OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **F. AKHTAR AND** **M. AKHTAR**	) OTA Case No. 19105322)))))

OPINION

Representing the Parties:

For Appellants: F. Akhtar and M. Akhtar

For Respondent: Brian Werking, Tax Counsel III

For Office of Tax Appeals: Carmen Vera, Graduate Student Assistant

J. MARGOLIS, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, F. Akhtar and M. Akhtar (appellants) appeal an action by respondent Franchise Tax Board (FTB) denying appellants' claim for refund of $1,279 for the 2018 tax year.

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

ISSUE

Whether appellants are entitled to a $1,279 earned income tax credit (EITC) pursuant to R&TC section 17052.

FACTUAL FINDINGS

1. Appellants filed a joint federal income tax return for 2018. On that return, appellants reported wages of $6,308; federal adjusted gross income of $6,308; zero taxable income; zero tax liability; and claimed a refundable federal EITC of $2,151. The IRS refunded to appellants the requested federal EITC.
2. Appellants also filed a joint California resident income tax return for 2018, reporting the same wage, income, and tax liability amounts that were reported on their federal return.

On this return, appellants claimed a refundable California EITC of $1,279. FTB did not pay appellants the requested refund.

3. All of the income appellants reported for 2018 was wage income that appellant-wife earned from an In-Home Supportive Services (IHSS) program administered by the Alta California Regional Center for caring for appellants' disabled daughter.[1]
4. The Forms W-2 issued to appellant-wife regarding the IHSS income indicated that no tax withholdings had been taken from her income.[2]
5. FTB requested that appellants provide additional information regarding their California EITC claim. Because appellants failed to provide that information by the requested response date, FTB sent appellants a Notice of Tax Return Change indicating that FTB had fully disallowed their California EITC.
6. Appellants then provided FTB with additional documentation.
7. After reviewing appellants' submission, FTB sent appellants a letter denying their claim for refund on the ground that they had not established entitlement to the California EITC.
8. Appellants bring this timely appeal from FTB's notice of claim denial.

DISCUSSION

In 1975, Congress enacted a federal EITC that provides benefits to low-income working individuals and households, particularly those with children. (Rueben, Sammartino & Stark, *Upward Mobility and State-Level EITCs: Evaluating California's Earned Income Tax Credit* (2017) 70 Tax L.Rev. 477.) Numerous states, and even a few local governments, have adopted their own versions of EITCs. (*Ibid*.) In 2015, California enacted the California EITC, which is based the federal EITC (codified at Internal Revenue Code (IRC) section 32), subject to various modifications. (R&TC, § 17052.) Among various requirements for both the federal and California EITCs is that the taxpayer must have had "earned income" during the tax year at issue. (IRC, § 32(a)(1); R&TC, § 17052(a)(1).)

[1] Appellants' daughter was born in 1999. She was a full-time student during 2018.

[2] Appellants attached two slightly different Forms W-2 to their California return covering the same income. One identified Public Authority In-Home Supportive Services of San Joaquin County as the payor of the wages and appellant-wife as the employee. The other, issued under the same employer identification number, identified appellants' daughter as the employer and appellant-wife as the employee.

Appellants' income tax returns for 2018 claimed both the federal and California EITCs. The IRS allowed the federal EITC in full; FTB denied the California EITC in full. Appellants bring this appeal from FTB's denial of their California EITC.

The resolution of this appeal depends upon whether appellants' income for 2018—the $6,308 that appellant-wife earned from the IHSS program for caring for her disabled daughter—was "earned income" within the meaning of R&TC section 17052. The definition of "earned income" contained in R&TC section 17052 is based primarily upon that term's definition in IRC section 32(c)(2)(A), which states that earned income means "wages, salaries, tips, and other employee compensation, *but only if such amounts are includible in gross income* for the taxable year, plus [net earnings from self-employment]." (Italics added.) However, California modifies that definition by eliminating the reference to self-employment income and by replacing the word "plus" with "and *only if such amounts are subject to withholding* pursuant to Division 6 (commencing with Section 13000) of the Unemployment Insurance Code." (R&TC, § 17052(c)(3)(A), italics added.) FTB contends that appellant-wife's IHSS income was not earned income because it was neither includible in gross income nor subject to withholding under Division 6 of the Unemployment Insurance Code. We disagree on both counts.

