

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

In the Matter of the Appeal of: ) OTA Case No. 18124079  
C. SYKES )  
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**OPINION**

Representing the Parties:

For Appellant: C. Sykes  
For Respondent: Mira Patel, Tax Counsel  
Maria Brosterhous, Tax Counsel IV

T. STANLEY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, C. Sykes (appellant) appeals an action by respondent Franchise Tax Board (FTB) proposing \$8,345 of additional tax, a late-filing penalty of \$2,086.25, a notice and demand (demand) penalty of \$2,086.25, a filing enforcement fee of \$84, and applicable interest, for the 2015 taxable year.

Office of Tax Appeals (OTA) Administrative Law Judges Teresa A. Stanley, Andrew J. Kwee, and Josh Lambert held an oral hearing for this matter in Sacramento, California, on November 18, 2019. After the conclusion of the hearing, OTA requested additional briefing. The record was closed on January 17, 2020, and this matter was submitted for decision.

**ISSUES**

1. Did FTB err in its proposed assessment of tax for taxable year 2015?
2. Should the late-filing penalty be abated?
3. Should the demand penalty be abated?
4. Should the filing enforcement fee be abated?
5. Should interest be abated?
6. Should a penalty be imposed on appellant for maintaining a proceeding that is frivolous or groundless?

### FACTUAL FINDINGS

1. Appellant did not file a 2015 tax return by its due date.
2. Subsequently, FTB received information indicating that appellant received income from four sources and was required to file a 2015 tax return. FTB's records indicated that appellant's gross income was well in excess of \$21,706.<sup>1</sup>
3. FTB sent appellant a Demand for Tax Return demanding that appellant either file a return, send a copy of an already filed return, or "provide information that [appellant does] not have a requirement to file a 2015 tax return," by June 17, 2017. The reply date was extended to July 21, 2017, at appellant's request.
4. As relevant to the imposition of a demand penalty for 2015, FTB issued prior Demands for Tax Return on November 17, 2011, February 7, 2012, January 16, 2013, and June 30, 2014, followed by Notices of Proposed Assessment on January 23, 2012, July 2, 2012, September 16, 2013, October 13, 2014, respectively.
5. On July 20, 2017, appellant sent a reply indicating that his federal adjusted gross income (AGI) was reported as \$0, federal AGI had not been changed, and he had received no demand to file a federal tax return. Appellant did not submit a 2015 California return or copy of an already filed return with the reply.
6. On August 15, 2017, FTB informed appellant that based on appellant's response, FTB determined that he was required to file a 2015 return by September 15, 2017.
7. Appellant did not file a return, and on November 27, 2017, FTB sent appellant a Notice of Proposed Assessment (NPA), which indicated that it had not received a copy of a 2015 return or information showing that appellant did not have a filing requirement. FTB proposed tax of \$8,345, a late-filing penalty of \$2,086.25, a demand penalty of \$2,086.25, a filing enforcement fee of \$84, and applicable interest.
8. Appellant protested the NPA, alleging the following: "1. My payee status is a United States (U.S.) person; 2. My state of citizenship is the State of California; 3. My domicile has been within the State of California (USA) since 1976 where I have been permanently domiciled with no intent to abandon my domicile; 4. My entire 2015 earnings were

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<sup>1</sup>For 2015, an individual was required to file a tax return if gross income exceeded \$16,256 for individuals under the age of 65, and \$21,706 for individuals 65 and older. (California 2015 Personal Income Tax Booklet <[https://www.ftb.ca.gov/forms/2015/15\\_540bk.pdf](https://www.ftb.ca.gov/forms/2015/15_540bk.pdf)> [as of March 13, 2020].) Regardless of appellant's age, his gross income exceeded the threshold for filing a 2015 return.

- sourced within my California domicile; and 5. My facts and circumstances do not include business connections nor services rendered within another state of the United States union." Additionally, FTB's records show that appellant earned income under a license issued by the California Department of Insurance.
9. On March 16, 2018, FTB notified appellant that his positions on protest had previously been identified as frivolous and provided appellant an opportunity to avoid a sanction by withdrawing the protest.
  10. Appellant declined to withdraw the protest and, following a protest hearing, FTB affirmed its NPA. This timely appeal followed.
  11. In its opening brief, FTB alerted appellant that courts, our predecessor the State Board of Equalization (BOE), and the Internal Revenue Service had all consistently found arguments such as appellant's to be frivolous. FTB's brief included a 3-page law summary, which explained that appellant's claims are frivolous.
  12. In a letter to appellant from the Office of Tax Appeals (OTA), appellant was informed that "if the OTA finds that your appeal has been instituted or maintained primarily for delay, or that your position on appeal is frivolous or groundless, the OTA may impose a penalty pursuant to [R&TC] section 19714."

