

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:
E. MORENO

) OTA Case No. 19125620
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OPINION

Representing the Parties:

For Appellant: Keesha Scott-Hogan,
Tax Appeals Assistance Program

For Respondent: Brian Werking, Tax Counsel III

H. LE, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, E. Moreno (appellant) appeals an action by Franchise Tax Board (respondent) denying appellant’s claim for refund of \$2,335 for the 2018 tax year.

Appellant waived the right to an oral hearing; therefore, we decide the matter based on the written record.

ISSUE

Whether respondent erred in disallowing the California earned income tax credit (EITC).

FACTUAL FINDINGS

1. Appellant filed a timely 2018 California resident income tax return, and, as relevant to this appeal, reported or claimed the following items: single filing status, two dependents, wages of \$8,199 that were included in gross income, total tax of \$0, an EITC of \$2,335, and a refund of \$2,335. On Form FTB 3514, appellant reported wages subject to California withholding and California earned income of \$8,199 and claimed an EITC of \$2,335.
2. Appellant also attached a federal Form W-2, indicating wages of \$8,199. Appellant received this income for being a personal care provider under an In-Home Supportive

- Services (IHSS) Program¹ and providing care for her father.² Appellant’s father lived with her for the entire 2018 tax year.
3. Respondent processed appellant’s return, reviewed the claimed EITC, and sent a Notice of Tax Return Change to appellant, informing appellant that she was not entitled to her claimed EITC because her reported earned income from the IHSS Program was considered a nontaxable “difficulty of care payment.”
 4. Subsequently, appellant submitted documentation for her claimed EITC of \$2,335, which respondent treated as a claim for refund.
 5. Respondent then denied appellant’s refund claim.
 6. This timely appeal followed.

DISCUSSION

As a general rule, taxpayers bear the burden of proving entitlement to their refund claim, which means they must not only prove that the tax assessment was incorrect but must also produce evidence to establish the proper amount of the tax due, if any. (*Appeal of Jali, LLC*, 2019-OTA-204P.) Tax credits are a matter of legislative grace, and taxpayers bear the burden of proving they are entitled to claimed tax credits. (*Appeal of Swat-Fame, Inc., et al.*, 2020-OTA-046P.)

The issue in this appeal is whether appellant’s income received for being a personal care provider under the IHSS Program is “earned income” includible in gross income, thereby entitling appellant to the EITC. In short, respondent argues that the income at issue is not includible in gross income because it is a “difficulty of care payment” under Internal Revenue Code (IRC) section 131(c). In contrast, appellant’s main contention is that the requirements of IRC section 131(c) are not met since appellant received IHSS payments for providing care for her father, who cannot be considered a “foster individual” living in a “foster family home,” and he was not “placed” in such home by a state agency.

¹ The IHSS Program allows aged, blind, or disabled persons, including children, who are at risk for out-of-home placement, to remain safely at home by providing payment for care provider services. The IHSS Program is considered an alternative to out-of-home care, such as nursing homes or board and care facilities. (See Welf. & Inst. Code, § 12300 et seq.)

² Although the W-2 listed appellant’s father as the employer, the employment identification number and address of the employer indicate that the wages reported were received from the IHSS Program.

California provides for its own EITC that generally conforms to the federal EITC. R&TC section 17052(a)(1) allows the EITC against net tax in an amount determined under IRC section 32, relating to earned income, with certain modifications. “Earned income” means wages, salaries, tips, and other employee compensation, but only if such amounts are *includible in gross income* for the taxable year and, for California purposes, only if such amounts are subject to withholding commencing with the California Unemployment Insurance Code section 13000 et seq.³ (IRC, § 32; R&TC, § 17052(c)(3).)

