California personal income tax return?
2. If appellant was required to file a 2014 California personal income tax return, has he shown that his late filing was due to reasonable cause and not willful neglect?

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<sup>1</sup> Unless otherwise indicated, all further statutory references are to the California Revenue and Taxation Code.

<sup>2</sup> Appellant filed this appeal in the amount of \$1,902.19 based on the proposed assessment in the Notice of Action. Subsequently, the FTB issued a Notice of Tax Return Change – Revised Balance showing a total tax liability of \$383.00, a late-filing penalty of \$134.00, and interest of \$25.61, totaling \$543.61, which appellant paid in full.

### FACTUAL FINDINGS

1. Appellant resided in the State of Idaho in tax year 2014.<sup>3</sup>
2. Appellant performed services exclusively in the State of Idaho in tax year 2014.
3. Appellant received non-employee income of \$46,400 from INFOSEND INC. (INFOSEND), reported on Form 1099-MISC bearing an INFOSEND address of 4240 E. LA Palma Ave., Anaheim, California.
4. INFOSEND has a facility in at least one other state, Texas, as shown on the Comprehensive Business Report submitted by respondent.
5. Appellant paid 2014 state tax of \$1,316.00 to the Idaho State Tax Commission.
6. FTB sent appellant a Request for Tax Return on May 25, 2016, and a Notice of Proposed Assessment (NPA) on July 25, 2016. The NPA proposed a tax liability of \$1,454, a late-filing penalty of \$363.50, and interest of \$71.02, for a total of \$1,888.52.
7. Appellant protested the NPA on August 2, 2016, using a Quick Resolution Worksheet indicating he neither lived nor worked in the State of California.
8. FTB issued a Notice of Action on October 21, 2016, that added additional interest and totaled \$1,902.19.
9. On November 15, 2016, Appellant filed a 2014 California personal income tax return using Form 540NR. The form showed \$35,138 in total taxable income, \$379 tax due, and \$95 in interest, for a total of \$474, which was paid by appellant. Appellant states that he filed a Form 540NR return because he felt harassed and threatened by FTB.
10. Respondent sent a Notice of Tax Return Change – Revised Balance on January 11, 2017, showing \$383 in taxes due, \$135 in late-filing penalties, and \$25.61 in interest. After crediting appellant's \$474 payment, FTB claimed a balance due of \$69.61, which appellant thereafter paid.
11. Appellant filed this timely appeal after paying a total of \$543.61 to the FTB.

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<sup>3</sup> Appellant provided rental receipts for April-December 2014 at a Rexburg, Idaho address, a Form W-9 listing a Rexburg, Idaho address as of February 14, 2014, and a vehicle registration document listing a Rexburg, Idaho address as of November 2, 2011.

DISCUSSION

Issue 1 - Did appellant have taxable income from a California source that required him to file a 2014 California personal income tax return?

Generally, residents of the State of California are subject to state taxes on all their income, including income from non-California sources; however, a nonresident who derives income from sources within California is only subject to tax on California-source income. (§ 17041, subds. (b) and (i)(1)(B).) Respondent contends that appellant is an independent contractor engaged in business both within and without California. Relying on sections 17951 and 17954, respondent further asserts that the source of appellant's income from INFOSEND is California to the extent that the purchaser of the services received the benefit of appellant's services in California.

It is respondent's initial burden 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.) Respondent does not deny that appellant is neither a resident of California nor that he performed his services outside of California. Instead, respondent explains that "neither of these bases constitutes the grounds for the sourcing of [appellant's] income from INFOSEND to California." Nonetheless, respondent asserts that appellant may have some liability for California taxes based on him having been an independent contractor "engaged in business both within and without California."

Respondent asserts that appellant's receipt of a Form 1099 from a company headquartered in California is sufficient to trigger application of California Code of Regulations, tit. 18, (Regulation) § 25136-2. We disagree because respondent has not made the initial threshold showing required by Regulation § 17951-4(c), that appellant conducted "a unitary business, trade, or profession within and without" California. Indeed, respondent sourced 100 percent of appellant's 1099 earnings from INFOSEND to California, thereby implicitly determining that appellant was not engaged in business without the state. Thus, appellant would not have been conducting an apportioning unitary business.

Tax on the income of a nonresident individual may be imposed on income derived from sources within this state. (§§ 17041(b) & (i), 17951.) Respondent has the authority to prescribe

rules and regulations to properly apportion and allocate income and deductions of a nonresident that earns income derived within and without California. (§§ 17954, 17301.) Respondent asserts that Regulation 17951-4 applies to appellant in this case. That regulation provides that if a nonresident's unitary business, trade, or profession is carried on entirely outside of this state, no portion of the income is derived from California. (Regulation § 17951-4(a).) Additionally, if a nonresident's business, trade or profession is conducted partly in California and partly in another state, but the part within the state is unconnected with the part outside of the state to such an extent that the respective activities do not constitute parts of a unitary business, trade, or profession, only the net income from activities within California are sourced to California. (Regulation § 17951-4(b).) Moreover, if a nonresident's business, trade or profession is a sole proprietorship which carries on a unitary business, trade, or profession within and without the state, the amount of business income derived from sources within this state is determined "in accordance with the provisions of the apportionment rules of Sections 25120 to 25139 . . . ." (Regulation §§ 17951-4(c) & (c)(2).)

