

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) No. 91R-0412-JG
GEORGE R. II AND EDNA HOUSE)

Appearances:

For Appellant: Kathleen House-Sharp
Enrolled Agent

For Respondent: John W. Penfield
Counsel

OPINION

This appeal is made pursuant to section 19057, subdivision (a),^{1/} of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claims of George R. II and Edna House for refund of personal income tax in the amounts of \$815 and \$2,142 for the years 1986 and 1987, respectively.

^{1/} Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the year in issue.

The issue presented by this appeal is whether appellants have demonstrated their entitlement to treat payments Mr. House received for accumulated sick leave earned while he was a state employee as nontaxable worker's compensation payments.

Appellant George R. House II was employed as a California Highway Patrol officer and, apparently due to an occupational injury or illness, applied for and was granted industrial disability retirement (IDR). However, prior to the date appellant's retirement became effective, he was paid a full year's salary pursuant to Labor Code section 4800^{2/}, and in 1986 and 1987 was paid all of his accumulated sick leave.^{3/} Appellants reported the accumulated sick leave as taxable income in their 1986 and 1987 returns. On or about December 15, 1989, respondent Franchise Tax Board received appellants' amended returns for 1986 and 1987 which claimed that appellant's accumulated sick leave paid in 1986 and 1987 was nontaxable as worker's compensation, citing the United States Tax Court's decision in Givens v. Commissioner, 90 T.C. 1145 (1988), as authority. Respondent denied appellants' refund claims, stating that it was following the Internal Revenue Service's nonacquiescence to the Givens decision.^{4/}

It is well settled that deductions and exclusions are a matter of legislative grace and are allowable only where the conditions established by the legislature have been satisfied. (New Colonial Ice Co. v. Helvering, 292 U.S. 435 [78 L.Ed. 1348] (1934); Appeal of Frederick A. Sebring, Cal. St. Bd. of Equal., Dec. 9, 1980.) Respondent's determination that a deduction or exclusion should be disallowed is presumed correct (Welch v. Helvering, 290 U.S. 111 [78 L.Ed. 212] (1933); Appeal of John A. and Julie M. Richardson, Cal. St. Bd. of Equal., Oct. 28, 1980), and appellants must prove their entitlement to the claimed deductions or exclusion. (Appeal of Ambrose L. and Alice M. Gordos, Cal. St. Bd. of Equal., Mar. 31, 1982.)

I.R.C. section 61 provides that, except as otherwise provided by law, gross income means all income from whatever source derived, including compensation for services. I.R.C. section 104(a)(1) provides in part that gross income does not include amounts received under worker's compensation acts as compensation for personal injuries or sickness.^{5/} The regulation interpreting

^{2/} California's Worker's Compensation Act appears in Labor Code sections 3200 et seq. Labor Code section 4800 provides in pertinent part that a member of the California Highway Patrol who is disabled in the line of duty is entitled to his full pay for a period not exceeding one year. It appears that the parties agree that payments made to appellant pursuant to Labor Code section 4800 are nontaxable under the applicable provisions of Internal Revenue Code (I.R.C.) section 104.

^{3/} It is not entirely clear what amount of sick leave appellant received. It appears that appellant initially claimed he received \$28,126.59 in 1986 and \$24,505.09 in 1987. However, in subsequent correspondence appellant claims he received \$34,567.64 in 1986 and \$21,590.63 in 1987.

^{4/} Appellants contend that numerous refund claims of the same nature as this case were allowed by respondent. We are not aware of any such cases. It may very well be that respondent routinely paid some refund claims, and failed to subsequently audit the taxpayers' claims. This procedure in no way binds respondent or this board in this case.

^{5/} I.R.C. sections 61 and 104 are made applicable in California by Revenue and Taxation Code sections 17071 and

I.R.C. section 104 provides that payments made under a statute that is in the nature of a worker's compensation act are also excludable from gross income; however, the exclusion does not apply to a retirement pension to the extent that it is determined by reference to the employee's age or length of service, even though the employee's retirement is occasioned by an occupational injury or sickness. The exclusion also does not apply to amounts received as compensation for an occupational injury or sickness to the extent that they are in excess of the amount provided in the applicable worker's compensation act or acts. (Treas. Reg. § 1.104-1(b).)