### DISCUSSION

#### Issue 1: Did FTB err in its proposed assessment of tax for taxable year 2015?

R&TC section 17041 imposes a tax "upon the entire taxable income of every resident of this state" and upon the entire taxable income of every nonresident or part-year resident which is derived from sources in this state. R&TC section 18501 requires every individual subject to the Personal Income Tax Law (R&TC, § 17001 et seq.) to make and file a return with FTB "stating specifically the items of the individual's gross income from all sources and the deductions and credits allowable . . . ." "If any taxpayer fails to file a return, or files a false or fraudulent return with intent to evade the tax for any taxable year, [FTB] at any time may require a return or an amended return under penalties of perjury or may make an estimate of the net income, from any available information, and may propose to assess the amount of tax, interest, and penalties due." When FTB proposes a tax assessment based on an estimate of income, FTB's initial burden is to show that its proposed assessment is reasonable and rational. (*Appeal of Myers* (2001-SBE-001))

2001 WL 37126924.) When a taxpayer fails to file a valid return and refuses to cooperate in the ascertainment of his or her income, FTB is given “great latitude” in estimating income. (*Appeals of Bailey* (92-SBE-001) 1992 WL 44503 [estimate based on third-party information reporting]; *Appeal of Tonsberg* (85-SBE-034) 1985 WL 15812 [use of third-party information reporting].) “A taxpayer is not in a good position to criticize [FTB’s] estimate of his or her liability when he or she fails to file a required return and, in addition, subsequently refuses to submit information upon request.” (*Appeals of Dauberger, et al.* (82-SBE-082) 1982 WL11759.)

Generally, California conforms to the definition of “gross income” contained in section 61 of the Internal Revenue Code (IRC). Gross income is defined as “all income from whatever source derived,” unless specifically excluded. (IRC, § 61(a).) IRC section 61 lists common types of income, including compensation for services, but the list is not limited to the items enumerated. (Treas. Reg. § 1.61-1.) Specifically, the term “wages” includes “all remuneration . . . for services performed by an employee for his [or her] employer.” (IRC, § 3401(a).)

Because appellant did not file a tax return for 2015, FTB estimated his gross income based on three Forms 1099-MISC, from H. Gradie Johnson & Associates Inc., Jack Hunter, and Health Net of California Inc., each reporting non-employee compensation paid to appellant. Additionally, California Public Employees Retirement System reported (on a Form 1099-R) a 2015 retirement distribution it made to appellant. The third-party records are reliable business records, and it was therefore reasonable for FTB to rely upon them to estimate appellant’s 2015 income. Furthermore, the totals reported on the Forms 1099 exceed the amount that would require appellant to file a tax return for 2015.

The burden shifts to appellant to show that FTB’s estimate was incorrect. Here, appellant provided arguments claiming that the third-party records reported “improper” withholdings because he claims, among other things, that as a domiciliary of California, he cannot be a California resident, and withholding taxes from his compensation violated his due process rights.<sup>2</sup> Appellant’s conclusion that if he is domiciled in California, he cannot be a resident of the state is without merit. Appellant has pointed to no authority suggesting that the terms “domiciliary” and “resident” are mutually exclusive. As an admitted domiciliary who resides in

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<sup>2</sup>To the extent that appellant makes other claims not specifically addressed herein, we find those to also be frivolous under well-settled law, and we do not address them further. (See, e.g., IRS Notice 2010-33(5), (18), (31), and (46).)

this state, appellant is also a resident of California. Appellant further argues that because the third-party payors should have excluded the compensation paid to him from taxable income, the reported income is incorrect, and thus, the records upon which FTB relied to estimate appellant's income are incorrect. Appellant acknowledges that third-party withholding reports may create a presumption that he received taxable income. He asserts that it is FTB's burden to support that presumption with more than the Forms 1099. Such an approach improperly shifts the burden to the tax agency, when it is appellant's own burden to prove that the third-party records are incorrect, thereby defeating the presumption that his compensation was taxable. Appellant relies only on arguments that show a gross misunderstanding of the applicable laws, and has not submitted any evidence to support those claims.<sup>3</sup> Appellant's arguments that the compensation received is not taxable are frivolous arguments that the BOE, the IRS, and the courts have consistently and emphatically rejected. (See, e.g., *Appeal of Balch*, 2018-OTA-159P; *Appeal of Myers, supra*; *U.S. v. Buras* (9th Cir. 1980) 633 F.2d 1356; *Fox v. Comm'r*, T.C. Memo. 1996-79.) 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. Comm'r*, T.C. Memo. 2016-86; *Sullivan v. U.S.* (1st Cir. 1986) 788 F.2d 813; *Waltner v. Comm'r*, 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. Moreover, 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.” Compensation for services and gross income from conduct of a business (self-employment income) are both includable in income. (IRC, § 61(a), (b).) “The income tax withholding provisions do not affect whether an amount is gross income.” (Rev. Rul. 2006-18, 2006-15 I.R.B. 743.) As such, appellant has not shown that he may exclude the reported compensation from his taxable income for the 2015 taxable year.

