

2. FTB reviewed appellants' return and determined that appellant-husband's Retiree Annuity Supplement of \$9,528 constituted California taxable income.
3. On February 7, 2019, FTB issued a Notice of Proposed Assessment (NPA) that added back to income the Retiree Annuity Supplement and thus increased appellants' California taxable income by \$9,528. The NPA proposed additional tax of \$886, plus applicable interest.
4. Appellants timely filed a protest with FTB, asserting that appellant-husband's Retiree Annuity Supplement of \$9,528 constituted "Social Security income" and, therefore, was excluded from California taxable income.¹
5. Appellants then filed this timely appeal.
6. During the appeal proceedings, appellants stated that the United States Office of Personnel Management (OPM) recently notified appellant-husband that he was not entitled to receive the Retiree Annuity Supplement of \$9,528 for the 2014 tax year because he had received "disability retirement income" at the "same time." In support, appellants provided a copy of a letter dated October 31, 2018, from the OPM to appellant-husband. The letter indicates that the OPM is adjusting appellant-husband's voluntary retirement to a disability retirement, and that this adjustment results in an overpayment to appellant-husband of \$41,449.74 for the period from August 26, 2011, through October 30, 2018. The letter also indicates that the overpayment received by appellant-husband will be collected in installments.

DISCUSSION

R&TC section 17071 incorporates Internal Revenue Code (IRC) section 61, which defines "gross income" as "all income from whatever source derived," except as expressly provided by statute. Exclusions from income are construed narrowly, and a taxpayer must clearly establish an entitlement to any exclusion. (*Polone v. Commissioner* (9th Cir. 2007) 505 F.3d 966, 969, citing *Commissioner v. Schleier* (1995) 515 U.S. 323, 328.) IRC section 86 provides that gross income includes "social security benefits" for certain taxpayers.

¹ Generally, social security benefits are excluded from California taxable income. (R&TC, § 17087.)

However, R&TC section 17087 provides that California does not conform to IRC section 86. The effect of R&TC section 17087 is to set forth an exclusion from taxation under the R&TC for “social security benefits” as defined under IRC section 86.

IRC section 86(d)(1) provides the following definition of a “social security benefit”:

(d) Social Security benefit.

(1) In general. For purposes of this section, the term “*social security benefit*” means any amount received by the taxpayer by reason of entitlement to—

- (A) a *monthly benefit under title II of the Social Security Act*, or
- (B) a *tier 1 railroad retirement benefit*.

(Emphasis added.)

Title II of the Social Security Act, as codified, can be found beginning at title 42 of the United States Code (U.S.C.) section 401. Under title 42 U.S.C. section 402(a), benefits are payable to:

Every individual who—

- (1) is a fully insured individual (as defined in section 414(a) of this title),
- (2) has attained age 62, and
- (3) has filed application for old-age insurance benefits or was entitled to disability insurance benefits for the month preceding the month in which [the individual] attained retirement age

Appellants argue that social security benefits and the Retiree Annuity Supplement² “serve the same purpose,” and therefore appellant-husband’s Retiree Annuity Supplement of \$9,528 should be excluded from California taxable income, just as social security benefits are excluded from California taxable income under R&TC section 17087.³ However, we find that appellant-husband’s Retiree Annuity Supplement of \$9,528 is not the same type of income as “social security benefits,” as defined under IRC section 86. Under the facts here, the income is not “a monthly benefit under title II of the Social Security Act,” as provided for in IRC section 86(d)(1)(A), because appellant-husband had not attained the age of 62 during the 2014

² Other common names for the FERS Retiree Annuity Supplement are (i) the special retirement supplement and (ii) the Social Security supplement, which should not be confused with Supplemental Security Income (commonly referred to as SSI).

