OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	OTA Case No. 18011374
ELEANOR BALCH	Date Issued: October 9, 2018

OPINION

Representing the Parties:

For Appellant: Eleanor Balch, Taxpayer

For Respondent: Andrew Amara, Tax Counsel III

For Office of Tax Appeals: Josh Lambert, Tax Counsel

A. VASSIGH, Administrative Law Judge: Pursuant to Revenue and Taxation Code section 19045,[1] Eleanor Balch (appellant) appeals an action by the Franchise Tax Board (FTB or respondent) determining $8,582 of additional tax, and applicable interest, for the 2011 tax year, and pursuant to section 19324, appellant appeals an action by respondent denying appellant's claim for refund of $788 for the 2012 tax year.[2]

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

[1] Unless otherwise indicated, all statutory ("section" or "§") references are to sections of the Revenue and Taxation Code.

[2] In appellant's second appeal letter, dated April 27, 2017, she attached an FTB Notice of Frivolous Return Penalty and Demand for Payment, relating to frivolous return penalties FTB imposed against her for tax years 2012, 2013 and 2014 pursuant to section 19179, together with an FTB notice denying her claims for income tax refunds for tax years 2012 and 2014. OTA has no authority to review frivolous return penalties imposed under section 19179. (See § 19719(c).) Furthermore, FTB has advised us that although it issued a claim denial letter to appellant for 2014, it subsequently granted the claimed refund in full and hence there is no longer a disputed refund claim at issue for that year. Accordingly, we only have jurisdiction over the disallowed claim for refund for the 2012 tax year, and the tax deficiency and penalties proposed for the 2011 tax year.

ISSUES

1. Whether appellant may exclude wages from her taxable income for the 2011 and 2012 tax years.
2. Whether a frivolous appeal penalty should be imposed in this case.
3. Whether appellant has demonstrated that she is entitled to abatement of interest for the 2011 tax year.

FACTUAL FINDINGS

2011 Tax Year

1. Appellant timely filed a 2011 California tax return (Form 540), reporting wages of $122,434, federal adjusted gross income (AGI) of $129,640, California adjustments (subtractions) of $7,206, California AGI of $122,434, claimed itemized deductions of $55,770, taxable income of $66,664, and tax of $3,851. After applying exemption credits of $102, appellant reported a total tax of $3,749. After applying California withholdings of $8,322, appellant reported an overpayment of $4,573 and requested a refund of the same amount.
2. The Form W-2 "Wage and Tax Statement" which was filed with appellant's 2011 California tax return shows that "Hanford Comm Med Ctr" reported paying appellant wages of $122,434 that year.
3. Respondent processed the return and issued appellant a refund of $4,573.
4. Subsequently, appellant filed a 2011 amended California tax return (Form 540X), amending her wages of $122,434 to zero and requesting an additional refund of $3,749. On her amended return and in a letter provided with the amended return, appellant stated that she did not earn wages in 2011 because she was a private sector employee and because the "payers" were not her "employers" and that she was not an "employee" as defined by Internal Revenue Code (IRC) section 3401.[3]
5. Respondent processed the 2011 amended return and issued appellant the additional refund of $3,749.

[3] Appellant simultaneously filed 2012, 2013, and 2014 amended returns, all with zero income and letters making the same claims. The 2014 amended return requested a refund of $1,630, which respondent erroneously refunded.

6. Thereafter, respondent determined that the additional refund was improper and issued a Notice of Proposed Assessment (NPA) which stated that respondent added back appellant's wages of $122,434. The NPA also stated that, because California does not tax state tax refunds, respondent made an adjustment to exclude appellant's California state tax refund of $7,206 from her California AGI. The NPA also stated that it allowed the standard deduction of $3,769. The NPA increased appellant's taxable income from zero to $118,665. The NPA proposed an assessment of additional tax of $8,582, plus interest.
7. Appellant timely protested the NPA, asserting that "at no time during 2011 did [she] receive 'wages' as an 'employee' in a 'trade or business' or any other federally connected activity."
8. Respondent affirmed the NPA in a Notice of Action dated December 27, 2016. Appellant then timely filed this appeal.
9. Respondent provided with its brief for the 2011 tax year a "Law Summary – Non-Filer, Frivolous Arguments" (law summary) which provided an overview of common arguments that have been determined by the courts to be frivolous. It also included a warning that a frivolous appeal penalty could be imposed when a taxpayer files an appeal based on a frivolous position.

