

**OFFICE OF TAX APPEALS  
STATE OF CALIFORNIA**

In the Matter of the Appeal of: ) OTA Case No. 18011315  
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**CHARLES DAVIS** ) Date Issued: August 29, 2018  
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**OPINION**

Representing the Parties:

For Appellant: Charles Davis, Taxpayer<sup>1</sup>

For Respondent: Judy F. Hirano, Tax Counsel IV

For the Office of Tax Appeals: Andrew Jacobson, Tax Counsel III

KWEE, Administrative Law Judge: Pursuant to Revenue and Taxation Code section 19324,<sup>2</sup> Charles Davis (appellant) appeals an action by the Franchise Tax Board (FTB or respondent) denying his claim for refund of \$1,032 in tax for the 2009 tax year.<sup>3</sup> This matter is being decided based on the written record because appellant waived his right to an oral hearing.

**ISSUE**

Whether appellant established that a portion of his U.S. military pension income for 2009 is nontaxable.

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<sup>1</sup> The Taxpayer Appeals Assistance Program (TAAP) indicated that it was representing appellant and was granted an extension of time to submit briefing through November 30, 2017. TAAP did not provide any briefing. Therefore, on April 24, 2018, we notified appellant and Mr. Craig Shaltes, Tax Counsel III, in the TAAP program, that the deadline to submit briefing has passed, and this matter will be decided based on the written record unless additional briefing was requested. No additional briefing was requested.

<sup>2</sup> All further section references are to the Revenue and Taxation Code unless otherwise indicated.

<sup>3</sup> Appellant also requests applicable interest on the claimed overpayment. (See § 19340.)

FACTUAL FINDINGS

1. On September 30, 1998, appellant retired from the U.S. Air Force. Thereafter, appellant received U.S. military pension payments (pension income) from the U.S. Department of Defense (DOD), based on his number of years of service.
2. Appellant subsequently applied to the U.S. Department of Veterans Affairs (VA) for nontaxable service-connected disability compensation. Effective December 1, 2007, appellant received an 80 percent service-connected disability rating from the VA, and based thereon he was granted nontaxable VA disability benefits. Additionally, appellant waived his right to receive a portion of his U.S. military pension income from the DOD, which was required as a condition of receiving the nontaxable VA disability benefits.
3. During the tax year at issue, the VA reported all of the VA's disability benefits as nontaxable and appellant did not report the disability benefits as taxable income to the Internal Revenue Service (IRS) or to FTB. No state or federal taxes were withheld from appellant's nontaxable VA disability benefits. Further, appellant's VA disability benefits are not at issue in this appeal.
4. During the tax year at issue, the U.S. government reported all of appellant's military pension income from the DOD as taxable to appellant on Form 1099-R. The U.S. government withheld federal and state taxes from appellant and remitted the withholdings to the IRS and FTB. The Form 1099-R reports that appellant received \$20,252.57 in military pension income, and that of this amount, \$20,252.57 was taxable for state and federal tax purposes. This amount does not include any of the nontaxable VA disability benefits that appellant received from the VA.
5. On April 13, 2010, appellant and his wife timely filed a joint 2009 California resident income tax return (California Form 540), reporting federal adjusted gross income (AGI) of \$94,391, including the \$20,252.57 in U.S. military pension income.<sup>4</sup> Appellant claimed no deductions or exclusions with respect to the U.S. military pension income.
6. On January 10, 2012, appellant and his wife filed an amended joint 2009 California tax return (California Form 540X). On the amended return, they reduced their AGI by \$16,202. In an attachment to the amended return, appellant explained that the \$16,202 is

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<sup>4</sup> All references to "appellant" are to Mr. Charles Davis because his wife did not join in this appeal.

nontaxable because appellant received an 80 percent disability rating from the VA. Appellant claimed \$16,202 is nontaxable because 80 percent of \$20,252.57 is \$16,202.<sup>5</sup> As a result of the claimed reduction in AGI, appellant requested a refund of \$1,032. Appellant and his wife also amended their 2009 federal tax return at the same time, claiming a \$16,202 reduction in federal AGI, with the same explanation attached to their amended federal return. The IRS processed the amended federal return, and refunded the federal tax on March 19, 2012.

7. In a letter to appellant dated May 11, 2012, FTB denied the claim for refund of state taxes because FTB determined that appellant's VA disability rating does not change the taxability of his U.S. military pension income from the DOD.
8. Appellant filed this appeal on September 26, 2012, contending that he received the \$20,252.57 in U.S. military pension income based on years of service, and the amount the U.S. Government reported as taxable fails to account for his disability rating awarded by the VA. The Board of Equalization (board or BOE) accepted his appeal as timely.<sup>6</sup>
9. In briefing dated August 8, 2017, FTB responded that appellant's taxable U.S. military pension income is separate from his nontaxable VA disability benefits, and appellant cannot use his disability rating to change the taxability of his pension income.<sup>7</sup>

### DISCUSSION

Gross income means all income from whatever source derived, including pension income. (§ 17071; Int.Rev. Code (IRC), § 61(a)(11).) U.S. Military retirement payments are pension income within the meaning of IRC section 61(a)(11).<sup>8</sup> (*Wheeler v. Commissioner* (2006) 127 T.C. 200, 205, fn. 11.)