At the outset, we note that appellants did not exclude the IHSS income from their gross income. To the contrary, that income was included in gross income for both federal and California tax purposes.[3]

The issue before us, however, is not whether the IHSS income was included in appellants' gross income, but whether such income was includible in their gross income. FTB relies upon IRS Notice 2014-7, 2014-4 I.R.B. 445, as support for its position that the income was not includible in gross income. In that notice, the IRS announced that it would treat Medicaid waiver payments made under section 1915(c) of the Social Security Act (42 U.S.C. § 1396n(c)) as being excludable from gross income under IRC section 131.[4] (IRS Notice 2014-7.) This

[3] After claiming the standard deduction, however, appellants' federal and California taxable income for 2018 was reported to be zero.

[4] In its briefing, FTB contends that the IHSS payments at issue in this appeal are comparable, for income tax purposes, to the Medicaid waiver payments at issue in IRS Notice 2014-7.

represented a reversal of the IRS's prior position, which it had prevailed upon in the U.S. Tax Court.[5]

While the IRS's new position regarding the applicability of IRC section 131 reduced the tax liability of some taxpayers, sometimes it would "actually cause more harm than good" because, by treating such payments as excludable from gross income, the recipients of such income often would have their EITCs reduced or eliminated. (*Feigh v. Commissioner* (2019) 152 T.C. 267, 276, fn. 7 (*Feigh*).) In *Feigh*, as in this instant appeal, even if the payments were included in the taxpayers' gross income, the recipients still would not have any income tax liability (since their income was so small), but they would be entitled to the refundable EITC. However, if the payments were treated as excludable from gross income under IRS Notice 2014-7, the taxpayers would have no income tax liability but they also would no longer qualify for the federal EITC as they would have no earned income. This perhaps unintended effect of the IRS notice disqualified many low-income taxpayers from the EITC.

In *Feigh*, the U.S. Tax Court ruled upon the propriety of the IRS using Notice 2014-7 to disallow an EITC credit on the ground that the Medicaid waiver payments there at issue did not constitute "earned income" within the meaning of IRC section 32(c)(2)(A) because they were not includible in the taxpayers' gross income. The taxpayers in *Feigh* reported receiving wages from Medicaid waiver payments that were treated as "difficulty of care" payments, which they excluded from gross income pursuant to IRC section 131. The issue before the court was "whether Medicaid waiver payments, which are treated as difficulty of care payments that are excludable from gross income pursuant to Notice 2014-7, *supra*, nevertheless qualify as 'earned income' for determining eligibility to receive an EITC …." After reviewing the plain language of the statutory requirements for excluding amounts as difficulty of care payments under IRC

[5] See, e.g., *Alexander v. Commissioner*, T.C. Summary Opinion 2011-48 (*Alexander*) [sustaining IRS, the tax court held that taxpayers caring for their disabled parents were required to include Medicaid personal care payments in gross income; payments were not excludable under IRC section 131(b)(1)(B)(i) because taxpayers' parents had not been "placed" in the taxpayers' home by an agency of a state or political subdivision thereof and because taxpayers did not operate a "foster family home"]; *Bannon v. Commissioner* (1992) 99 T.C. 59, 66 (*Bannon*) [sustaining IRS, the tax court held that IHSS payments made under the jurisdiction of the California Department of Social Services to a taxpayer who cared for her handicapped adult daughter in the taxpayer's residence must be included in gross income; payments were not a tax-exempt welfare benefit]; *Harper v. Commissioner*, T.C. Summary Opinion 2011-56 (*Harper*) [citing *Bannon*, the tax court sustained the IRS and held that payments received by the taxpayer from the county for providing care to taxpayer's disabled adult son in taxpayer's residence was includible in gross income]; see also IRS Program Manager Technical Advice 2010–007 (https://www.irs.gov/pub/lanoa/pmta_2010-07.pdf (accessed Jan. 7, 2021) [IRS concluded that a biological parent did not qualify as a foster care provider under IRC section 131].)

