

**OFFICE OF TAX APPEALS**  
**STATE OF CALIFORNIA**

In the Matter of the Appeal of:

**D. MILLER**) OTA Case No. 19064852  
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)**OPINION**

Representing the Parties:

For Appellant:

D. Miller

For Respondent:

Angelina Yermolich, Legal Assistant

T. STANLEY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, D. Miller (appellant) appeals an action by respondent Franchise Tax Board (FTB) proposing \$1,631.60 of additional tax, and applicable interest, for the 2015 taxable year.

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

**ISSUE**

Has appellant established error in FTB's proposed assessment for taxable year 2015, which is based on a federal determination?

**FACTUAL FINDINGS**

1. Appellant filed a timely 2015 California tax return reporting total wages of \$45,095.
2. Subsequently, FTB received information from the Internal Revenue Service (IRS) that it had increased appellant's federal adjusted gross income based on unreported wages reported by one of appellant's employers. Specifically, the IRS increased appellant's adjusted gross income by \$24,255, from \$45,095 to \$69,350.

3. Based on that information, FTB revised appellant's California income accordingly and issued a Notice of Proposed Assessment (NPA) proposing additional tax of \$1,631.60,<sup>1</sup> plus applicable interest.
4. Appellant protested the NPA and provided an amended federal income tax return that reported an adjusted gross income amount of \$56,324, which is \$13,026 lower than the IRS's revised adjusted gross income amount of \$69,350 as reported to FTB. Appellant explained that this amount represented mandatory tip sharing. As a result, it was appellant's position that he did not receive the full amount of income reported by his employers.<sup>2</sup> Appellant also provided an amended California income tax return reporting state wages of \$69,350 and a federal adjusted gross income amount of \$56,324. This amended state income tax return contained the same explanation as found in the amended federal income tax return.
5. Subsequently, FTB requested that appellant provide information showing that the IRS had canceled or reduced its assessment.
6. Appellant did not respond, and FTB issued a Notice of Action, which affirmed its NPA.
7. This timely appeal followed.
8. An IRS account transcript dated August 9, 2019, reported that appellant had an adjusted gross income amount of \$69,350 and that he had filed amended returns on January 15, 2019, and on February 27, 2019. However, the transcript does not show a reduction in appellant's federal tax or gross income.
9. Each of appellant's employers reported tips on his Forms W-2 (Box 7).

### DISCUSSION

R&TC section 18622(a) provides that a taxpayer must report federal changes to a return to FTB and either concede the accuracy of a federal determination or state how it is incorrect. It

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<sup>1</sup> This figure already accounted for a \$483.40 withholding credit from the two additional employers.

<sup>2</sup> Appellant explained that his employers calculated staff tips using an 11.5 percent ratio of the gross sales for the business. Appellant also stated that out of the 11.5 percent, 3 percent represented tip sharing for nontipped employees. Marriott International, Inc. reported appellant's tips of \$45,095.20; Ladeki Restaurant Group reported tips of \$23,270.28; and Fargo Colonial, LLC reported tips of \$492.67, for a total of \$68,858.15. Appellant claims that these amounts were calculated based on the 11.5 percent ratio of the gross sales for the businesses, and that out of that percentage, 3 percent represents pooled tip sharing for nontipped employees. Appellant calculated the pooled tip amount to be \$13,026, which is the amount by which he reduced his adjusted gross income on his amended returns (\$68,858.18 divided by 11.5 percent multiplied by 3 percent = \$13,026.)

is well-settled law that a deficiency assessment based on a federal audit report is presumptively correct and that a taxpayer bears the burden of proving that the determination is erroneous. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509, 514; *Appeal of Brockett* (86-SBE-109) 1986 WL 22731.)

Tax is imposed on the entire taxable income of a California resident. (R&TC, § 17041(a).) California uses the definition of “gross income” found in Internal Revenue Code (IRC) section 61. (R&TC, § 17071.) Tips are income to recipients unless excluded by law. (Treas. Reg. § 1.61-2(a).)

Here, FTB received information from the IRS that appellant’s federal adjusted gross income was increased due to appellant’s failure to include income reported as wages, tips, or other compensation to appellant by two of his employers for the taxable year at issue. Although appellant provided an amended federal income tax return, as of August 9, 2019, the IRS did not adjust appellant’s adjusted gross income of \$69,350. Therefore, appellant has not established that the federal determination was canceled or reduced.

FTB only addressed the issue of whether the IRS had canceled or reduced its assessment. FTB did not address appellant’s argument that it was error to include the full 11.5 percent tip income in his gross income. Essentially, appellant claims that his employers erred by reporting tip income that was paid to other, nontipped employees. Appellant asserts that all three of his employers report tips based on 11.5 percent of gross sales. Appellant refers to this as a “safe harbor” used by his employers to estimate the tips paid to servers and bartenders. Appellant further asserts that the tip rate and amount reported on his Forms W-2 should be reduced by the 3 percent that is pooled and paid to other, nontipped employees.

Appellant has presented no authority that would allow an employer to use a percentage of gross sales as a safe harbor for reporting employee tips to the IRS. We, therefore, look to the employer’s tip reporting requirements to determine if appellant’s argument (that reported tips exceeded his actual tips) has merit. Unless an employee receives less than \$20 in cash tips in a month, employees must report tip income to the employer by the tenth day following the month reported. (IRC, §§ 6053(a), 3121(a)(12)(B).) Tips are also reported on employees’ Forms W-2, Box 7. Employers that rely solely on employee reports of tips may be subject to reassessment of tips for FICA purposes. (See *United States v. Fior D’Italia, Inc.* (2002) 536 U.S. 238.) Thus, we find that there are no “safe harbors” for tip reporting, as alleged by appellant. Moreover, indirect

tips paid to nontipped employees must be reported to the IRS for FICA purposes, so appellant's employers and coworkers must report tips received from a tip pool.


Appellant has not presented evidence showing actual tips received and reported to his employers. Appellant has not shown how his employers calculated the reported tip income and has not shown that the reported tips included the 3 percent pooled tip amount. Therefore, appellant has not established that FTB erred in disallowing a deduction of 3 percent from appellant's tip income.

### HOLDING

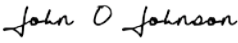
Appellant has not established error in FTB's proposed assessment, which is based on a federal determination.

### DISPOSITION

FTB's action is sustained.

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Teresa A. Stanley  
Administrative Law Judge

We concur:

DocuSigned by:  
  
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John O. Johnson  
Administrative Law Judge

DocuSigned by:  
  
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Daniel K. Cho  
Administrative Law Judge

Date Issued: 4/15/2020