“Gross income” is defined as “all income from whatever source derived” and includes compensation for services. (R&TC, § 17071; IRC, § 61(a).) However, specifically excluded from gross income are certain foster care payments under IRC section 131, which California incorporates pursuant to R&TC section 17131. “Gross income shall not include amounts received by a foster care provider during the taxable year as qualified foster care payments.” (IRC, § 131(a).) A “qualified foster care payment” is any payment: (1) made pursuant to a foster care program of a state or a political subdivision thereof; (2) paid by a state or political subdivision thereof, or a qualified agency; and (3) is either paid to the foster care provider for caring for a qualified foster individual in the foster care provider’s home, or is a “difficulty of care payment.” (IRC, § 131(b).) The term “difficulty of care payment” generally means compensation for providing the additional care of a “qualified foster individual,” which is required by reason of a physical, mental, or emotional handicap of such individual and provided in the home of a foster care provider. (IRC, § 131(c)(1).) A “qualified foster individual” is any individual who is living in a “foster family home” and who was “placed” there by a state agency or a qualified foster care placement agency. (IRC, § 131(b)(2).)

The plain text of IRC section 131 renders it inapplicable to payments made to an individual care provider caring for a biological relative. (See *Feigh v. Commissioner* (2019) 152 T.C. 267, 271-272 (*Feigh*).)⁴ *Feigh* noted that this plain text interpretation of IRC

³ It is unclear if respondent alleges that appellant’s income is not subject to withholding under the California Unemployment Insurance Code. But, since we conclude in this Opinion that appellant’s income is “earned income” includible in gross income, this income appears subject to California withholding. (See Unemp. Ins. Code, § 13000 et seq.) Respondent has not cited a specific provision that would indicate that IHSS payments are not subject to California withholding.

⁴ Because R&TC section 17131 incorporates IRC section 131, federal decisions construing IRC section 131 are persuasive authority. (See *Sahadi v. Scheaffer* (2007) 155 Cal.App.4th 704, 733.)

section 131 had been previously advanced by the IRS and upheld by the Tax Court of the United States (Tax Court). (*Ibid.*, citing IRS Program Manager Technical Advice, PMTA 2010-007 [concluding that a biological parent of a disabled child may not exclude payments under IRC section 131 because the ordinary meaning of foster care excludes care by a biological parent] and *Alexander v. Commissioner* (2011) T.C. Summ. Op. 2011-48, 2011 WL 1422015 [holding that Medicaid waiver payments to taxpayers caring for a taxpayer’s parents residing in the taxpayers’ home are not excludable under IRC section 131 because the taxpayers did not show that they operated a “foster family home” under state law and the parents were not “placed” in the taxpayers’ home by the state.]

However, in 2014, the IRS took a contrary position and issued IRS Notice 2014-7, 2014 WL 27959 (IRS Notice 2014-7), which states that the IRS, as of January 3, 2014, will treat qualified Medicaid waiver payments as “difficulty of care payments” that are excludable from gross income under IRC section 131, whether or not the care provider is related or unrelated to the individual receiving care. Relying on the underlying rationale in IRS Notice 2014-7, IRS Private Letter Ruling 127776-15, 2016 WL 3098404 (IRS PLR 127776-15)⁵ explains that since the IHSS Program is similar to the purpose, design, and nature of the Medicaid waiver program and the foster care program under IRC section 131, IHSS payments also qualify as “difficulty of care payments” excludable from gross income under IRC section 131, whether or not the care provider is related or unrelated to the individual receiving care.

But the Tax Court in *Feigh* determined that IRS Notice 2014-7 “is entitled little, if any, deference” because the notice lacks persuasiveness for being contrary to the plain language of IRC section 131, and the notice lacks consistency as it reverses the IRS’s historical practice of challenging the excludability of Medicaid waiver payments from gross income. (*Feigh, supra*, 152 T.C. at p. 275.) *Feigh* noted that “[w]hile [the IRS’s] notice may be well intended and we are not critical of the motivation, our role is to apply the statutory provisions as they present themselves.” (*Id.* at p. 276.) *Feigh* held that “where income does not fall within the plain text of a statutory exclusion from gross income [IRC section 131], the IRS cannot reclassify that income through [IRS Notice 2014-7] so that it no longer qualifies as ‘earned income’ for the purpose of determining tax credits.” (*Id.* at p. 277.) We find the Tax Court’s opinion in *Feigh*, dealing Medicaid waiver payments, to be well reasoned, persuasive, and equally applicable to the IHSS

⁵ Respondent relied on this nonprecedential authority in its brief.

Program payments at issue in this appeal.