section 131, the court found that the IRS's new interpretation of those requirements in Notice 2014-7 was entitled to "little, if any, deference," and concluded that the IRS was *not* entitled to use its notice as the basis for disqualifying the taxpayers' income as constituting earned income for purposes of the EITC. (*Feigh*, *supra*, 152 T.C. at pp. 274-276.) The court stated: "[T]he IRS is not free to circumscribe the credits that the legislature has chosen to authorize through statute; that is a power only Congress has." (*Id.* at p. 276.) "Therefore, to the extent [the IRS] seeks to use Notice 2014-7, *supra*, to deprive [the taxpayers] of a benefit bestowed by Congress, we hold [the IRS] may not do so."[6] (*Ibid.*)

After *Feigh* was decided, the IRS issued AOD-2020-2, 2020 WL 2063931, announcing that: "The [IRS] will follow the *Feigh* opinion. Accordingly, in cases in which the [IRS] permits taxpayers, pursuant to the Notice [2014-7], to treat qualified Medicaid waiver payments as difficulty of care payments excludable under [IRC section] 131, the [IRS] will not argue that payments that otherwise fall within the definition of earned income under [IRC section] 32(c)(3) are not earned income for determining eligibility for the [EITC] and the [additional child tax credit] merely because they are excludable under the Notice." In addition, on May 8, 2020, the IRS posted a Q&A on its website explaining that it will give taxpayers the option, for all open tax years, to include difficulty of care payments in their earned income for EITC purposes.

> Q9. I received payments described in Notice 2014-7 that are treated as difficulty of care payments under [IRC] § 131. May I choose to include these payments in earned income for purposes of the earned income credit (EIC) or the additional child tax credit (ACTC)?
>
> A9. Yes, for open tax years, you may choose to include all, but not part, of these payments in earned income for determining the EIC or the ACTC, if these payments are otherwise earned income (wages or income from self-employment).

(https://www.irs.gov/individuals/certain-medicaid-waiver-payments-may-be-excludable-from-income, Q&A No. 9 [accessed Jan 5, 2021].)

[6] FTB's attempt to distinguish *Feigh* is unavailing. FTB admits that the payments at issue here are comparable, for tax purposes, to those in *Feigh*, but alleges that "[t]he court in *Feigh* did not determine that qualified Medicaid waiver payments or payments received under other similar state funded programs were includible in federal gross income …." However, the court in *Feigh* clearly held that the taxpayers' "Medicaid waiver payment is 'includible' in their gross income but for Notice 2014-7" and that—at least for EITC purposes—Notice 2014-7 did not change that result. (*Feigh*, *supra*, 152 T.C. at pp. 274-277.) Further, in *Feigh* the court did not disavow its holdings in *Bannon*, *Alexander*, and *Harper* that these types of payments *are* includible in gross income. And in this appeal, FTB does not assert that any of these cases (*Feigh*, *Bannon*, *Harper*, or *Alexander*) were wrongly decided. It merely asserts that a taxpayer's EITC credit may be denied on account of IRS Notice 2014-7, a position the court clearly rejected in *Feigh*.