³ Appellants do not assert that any other income tax exclusion in the R&TC (or in the IRC, as incorporated by the R&TC) applies in this case.

tax year. (42 U.S.C., § 402(a)(2)).⁴ Thus, appellant-husband's Retiree Annuity Supplement income is not properly characterized as "social security benefits" income under IRC section 86 and therefore cannot be excluded from California taxable income under IRC section 17087.⁵

Appellants also contend, however, that the OPM recently notified appellant-husband that he was not entitled to receive the Retiree Annuity Supplement of \$9,528 for the 2014 tax year because he had received "disability retirement income" at the "same time." In support, appellants provide a copy of a letter dated October 31, 2018, from the OPM to appellant-husband. The letter indicates that the OPM is adjusting appellant-husband's voluntary retirement to a disability retirement, and that this adjustment results in an overpayment to appellant-husband of \$41,449.74 for the period from August 26, 2011, to October 30, 2018. The letter also indicates that the overpayment received by appellant-husband will be collected in installments. Based on the foregoing, appellants contend that appellant-husband's Retiree Annuity Supplement of \$9,528 for the 2014 tax year must be "refunded to the federal government" and, therefore, the "income in question is void from effect."

We note, however, that under the claim of right doctrine, a taxpayer generally must recognize income if the taxpayer received the income, even though the taxpayer did not have a fixed right to the income. (*North American Oil Consolidated v. Burnet* (1932) 286 U.S. 417; *Smarthealth, Inc. v. Commissioner*, T.C. Memo. 2001-145.) We also note that each taxable year stands on its own terms and must be separately considered. (See *United States v. Skelly Oil Co.* (1969) 394 U.S. 678, 684; *Pekar v. Commissioner* (1999) 113 T.C. 158, 166.) Here, appellants have not argued (or provided evidence demonstrating) that the claim of right doctrine does not apply to appellant-husband's receipt of the Retiree Annuity Supplement of \$9,528 for the 2014 tax year, and we find no such evidence in the appeal record. Also, even if the \$9,528 could be classified as "disability retirement" (as opposed to a "Retiree Annuity Supplement"), appellants have not demonstrated that this income qualifies for exclusion from California taxable income

⁴ We also note that, based on the evidence in the appeal record, appellant-husband's Retiree Annuity Supplement is not a "tier 1 railroad retirement benefit." (IRC, § 86(d)(1)(B).)

⁵ Indeed, appellants submit with their brief an "Extraction Form" from the OPM regulations, which supports our conclusion: "The retiree annuity supplement is a benefit paid *until age 62* to certain FERS employees who retire *before age 62* and who are entitled to an immediate annuity. The supplement approximates the value of FERS service in a Social Security benefit. The general purpose of the supplement is to provide a level of income before age 62 *similar to what the retiree will receive at age 62 as part of a Social Security benefit*, if eligible for Social Security at that age." (Emphasis added.)

under the R&TC (or under the IRC, as incorporated by the R&TC) for the for the 2014 tax year.⁶ Further, as discussed above, appellants have not demonstrated that any other income tax exclusion provided for in the R&TC (or in the IRC, as incorporated by the R&TC) is applicable to the facts at hand, and we find no such evidence in the appeal record. (See, e.g., IRC, § 104(a)(1) [providing an exclusion for workmen’s compensation].) In summary, appellants have not demonstrated that the \$9,528 is properly excluded from California taxable income for the 2014 tax year.

HOLDING

Appellant-husband’s FERS Retiree Annuity Supplement income is California taxable income for the 2014 tax year.

DISPOSITION

FTB’s action is sustained.

DocuSigned by:
Elliott Scott Ewing
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Elliott Scott Ewing
Administrative Law Judge

We concur:

DocuSigned by:
Sheriene Anne Ridenour
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Sheriene Anne Ridenour
Administrative Law Judge

DocuSigned by:
Kenneth Gast
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Kenneth Gast
Administrative Law Judge

Date Issued: 8/13/2020

⁶ We note, for example, that “disability retirement” under the FERS is generally subject to taxation. (See, e.g., IRS Publication 721 (2019), p. 18.)