Without proving that appellant conducted a unitary trade or business within and without California pursuant to Regulation §§ 17951-4(a) and (b), respondent jumps to Regulation § 17951-4(c) and asserts that the amount of income derived from sources in California should be determined as provided in sections 25120-25139. Respondent then proceeds to apply section 25136-2 to conclude that the benefit of appellant's services was received in California. Respondent's conclusion rests on the facts that appellant's 1099-MISC was sent from a California address, and that the company that paid appellant has offices in this state. We note that INFOSEND has facilities in at least one other state, in Texas.

We do not believe that respondent has provided sufficient evidence to support its position. Respondent's own Regulations § 17951-4 provides that the market-based sourcing rules prescribed under Regulation 25136-2 are not applicable unless the taxpayer is an apportioning taxpayer. We find that if respondent wishes to apply the regulation on which it relies, it has the burden to show that each of the conditions in the regulation are satisfied before we presume that the benefit of the services was received in California.

The evidence presented in this case shows appellant resided in the State of Idaho and filed a state tax return there for tax year 2014. Appellant stated that he did not do any work in California during 2014. Instead, he claimed he provided 100 percent of his services in Idaho,

which is supported by his documents showing residency and filing an Idaho tax return that included the income respondent claims to be from a California source. Respondent does not refute appellant's claims with any evidence showing the nature of appellant's business or profession, or the contracts, books or records of appellant and INFOSEND.

Based on the foregoing, we find that respondent's evidence is insufficient to satisfy respondent's burden of proving that there is a reasonable and rational basis for its determination that appellant was engaged in a unitary business within and without California. Appellant was not obligated to file a tax return with the State of California for tax year 2014, and he is entitled to a refund.

Issue 2 - If appellant was required to file a California income tax return, has he shown that his late filing was due to reasonable cause and not willful neglect?

Since we conclude that appellant had no obligation to file a California tax return for tax year 2014, we need not determine whether there is reasonable cause to abate the penalty assessment. (*Walker v. Commissioner* (1962) 37 T.C. 962, 972-973 [a finding that plaintiffs had no tax liability resulted in inability to sanction].)

HOLDINGS

1. Appellant did not have taxable income from a California source that required him to file a 2014 California personal income tax return. He is entitled to a refund of the \$543.61 he paid for that year, plus applicable interest.
2. Since there was no filing requirement, appellant is not subject to a delinquent filing penalty.

DISPOSITION

Respondent's action in denying appellant's claim for refund is overturned, and appellant is entitled to a refund of the \$543.61 he paid for that year, plus applicable interest.

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Teresa A. Stanley  
Administrative Law Judge

Concurring:

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Tommy Leung  
Administrative Law Judge

DISSENT

G. THOMPSON, Administrative Law Judge, dissenting: I respectfully dissent. Appellant operated a sole proprietorship in 2014 and reported \$46,350 of business income on his Idaho tax return. An IRS Wage and Income Transcript indicates that INFOSEND reported on Form 1099-MISC that it paid \$46,400 to appellant. The IRS Wage and Income Transcript shows INFOSEND's address as being in Anaheim, California,<sup>1</sup> and the FTB has provided evidence suggesting that INFOSEND was based in California during 2014.<sup>2</sup>

Having received information suggesting that appellant received a payment from a California company, the FTB sent appellant a Request for Tax Return. The FTB noted that it had received information of payment of the income by INFOSEND and asked appellant to file a California tax return or explain why he was not required to file a California tax return. Appellant did not respond.

Receiving no response, the FTB determined that, absent any evidence to the contrary, appellant was operating a unitary business, trade or profession within and without the state, and the benefit of the services provided was received in California.<sup>3</sup> It therefore proposed the

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<sup>1</sup> The transcript also indicates that the Utah State Tax Commission and Brigham Young University each reported that appellant's address was in Brea, California, which is near Anaheim.

<sup>2</sup> LexisNexis records provided by the FTB show addresses for INFOSEND in Anaheim and Fullerton, California, and also an address in Carrollton, Texas. The records show more than 25 lien filings listing an INFOSEND location in California, including liens on equipment, software, goods, mailing equipment, and investment property. The records list only one filing for the Carrollton, Texas address, for an alarm system, and it was filed after 2014.