Because California's definition of a statutory term (here, "earned income") is based, in large part, upon the federal statute defining that term, "the interpretations and effect given [that term] by the federal courts are highly persuasive." (*Rihn v. Franchise Tax Bd.* (1955) 131 Cal.App.2d 356, 360; see also *J. H. McKnight Ranch, Inc. v. Franchise Tax Bd.* (2003) 110 Cal.App.4th 978, 984, fn. 1.) Federal decisions are relevant regardless of "whether such decisions were rendered before or after the enactment of the state laws." (*Andrews v. Franchise Tax. Bd.* (1969) 275 Cal.App.2d 653, 658.) And there is a "strong public policy favorable to interpreting" state tax statutes that are based upon federal statutes consistent with the interpretations of their federal analogs. (*Meanley v. McColgan* (1942) 49 Cal.App.2d 203, 209.) These concepts are particularly applicable here, where FTB has not issued any regulations or rulings of its own that are inconsistent with the relevant federal authorities. Based on those authorities, particularly *Feigh* and the IRS pronouncements acquiescing to and interpreting *Feigh*, we adopt the rationale of the U.S. Tax Court in *Feigh* and reject FTB's position that the IRS's adoption of Notice 2014-7 disqualifies appellants from the California EITC.[7]

FTB's final objection to appellants' California EITC claim is that the IHSS payments to appellant-wife may not be treated as earned income because they were not "subject to withholding pursuant to Division 6 (commencing with Section 13000) of the Unemployment Insurance Code" as is required by R&TC section 17052(c)(3)(A). FTB only fleetingly mentioned this point in its briefs, placing primary emphasis on the position we reject above, that the payments were excludable from gross income pursuant to IRS Notice 2014-7. FTB has provided us with no argument as to why, if the IHSS payments were includible in gross income, they would not be subject to withholding pursuant to Unemployment Insurance Code section 13020(a)(1), which provides as follows:

> Every employer who pays wages to a resident employee for services performed either within or without this state, or to a nonresident employee for services performed in this state, shall deduct and withhold from those wages, except as provided in subdivision (c) and Sections 13025 and 13026, for each payroll period, a tax computed in that manner as to produce, so far as practicable, … a

[7] As noted earlier, this case does not involve a situation where the taxpayer excluded the IHSS payment from gross income, and we do not decide whether a taxpayer may exclude the IHSS payments from gross income under IRC section 131 and simultaneously claim that the income constitutes earned income for purposes of the California EITC, or whether the taxpayer must take consistent positions. That issue was *not* decided in *Feigh* and it is not before us either. We do note, however, that in AOD-2020-2, 2020 WL 2063931, the IRS announced that it will permit taxpayers to exclude such payments from gross income under Notice 2014-7 while simultaneously treating such amounts as earned income for federal EITC purposes.

> sum which is substantially equivalent to the amount of tax reasonably estimated to be due under Part 10 (commencing with Section 17001) of Division 2 of the Revenue and Taxation Code resulting from the inclusion in the gross income of the employee of the wages which were subject to withholding. …

The record shows that appellants *did* include their IHSS income in their gross income; it also shows that the payor of that income (the Public Authority In-Home Supportive Services of San Joaquin County) made no withholdings from that income. We do not know the reason for the payor's failure to withhold. As a general rule, a payor of taxable income is required to make withholdings from such amounts unless the taxpayer submits a Form W-9 indicating that the taxpayer expects to incur no income tax liability for the year and hence the payor should refrain from making withholdings. (See Unemp. Ins. Code, §§ 13020, 13026.) We find it unlikely that the California Legislature intended to disallow the EITC to persons whose income was so low that they were entitled to ask the income payor to refrain from withholding income taxes from their income. The purpose of the EITC is, after all, "to reduce poverty among California's poorest working families and individuals." (R&TC, § 17052(j)(1).) That purpose would be frustrated if we were to interpret the withholding requirement to mean that the recipients' earnings must have been "subjected to" withholding, as opposed to merely being "subject to" withholding. Accordingly, we find that appellants' IHSS income was subject to withholding within the meaning of R&TC section 17052(c)(3)(A).

HOLDING

Appellants are entitled to a $1,279 California EITC for 2018.

DISPOSITION

FTB's action is reversed and appellants are entitled to a refund of $1,279, plus applicable interest.

DocuSigned by:
Jeffrey I. Margolis
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Jeffrey I. Margolis
Administrative Law Judge

We concur:

DocuSigned by:
Daniel Cho
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Daniel K. Cho
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