2012 Tax Year

10. Appellant timely filed a 2012 California tax return (Form 540), reporting wages of $74,339, federal AGI of $78,927, California adjustments (subtractions) of $4,573, California AGI of $74,354, claimed itemized deductions of $43,009, taxable income of $31,345, and tax of $892. After applying exemption credits of $104, appellant reported a total tax of $788. After applying California withholdings of $4,204, appellant reported an overpayment of $3,416 and requested a refund of that amount.
11. The Form W-2 "Wage and Tax Statement" which was filed with appellant's 2012 California tax return shows that "Hanford Comm Med Ctr" reported paying appellant wages of $74,339 that year.
12. Respondent processed the return and issued appellant a refund of $3,416.
13. Subsequently, appellant filed a 2012 amended California tax return (Form 540X), amending her wages of $74,339 to zero and requesting an additional refund of $788. On

the amended return, appellant stated: "I did not receive any 'gains, profits or income' as defined by U.S. TITLE 26 of the IRC. I was not an employee, nor did I receive wages as defined by the IRC § 3401 or § 3121. I was then, and am now, in the private sector, NOT in the public sector." Appellant also provided a letter stating that she did not receive any "wages" and that the "payers" were not her "employers" and that she was not an "employee" as defined by IRC section 3401.

14. Respondent treated appellant's amended return as a claim for refund and, by notice dated April 11, 2017, denied the claim for refund, stating that appellant's amended return was a frivolous return. Appellant then timely appealed. Appellant's appeal was consolidated with the appeal she had filed for the 2011 tax year.

15. Respondent provided with its brief for the 2012 tax year a law summary, which included a warning that a frivolous appeal penalty could be imposed if a taxpayer files an appeal based on a frivolous position.

16. Appellant was informed that her appeal had been accepted via an acknowledgement letter dated July 20, 2017. The letter stated that in prior cases OTA's predecessor, the Board of Equalization (BOE), had addressed arguments similar to those appellant raised in her appeal and that the BOE "had ruled against the taxpayer based on clear statutory provisions and numerous court precedents." Appellant was informed that if her appeal was found to have been "instituted or maintained primarily for delay, or that [her] position on appeal is frivolous or groundless," a penalty of up to $5,000 may be imposed.

DISCUSSION

Issue 1: May appellant exclude wages from her taxable income for the 2011 and 2012 tax years?

Appellant argues that she is not a taxpayer and relies on a misreading of the IRC to conclude that the wages of private sector employees are not income. Section 17041(a) provides, in pertinent part, that tax shall be imposed upon the entire taxable income of every resident of California. Sections 17071 and 17072 define "gross income" and "adjusted gross income" by referring to and incorporating into California law IRC sections 61 and 62, respectively. IRC section 61 states that, unless otherwise provided, "gross income means all income from whatever source derived," including compensation for services. Income includes any "accessions to wealth." (*Commissioner v. Glenshaw Glass Co*. (1955) 348 U.S. 426, 431.) Wages and

compensation for services are gross income within the meaning of IRC section 61. (*United States v. Romero* (1981) 640 F.2d 1014, 1016; *Appeals of Robert E. Wesley, et al*., 2005-SBE-002, Nov. 15, 2005.)[4]

Appellant's employer reported on federal Forms W-2 that appellant earned wages of $122,434 in 2011 and $74,339 in 2012. Therefore, appellant must include her wages in her gross income for 2011 and 2012, pursuant to IRC section 61. Appellant's argument that her wages do not constitute income is a frivolous argument that the Board of Equalization, the Internal Revenue Service (IRS), and the courts have consistently and emphatically rejected. (See, e.g., *Appeal of Michael E. Myers,* 2001-SBE-001, May 31, 2001; *United States v. Buras* (9th Cir. 1980) 633 F.2d 1356; *Fox v. Commissioner,* T.C. Memo. 1996-79.)[5] With regard to the contention that wages from private-sector employers are not income, the courts have consistently held that this argument is frivolous and without merit. (See, e.g., *Briggs v. Commissioner,* T.C. Memo. 2016-86; *Sullivan v. United States* (1st Cir. 1986) 788 F.2d 813; *Waltner v. Commissioner,* T.C. Memo. 2014-35.) The IRS has concluded that this argument is based on a misinterpretation of IRC section 3401 and has warned taxpayers that this argument is frivolous.[6]

As held in Revenue Ruling 2006-18, "[f]ederal income tax laws do not apply solely to federal employees . . . and any contrary contention is frivolous. The terms 'employee' and 'wages' as used by the Internal Revenue Code apply to all employees, unless specifically exempted by the Internal Revenue Code. The income tax withholding provisions do not affect whether an amount is gross income." (Rev. Rul. 2006-18, 2006-15 I.R.B. 743.) Therefore, appellant's arguments that her wages are not income have no merit. As such, appellant has not shown that she may exclude wages from her taxable income for the 2011 and 2012 tax years.

[4] Published decisions of the BOE, designated by "SBE" in the citation, are generally available for viewing on the BOE's website: <http://www.boe.ca.gov/legal/legalopcont.htm>.

[5] The IRS published a list of identified frivolous positions, which includes the arguments asserted by appellant, in IRS Notice 2010-33 (Int. Rev. Bull. 2010-17, Apr. 26, 2010) and the IRS publication, "The Truth About Frivolous Tax Arguments" (<http://www.irs.gov/Tax-Professionals/The-Truth-About-Frivolous-Tax-Arguments-Introduction> (as of Aug. 15, 2018)).

[6] See <https://www.irs.gov/privacy-disclosure/the-truth-about-frivolous-tax-arguments-section-i-a-to-c>, (as of Aug. 15, 2018).