The significance of the above is that an employee granted IDR can elect to receive an ordinary retirement pension based on age or years of service which may be larger than the IDR, and only the excess over the IDR amount is taxable. The portion equal to the IDR amount is considered "paid under a statute in the nature of workmen's compensation," and exempt from tax under I.R.C. section 104(a)(1), and the excess is considered taxable income because it is determined by reference to the employee's age or length of service. (See, e.g., Neill v. Commissioner, 17 T.C. 1015 (1951); see also Freeman v. United States, 265 F.2d 66, 71 (9th Cir. 1959).) For example, employee A, due to an occupational injury, retired under the disability provisions of a city plan that entitled him to the greater of 60 percent of his average final compensation, or because of years of service, a retirement allowance of 80 percent of his average final compensation. Employee A's average final compensation was \$200 per week, and consequently he elected to receive an allowance of 80 percent of his average final compensation. Of employee A's \$160 allowance (80 percent of \$200), \$120 is treated as worker's compensation and is excludable under I.R.C. section 104(a)(1). The balance, because it is attributable to years of service, is taxable. (See Rev. Rul. 80-44, 1980-1 C.B. 34.) Thus, here, to the extent that appellant's accumulated sick leave payments were attributable to years of service, such amounts are not exempt from tax under the provisions of I.R.C. section 104(a)(1).

It is clear that appellant's accumulated sick leave was determined by reference to his length of service with the California Highway Patrol. (See Govt. Code, §§ 19859, 19862.) Further, the provision of Government Code section 21025.2 which provides that the retirement date of a member^{6/} shall not become effective until the expiration of the member's accumulated sick leave simply means that the retirement of a member who is too sick to work, and thus is entitled to sick leave, shall not become effective until the expiration of the sick leave, unless the member agrees to an earlier date. (See Patton v. Governing Board, 77 Cal.App.3d 495, 504 [143 Cal.Rptr. 593] (1978).) Thus, it is clear that the sick leave payments received by appellant were not paid under California's Worker's Compensation Act (see Labor Code section 3200 et seq.). In order to treat such payments here as excludable under I.R.C. section 104(a)(1), we would have to conclude that the payments were made under a statute that is in the nature of a worker's compensation act. This was clearly not the intended meaning of Government Code section 21025.2. (Patton v. Governing Board, supra, 77 Cal.App.3d at (. . . continued)
17131, respectively.

^{6/} The term "member" means a state employee who has qualified for membership in the Public Employees Retirement System, and includes patrol members employed by the California Highway Patrol. (Govt. Code, §§ 20013, subd. (a) & (b), 20017.)

504.) A statute is in the nature of a worker's compensation act only if it allows disability payments solely for service-related personal injury or sickness. (See Take v. Commissioner, 82 T.C. 630, 631 (1984), and the cases cited therein.) The determination of the amount of sick leave to which appellant was entitled, however, was dependent upon the regular requirements of the law and rules governing the accumulation and use of sick leave by state employees (see Govt. Code, § 19859 et seq; see also Willis v. Garden Grove, 93 Cal.App.3d 208 [155 Cal.Rptr. 493] (1979).) Payments for such sick leave do not require a service-related injury or illness. Therefore, the sick leave payments appellant received were not made under a statute that was in the nature of a worker's compensation act.

The case of Givens v. Commissioner, supra, upon which appellant relies, is readily distinguishable. In Givens, like here, the taxpayer received a full year's salary pursuant to a section of California's Worker's Compensation Act (Labor Code section 4850), which, pursuant to I.R.C. section 104(a)(1), the parties treated as nontaxable compensation. However, in Givens the taxpayer was paid for his accumulated sick leave under Los Angeles County Code section 6.20.070, which the court found was the county's worker's compensation act, and payments thereunder applied solely to injuries sustained in the course of employment. Accordingly, the court held that the payments were made under a statute that was in the nature of a worker's compensation act and thus were nontaxable pursuant to I.R.C. section 104(a)(1). By comparison, here the payments were made to appellant, not because he suffered an injury or illness in the line of duty as a highway patrol officer, but simply because he was too sick to work, and was thus entitled to payment of his accumulated sick leave. Therefore, the sick leave payments were not made under a qualifying statute, and were properly determined by respondent not to be excludable under the provisions of I.R.C. section 104(a)(1).^{7/}

For the reasons stated above, respondent's action in this matter must be sustained.

^{7/} At the hearing of this matter on October 1, 1992, the board granted the appellant 30 days to furnish information as to the amount of disability income payments he would have received if he had not received sick leave payments. Appellant's post-hearing submissions do not supply this information. Subsequently, by letter on April 28, 1993, and by a telephone conversation on June 7, 1993, the request for this information was renewed. Appellant, to this date, has not supplied the requested information. We therefore have no basis for concluding how much, if any, of the payments received by the appellant should be excluded from taxation.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED, pursuant to section 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claims of George R. II and Edna House for refund of personal income tax in the amounts of \$815 and \$2,142 for the years 1986 and 1987, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 28th day of October, 1993, by the State Board of Equalization, with Board Members Mr. Sherman, Mr. Dronenburg, Mr. Fong, and Ms. Scott present.

Brad Sherman _____, Chairman

Matthew K. Fong _____, Member

Ernest J. Dronenburg, Jr. _____, Member

Winnie Scott* _____, Member

_____, Member

For Gray Davis per Government Code section 7.9

House.jg