To support a deduction from gross income, the taxpayer must establish by credible evidence, other than mere assertions, that the deduction claimed falls within the scope of a

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<sup>5</sup> Appellant also increased the claimed miscellaneous itemized deduction by \$324 to reflect the corresponding reduction in the AGI limitation by two percent of \$16,202. (§ 17076; Int.Rev. Code, § 67(a).)

<sup>6</sup> Appellant attempted to file an appeal via fax on June 13, 2012; however, the board had discontinued service to that line. The issue was discovered when appellant contacted the board to inquire about his appeal.

<sup>7</sup> This appeal was deferred from December 21, 2012, through May 10, 2017, because appellant filed for protection with the U.S. Bankruptcy Court.

<sup>8</sup> As relevant, California tax is imposed on the entire taxable income of a California resident. (§ 17041(a).)

statute authorizing the deduction. (*New Colonial Ice Co., Inc. v. Helvering* (1934) 292 U.S. 435, 440; *Appeal of Robert R. Telles*, 86-SBE-061, Mar. 4, 1986; *Appeal of James C. and Monablanc A. Walshe*, 75-SBE-073, Oct. 20, 1975.)<sup>9</sup> Additionally, an FTB determination is presumed correct and, therefore, a taxpayer has the burden of proving such determination erroneous. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509, 514; *Appeals of George H. and Sky Williams, et al.*, 82-SBE-018, Jan. 5, 1982.)

Under certain circumstances, the law provides for an exclusion from gross income for pension income received for personal injuries or sickness resulting from active service in the armed forces. (§ 17131; IRC, § 104(a)(4).) Additionally, VA disability benefits are exempt from state and federal taxes. (IRC, § 140(a)(3); 38 U.S.C. § 5301(a)(1).) Disbursement of nontaxable disability benefits by the VA is conditioned upon waiver of an amount of U.S. military pension income in an amount equal to the nontaxable disability compensation so as to prevent payment of double benefits to a single individual. (38 U.S.C. § 5305; *Strickland v. Commissioner* (4th Cir. 1976) 540 F.2d 1196, 1198.) Therefore, one circumstance when U.S. military pension income is nontaxable is if the person, on application to the VA, would have been entitled to receive nontaxable disability benefits from the VA in lieu of the U.S. military pension income. (IRC, § 104(b)(2)(D).) Interpreting IRC section 104(a)(4), the courts have concluded that when the VA awards a retroactive disability rating to a person who was receiving taxable U.S. military pension income, an amount of the pension income, equal to the nontaxable disability income that the person would have been entitled to receive from the VA for the tax year at issue, may be excluded from gross income. (*Strickland, supra*, at p. 1198.)

Here, appellant received a disability rating, and pursuant thereto, appellant received nontaxable disability benefits from the VA. In exchange for the nontaxable disability compensation, appellant waived his right to receive an equal amount of taxable U.S. military pension income from the DOD.<sup>10</sup> Further, the VA did not make a retroactive determination of

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<sup>9</sup> Precedential BOE opinions may be cited as precedential authority to the Office of Tax Appeals unless a panel removes, in whole or in part, the precedential status of the opinion. Precedential BOE opinions are viewable on the board's website: <http://www.boe.ca.gov/legal/legalopcont.htm>.

<sup>10</sup> During the tax year at issue, appellant was eligible to receive concurrent payment of U.S. military pension income and nontaxable VA disability benefits pursuant to a special computation for certain veterans, without regard to his waiver of an equal portion of the U.S. military pension income. (10 U.S.C. § 1414(a) [special computation of U.S. military pension income for persons with a VA disability rating of 50 percent or higher].) This increased appellant's U.S. military pension income; however, it did not change the taxability of his U.S. military pension income. (10 U.S.C. § 1414(c)(6), (11).)

disability affecting the year at issue. To the contrary, the VA’s disability determination was awarded *before* the start of the tax year, and appellant received the nontaxable VA disability benefits *during* the 2009 tax year based on the VA’s disability rating. Appellant’s U.S. military pension income represents the amount of taxable income paid to appellant for his retirement from the U.S. military, and is based on years of service, and not based on disability. Therefore, we find that the amount of U.S. military pension income reported on Form 1099-R was correctly reported as taxable for state and federal tax purposes, and that the U.S. government properly withheld state taxes from appellant.

Appellant also contends that he is entitled to a state tax refund because the IRS processed and issued him a federal tax refund based on the same adjustment. Although the IRS processed the amended return, there is no evidence that the IRS performed an audit of the return or made a determination that the amount is nontaxable. Furthermore, we are not bound to follow any IRS determinations which we find to be erroneous, even when such a determination results from a detailed audit. (*Appeal of Der Wienerschnitzel International, Inc.*, 79-SBE-063, Apr. 10, 1979.)

HOLDING

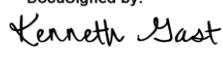
Appellant has failed to establish that any portion of his U.S. military pension income is nontaxable for 2009.

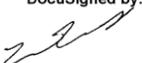
DISPOSITION

FTB’s action is sustained.

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Andrew J. Kwee  
Administrative Law Judge

We concur:

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Kenneth Gast  
Administrative Law Judge

DocuSigned by:  
  
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Tommy Leung  
Administrative Law Judge