Here, appellant received payments for being a personal care provider under the IHSS Program and providing care for her father, who lived with appellant for the entire 2018 tax year. Under the plain language of IRC section 131, since appellant and her father are biological relatives, her father cannot be considered a “qualified foster individual” because appellant did not operate a “foster family home.” Also, no evidence in the record indicates a state agency “placed” appellant’s father in her home. Indeed, we note that respondent advances no arguments that the requirements under the plain language of IRC section 131 have been met in this appeal. Respondent appears to rely on IRS Notice 2014-7,⁶ but, as noted above, this notice “is entitled little, if any, deference.” (*Feigh, supra*, 152 T.C. at p. 275.) Since the exclusion in IRC section 131 is inapplicable, we find that appellant’s income from the IHSS Program is “earned income” includible in gross income. Thus, appellant is entitled to a California EITC of \$2,335 for the 2018 tax year.

Respondent attempts to distinguish *Feigh* by arguing that the Tax Court “did not determine that qualified Medicaid waiver payments were *includible* in federal gross income[;] therefore qualified Medicaid waiver payments do not meet the requirements to be earned income necessary to be eligible for the earned income tax credit.” (Italics added.) For this argument, respondent cites to language in *Feigh* that states, “[w]e do not reach the question of whether, in the light of our holdings, petitioners should have *included* their Medicaid waiver payment in gross income.” (*Feigh, supra*, 152 T.C. at p. 277, italics added.) However, respondent overlooks the Tax Court’s in-depth discussion of the difference between “includible” and “included,” and the Tax Court’s finding that Medicaid waiver payments are indeed includible in gross income for purposes of the federal EITC:

While “included” refers to the actual treatment of income, “includible” refers to a required treatment of income, whether or not the income was actually so treated. [Citations omitted.] Thus, an item of income is “includible” in gross income if it is required to be included as income irrespective of whether the item was actually included in the taxpayer’s gross income. *Because petitioners’ Medicaid waiver payment is “includible” in their gross income but for Notice 2014-7, supra*, the question for us becomes whether a notice can effectively usurp Congress’

⁶ Respondent also cites to IRS PLR 127776-15, which relies on the underlying rationale in IRS Notice 2014-7.

authority in granting tax credits by denying petitioners a credit they would have been entitled to in the absence of the notice. [¶] . . . [¶] Petitioners’ income cannot be reclassified by [the IRS], through a notice, to fall outside the plain text of [IRC] section 32.

(*Feigh*, *supra*, 152 T.C. at pp. 274, 276, italics added.)

Contrary to respondent’s argument, the Tax Court in *Feigh* only mentioned that it need not determine whether the taxpayers in the case should have *included* their Medicaid waiver payment in gross income⁷—an issue separate from whether amounts are *includible* in gross income for purposes of the EITC. Accordingly, we find respondent’s argument unpersuasive.


⁷ After *Feigh* was decided, the IRS addressed this issue in its Action on Decision, AOD-2020-2, 2020 WL 2063931, noting that payments can be treated as excludable from gross income pursuant to IRS Notice 2014-7, but nevertheless be “earned income” (which is defined as amounts “includible in gross income”) for determining a taxpayer’s eligibility to receive the federal EITC: “The Service will follow the *Feigh* opinion. Accordingly, in cases in which the Service permits taxpayers, pursuant to the Notice, to treat qualified Medicaid waiver payments as difficulty of care payments excludable under [IRC section] 131, the Service 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.” (See also IRS Q&A No. 9, Certain Medicaid Waiver Payments May Be Excludable From Income, <https://www.irs.gov/individuals/certain-medicaid-waiver-payments-may-be-excludable-from-income>.) To date, respondent has not issued any of its own guidance regarding whether Medicaid waiver payments will continue to be treated as difficulty of care payments excludable under IRC section 131 after the Tax Court’s decision in *Feigh*.

HOLDING

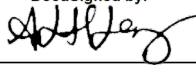
Appellant is entitled to the California EITC for the 2018 tax year.


DISPOSITION

We reverse respondent’s action denying appellant’s claim for refund of \$2,335 for the 2018 tax year and grant appellant’s appeal.

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Huy 'Mike' Le
Administrative Law Judge

We concur:

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Andrea L.H. Long
Administrative Law Judge

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Cheryl L. Akin
Administrative Law Judge

Date Issued: 2/2/2021