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<sup>3</sup> Appellant's federal tax account transcript shows that appellant had \$0 AGI in 2015. Appellant also provided a copy of a statement from the Social Security Administration showing his 2015 income as \$0. To the extent that those two records contradict the third-party records discussed herein, we note that both of those documents reflect appellant's self-supporting assertions of his income, with no support for their accuracy.

Issue 2: Should the late-filing penalty be abated?

R&TC section 19131 requires imposition of a late-filing penalty where a taxpayer has failed to timely file a return. When FTB imposes such a penalty, the law presumes it is correct. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509, 514.) The taxpayer then has the burden of proving reasonable cause exists to support abatement of the penalty. (*Appeal of Beadling* (77-SBE-021) 1977 WL 3831; *Appeal of Walshe* (75-SBE-073) 1975 WL 3557.) In that respect, the taxpayer's reason for failing to file the return by the due date must be such that an ordinarily intelligent and prudent businessperson would have acted similarly under the circumstances. (*Appeal of Tons* (79-SBE-027) 1979 WL 4068.) Unsupported assertions are insufficient to satisfy a taxpayer's burden of proof. (*Appeal of Magidow* (82-SBE-274) 1982 WL 11930.) Appellant has not specifically asserted any reasonable cause-based defense for the failure to timely file a return. The only argument advanced on appeal is that no returns were required so the late-filing penalty does not apply. However, as noted above, appellant's arguments that no returns were required are frivolous and as such, they do not show reasonable cause for failing to timely file.

Issue 3: Should the demand penalty be abated?

R&TC section 19133 provides that if a taxpayer fails to file a return upon notice and demand by FTB, then FTB may impose a penalty of 25 percent of the amount of tax assessed pursuant to R&TC section 19087, unless the failure is due to reasonable cause and not willful neglect. California Code of Regulations, title 18, section (Regulation) 19133 further provides that for individuals, the demand penalty will only be imposed if the following two conditions are satisfied:

- (1) the taxpayer fails to timely respond to a current Demand for Tax Return in the manner prescribed, and
- (2) the FTB has proposed an assessment of tax under the authority of Revenue and Taxation Code section 19087, subdivision (a), after the taxpayer failed to timely respond to a Request for Tax Return or a Demand for Tax Return in the manner prescribed, at any time during the four-taxable-year period preceding the taxable year for which the current Demand for Tax Return is issued.

(Cal. Code Regs., tit. 18, § 19133(b)(1)-(2).)

In order for the penalty to apply to appellant, an NPA must have been issued after appellant failed to adequately respond to a Request or Demand for Tax Return during 2011, 2012, 2013, and/or 2014 (the four years preceding the taxable year at issue). FTB issued at least four demands during this time period, followed by timely issuance of NPAs in each instance, when appellant did not file the required tax return. The demand penalty was properly imposed for 2015.<sup>4</sup>

A properly imposed penalty may be abated if a taxpayer can establish reasonable cause, as discussed above, for the failure to timely and appropriately respond to a Demand for Tax Return. Here, appellant argues that he in fact did respond to FTB's demand and explained why he believed he was not required to file a return. Thus, appellant argues that he has satisfied the technical requirement as stated on the notice itself by "provid[ing] information that [appellant does] not have a filing requirement to file a 2015 tax return." FTB counters that appellant's evidence related to another taxable year and was irrelevant. FTB argues that, for 2015, appellant only indicated that the IRS had removed a lien, neither of which show that appellant was not required to file a return. FTB did not immediately impose the demand penalty, however, but rather notified appellant of its determination that, based on the information he provided, he was required to file a 2015 return. Appellant was given an additional 30 days to file, but he did not do so. Appellant has advanced no reasonable cause arguments for his failure to file a return. Therefore, there is no basis to abate the demand penalty.

Issue 4: Should the filing enforcement fee be abated?

R&TC section 19254(a)(2) authorizes the imposition of a filing enforcement fee when FTB mails a notice to a taxpayer that the continued failure to file a return may result in the imposition of the fee. The amount is determined annually to reflect actual costs as reflected in the annual Budget Act. (R&TC, § 19254(b).) Once the fee is properly imposed, there is no language in the statute that would excuse the fee for reasonable cause. (*Appeal of Myers, supra.*) Appellant has not disputed the amount of the fee, which is set by statute. Accordingly, we have no basis upon which to overturn FTB's imposition of the filing enforcement fee.