Issue 2: Should a frivolous appeal penalty be imposed in this case?

Section 19714 provides that a penalty of up to $5,000 shall be imposed whenever it appears to OTA that proceedings before it have been instituted or maintained primarily for delay, or that an appellant's position is frivolous or groundless. (*Appeal of Michael E. Myers, supra; Appeal of Alfons Castillo*, 92-SBE-020, July 30, 1992). California Code of Regulations, title 18, section 30502 (the regulation), subdivision (a), provides that OTA may impose a frivolous appeal penalty pursuant to section 19714 "if a panel determines that an appeal is frivolous or is maintained for the purpose of delay." Subdivision (b) of the regulation lists the following factors to be considered in determining whether, and in what amount, to impose a frivolous appeal penalty under section 19714: (1) whether the appellant is making arguments that OTA, in a precedential opinion, or the BOE, in a formal opinion, or courts have rejected; (2) whether the appellant is making the same arguments that the same appellant made in prior appeals; (3) whether the appellant filed the appeal with the intent of delaying legitimate tax proceedings or the legitimate collection of tax owed; and (4) whether the appellant has a history of filing frivolous appeals or failing to comply with California's tax laws. OTA may consider other relevant factors in addition to the factors listed above. (Cal. Code Regs., tit. 18, § 30502 subd. (c).)

Appellant's argument that she is not a taxpayer because she works in the private sector is similar to arguments that have been clearly and consistently rejected by the IRS, the federal courts, respondent, and the BOE. (See, e.g., *Appeal of Michael E. Myers, supra; Appeal of Alfons Castillo, supra; Appeals of Walter R. Bailey,* 92-SBE-001, Feb. 20, 1992; *Appeals of Fred R. Dauberger, et al.*, 82-SBE-082, Mar. 31, 1982.) In the present appeal, the law summaries respondent twice sent to appellant (with respondent's opening brief for tax year 2011 and respondent's opening brief for tax year 2012) detailed how appellant's arguments have been consistently refuted by the courts and the BOE. The law summaries also explained how California law, as well as federal law, define taxable income. As such, appellant had been informed on several occasions that the argument she was making in this appeal had been determined to be a frivolous argument.

The law summaries and the acknowledgement letter provided appellant with notice that the frivolous appeal penalty may be applied against appellants who maintain frivolous or groundless appeals. Nevertheless, appellant maintained this appeal. In light of that fact, we find

that appellant has maintained a frivolous and groundless position before this body, and hereby impose a frivolous appeal penalty of $500.[7]

Issue 3: Has appellant demonstrated that she is entitled to abatement of interest for the 2011 tax year?

The imposition of interest on a tax deficiency is mandatory. (§ 19101, subd. (a).) Interest is not a penalty but is compensation for a taxpayer's use of money which should have been paid to the state. (*Appeal of Amy M. Yamachi*, 77-SBE-095, June 28, 1977.) Interest accrues on a deficiency assessment regardless of the reason for the assessment. (*Appeal of Audrey C. Jaegle*, 76-SBE-070, June 22, 1976.)

To obtain relief from interest, under the facts presented, a taxpayer must qualify under the provisions of either sections 19104, 21012, or 19112. Section 19104 provides for an abatement when the interest is attributable to any unreasonable error or delay by an officer or employee of FTB when performing a ministerial or managerial act. These circumstances are neither alleged nor shown to be present here. The relief of interest under section 21012 is not relevant here, as respondent did not provide appellant with any written advice. Section 19112 requires a taxpayer to make a showing of extreme financial hardship caused by a significant disability or other catastrophic circumstance. However, there is no evidence of these circumstances in the record. Therefore, appellant has not demonstrated any grounds for the abatement of interest.

HOLDINGS

1. Appellant has not demonstrated that she may exclude wages from her taxable income for the 2011 or 2012 tax years.
2. A frivolous appeal penalty of $500 shall be imposed in this case.
3. Appellant has not demonstrated that she is entitled to the abatement of interest for the 2011 tax year.

[7] In determining the amount of the frivolous appeal penalty to impose in this case, we consider fairness to the appellant, as well as to the public, which is impacted by the cost of adjudicating frivolous and groundless appeals. In this case, appellant originally submitted two frivolous appeals which were consolidated into the present appeal. Each of the tax years at issue in this appeal would qualify for its own frivolous appeal penalty, which would tend to increase the penalty amount in this case. On the other hand, we have no indication that appellant has submitted frivolous appeals in the past and take that mitigating factor into consideration. We determine that a $500 penalty, which is on the lower end of the potential penalty amount, is fair. We believe this amount is appropriate as a deterrent for future frivolous appeals, while not being too high as to be unduly punitive to appellant.

DISPOSITION

Respondent's actions are sustained in full. In addition, a frivolous appeal penalty in the amount of $500 is hereby imposed against appellant.

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Amanda Vassigh
Administrative Law Judge

We concur:

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Teresa Stanley
Administrative Law Judge

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Tommy Leung
Administrative Law Judge