<sup>3</sup> Section 17954 states that taxable income of nonresidents "shall be allocated and apportioned under rules and regulations prescribed by the [FTB]." Exercising this statutory grant of authority, Regulation § 17951-4(c)(2) provides that, if a nonresident's sole proprietorship carries on a unitary business within and without the state, the amount of business income derived from California "shall be determined in accordance with the provisions of the apportionment rules of the Uniform Division of Income for Tax Purposes Act, Sections 25120 to 25139, inclusive,

assessment that is at issue in this appeal. The majority finds that the FTB's proposed assessment lacks a reasonable and rational basis and therefore places the burden of proof on the FTB. I disagree.

Generally, a proposed assessment is presumed correct, and the taxpayer has the burden of providing evidence to show error in that determination. (See, e.g., *Hardy v. Commissioner* (9th Cir. 1999) 181 F.3d 1002, 1004-1005; *Rapp v. Commissioner* (9th Cir. 1985) 774 F.2d 932, 935.) Unless the assessment is without rational foundation or arbitrary, this normal presumption of correctness will apply. (See, e.g., *Trescott v. Commissioner*, T.C. Memo. 2012-321; *Schuman Aviation Company, Ltd. v. United States* (D. Hawaii 2011) 816 F.Supp.2d 941, 950.) However, the normal presumption of correctness will not apply if the government "has failed to provide any evidentiary foundation for the deficiency notice." (*Hardy, supra*, 181 F.3d at p. 1005.)

In my view, the FTB has satisfied the "minimal factual predicate" necessary for the normal presumption of correctness to apply. (See *Andrews v. Commissioner*, T.C. Memo. 1998-316, 76 T.C.M. (CCH) 381 (*Andrews*), 385 [stating that only a "minimal factual predicate" is needed and using third party reporting and Department of Labor statistics as the basis for an assessment].) Specifically, appellant, who apparently resided in Idaho, operated a business that earned \$46,400 from services that were provided to a company that appears to have been primarily based in California.

At a minimum, the California address of the payor and the LexisNexis records provide a reasonable basis for concluding that the benefit of appellant's services was received in California. The available evidence is specific to appellant and more probative than other types of evidence, such as average income statistics, that have been held to be sufficient to meet the taxing agency's initial burden. (See, e.g., *Andrews, supra* [using third party reporting and cost of living averages]; *Kindred v. Commissioner*, T.C. Memo. 1979-457, *aff'd* (6th Cir. 1982) 669 F.2d 400 [use of cost of living averages].)

I disagree with the majority's conclusion that, because the FTB determined that all the earnings from INFOSEND had a California source, the FTB implicitly conceded that appellant was not engaged in a unitary business. Under Regulation § 17951-4(c)(2), if a nonresident's business, trade or profession is a sole proprietorship which carries on a unitary business, trade, or

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Revenue and Taxation Code, and the regulations thereunder . . . ." Section 25136 and Regulation § 25136-2 require that we source sales of services to California if the benefit of the services was received in California.

profession within and without the state, then the amount of business income derived from sources within this state is determined “in accordance with the provisions of the apportionment rules of . . . Sections 25120 to 25139 . . . and the regulations thereunder . . .” It appears to me that the FTB had a reasonable basis for determining that appellant’s sole proprietorship carried on a unitary business, trade or profession within and without the state. Accordingly, the rules made applicable by Regulation § 17951-4(c)(2) require that the source of appellant’s business income be determined based on where the benefit of the services was received pursuant to section 25136(1) and Regulation § 25136-2(c).

It appears to me that the majority opinion may be based in part on its factual finding that appellant performed services exclusively in the State of Idaho in 2014. In my view, there is no evidence to support this factual finding. Appellant asserts that he performed the services in Idaho, but he has the burden of proof and has not provided any evidence, such as correspondence with INFOSEND or a copy of his contract with INFOSEND, to support this assertion. I note in this connection that the federal information received by the FTB reflected that two payors listed a California address for appellant near the location of INFOSEND’s offices. Moreover, the benefit of services is not necessarily received where the services are performed. For example, a computer programming business may physically develop software outside of the state for sale to a customer that will use the software in California. In that situation, the benefit of the services would be received in California. (See Regulation § 25136-2(b)(1)(C).)

As the FTB’s determination has a rational basis, appellant has the burden of providing evidence to show error in the FTB’s determination. The FTB’s brief explained that its assessment was based on where the benefit of the services was received and invited appellant to provide a copy of the contract for services or other documents to show the source of the income. However, appellant did not reply and has not provided any evidence regarding the services provided. As a result, appellant has not met his burden of proving error in the FTB’s determination. Furthermore, appellant’s failure to provide evidence within his control gives rise to a presumption that such evidence would be unfavorable to his case. (*Appeal of James C. Coleman Psychological Corp., et al.*, 85-SBE-028, Apr. 9, 1985.)

While I dissent, I agree with my colleagues that the record is not well developed. In order to have a better understanding of the relevant facts and provide appellant with every opportunity to support his appeal, I would have requested that he provide a copy of the contract

he referenced, together with any other records that might shed light on the services he provided through his sole proprietorship.

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*Grant S. Thompson*  
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Grant S. Thompson  
Administrative Law Judge