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<sup>4</sup> FTB has interpreted Regulation 19133 as allowing for imposition of the demand penalty when a Request or Demand for Tax Return is issued for one of the years prior to the year at issue, regardless of when the associated NPA is issued. Under any interpretation, FTB has met the requirements to impose the demand penalty. Therefore, we need not address any issues related to FTB's interpretation.

Issue 5: Should interest be abated?

While there are certain statutory provisions that would allow relief from interest, appellant has not established a basis for relief under any of them. (See R&TC, § 19104.) Instead, the claim for relief from interest is only that appellant believes he is not liable for the underlying taxes and penalties. Appellant provides no argument or evidence to show interest should be abated. Thus, we find that he is not entitled to relief from interest.

Issue 6: Should a penalty be imposed on appellant for maintaining a proceeding that is frivolous or groundless?

R&TC section 19714 provides that a penalty of up to \$5,000 shall be imposed whenever it appears to OTA that proceedings were instituted or maintained primarily for delay, or that an appellant's position is frivolous or groundless. (*Appeal of Balch, supra; Appeal of Myers, supra; Appeal of Castillo (92-SBE-020) 1992 WL 202571; Cal. Code Regs., tit. 18, § 30502(a).*) The following factors will be considered in determining whether, and in what amount, to impose a frivolous appeal penalty under R&TC section 19714: (1) whether appellant is making arguments that OTA, in a precedential opinion, or the BOE, in a formal decision, or courts have rejected; (2) whether appellant is making the same arguments that the same appellant made in prior appeals; (3) whether appellant filed the appeal with the intent of delaying legitimate tax proceedings or the legitimate collection of tax owed; and (4) whether appellant has a history of filing frivolous appeals or failing to comply with California's tax laws. (Cal. Code Regs., tit. 18, § 30502(b).) OTA may consider other relevant factors in addition to the factors listed above. (Cal. Code Regs., tit. 18, § 30502(c).)

Appellant's arguments that he was a domiciliary of California and thus could not be a resident of California, that FTB violated his due process rights by accepting third-party reports of compensation, and that he could not have taxable wages because he didn't do business in a foreign state, have all been clearly and consistently rejected by the IRS, the federal courts, FTB, the BOE, and OTA. (See, e.g., *Appeal of Balch, supra; Appeal of Myers, supra; Appeal of Castillo, supra; Appeals of Bailey, supra; Appeals of Dauberger, et al. (82-SBE-082) 1982 WL 11759.*) The law summaries FTB sent to appellant (with its opening brief) detailed how appellant's arguments have been consistently refuted by the courts and the BOE. The law summary also explained how California law, as well as federal law, define taxable income.



In addition, appellant made similar arguments in prior appeals before the BOE and was assessed frivolous appeals penalties of \$750 on March 24, 2010, \$2,500 on January 27, 2011, \$750 on July 15, 2011, \$5,000 on November 20, 2014, and \$5,000 on July 29, 2015. Appellant was thereafter notified that the penalty could be assessed in this appeal if it were based on frivolous or groundless positions. As such, appellant has been informed on several occasions during protest proceedings and in this appeal proceeding that the arguments he was making in this appeal had been determined to be frivolous arguments. Nevertheless, appellant maintained this appeal, causing the state to incur unnecessary expense in processing the appeal. Based on these facts, we find that appellant has maintained frivolous and groundless positions that he knew or should have known to be frivolous, and we hereby impose a frivolous appeal penalty of \$5,000.<sup>5</sup>

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<sup>5</sup> 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. We believe this amount is appropriate based on appellant's history of frivolous filings and as a deterrent for future frivolous appeals.

HOLDINGS

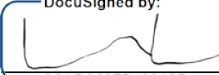
1. FTB did not err in its proposed assessment of tax for taxable year 2015.
2. Appellant has not established a basis to abate the late-filing penalty.
3. Appellant has not established a basis to abate the demand penalty.
4. Appellant has not established a basis to abate interest.
5. We impose a penalty of \$5,000 for maintaining a frivolous or groundless proceeding, pursuant to R&TC section 19714.

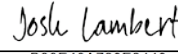
DISPOSITION

FTB’s action is sustained. In addition, we impose a frivolous appeal penalty of \$5,000, pursuant to R&TC section 19714.

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 Teresa A. Stanley  
 Administrative Law Judge

We concur:

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 Andrew J. Kwee  
 Administrative Law Judge

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 Josh Lambert  
 Administrative Law Judge

Date Issued: 4/15/2020