OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **J. O'NEILL**	) OTA Case No. 19115444)))))

OPINION

Representing the Parties:

For Appellant: J. O'Neill

For Respondent: Camille Dixon, Tax Counsel
Cynthia Kent, Tax Counsel IV

A. VASSIGH, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, J. O'Neill (appellant) appeals an action by respondent Franchise Tax Board (FTB) proposing additional tax of $3,437 and applicable interest for the 2014 tax year.

Office of Tax Appeals (OTA) Administrative Law Judges John O. Johnson, Tommy Leung, and Amanda Vassigh held an electronic hearing for this matter via web-based conferencing on November 17, 2021. At the conclusion of the hearing, the record was closed, and this matter was submitted for an opinion.

ISSUES

1. Whether appellant has met his burden to establish error in FTB's proposed assessment of additional tax for 2014, or the federal adjustments upon which it is based.
2. Whether a penalty for instituting and maintaining a proceeding based upon a frivolous or groundless position should be imposed on appellant pursuant to R&TC section 19714.

FACTUAL FINDINGS

1. Appellant filed a purported 2014 California tax return (Form 540 2EZ) within the deadline for filing a return, reporting zero wages, zero taxable income, and zero tax. Appellant reported tax withholdings of $3,845 and requested a refund of the same amount.
2. Appellant attached to the Form 540 2EZ a Form 3525, Substitute for Form W-2, Wage and Tax Statement, or Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. On Form 3525, appellant asserted that he had not received wages or income, as defined by Internal Revenue Code (IRC) sections 3401 and 3121, from Datasat Digital Entertainment (Datasat). Appellant also stated on Form 3525 that the reported withholding by Datasat was correct.
3. FTB processed the Form 540 2EZ and sent appellant a refund in the amount of $3,845. Subsequently, the IRS provided information to FTB of adjustments made to appellant's federal account for the 2014 tax year. The IRS increased appellant's taxable income by $68,847, to reflect wages which were reported as paid by Datasat to appellant.
4. Based on the IRS information, FTB made corresponding adjustments to appellant's California taxable income. FTB issued appellant a Notice of Proposed Assessment (NPA) dated April 4, 2019. As reflected on the NPA, FTB increased appellant's California taxable income, and proposed additional tax of $3,437, plus interest.
5. Appellant protested the NPA, arguing that the payments he received from Datasat did not constitute taxable income.
6. FTB affirmed the NPA in a Notice of Action. Appellant then timely filed this appeal.
7. FTB provided with its brief a "Law Summary – Non-Filer, Frivolous Arguments" (Law Summary) which provided an overview of common arguments that have been determined by the courts to be frivolous. FTB also included in its brief an argument in favor of imposing a frivolous appeal penalty in this case.
8. Prior to the 2014 tax year, appellant appears to have filed valid tax returns.

DISCUSSION

Issue 1: Whether appellant has met his burden to establish error in FTB's proposed assessment of additional tax for 2014, or the federal adjustments upon which it is based.

R&TC section 18622(a) provides that a taxpayer shall either concede the accuracy of a final federal determination or state wherein it is erroneous. It is well settled that a deficiency assessment based on a federal determination is presumptively correct and that a taxpayer bears the burden of proving that the determination is erroneous. (*Appeal of Gorin*, 2020-OTA-018P.) The applicable burden of proof is by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(c).) A preponderance of the evidence means that the taxpayer must establish by documentation or other evidence that the circumstances he or she asserts are more likely than not to be correct. (*Concrete Pipe and Products of California, Inc. v. Construction Laborers Pension Trust for Southern California* (1993) 508 U.S. 602, 622.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof with respect to an assessment based on a federal action. (*Appeal of Gorin, supra*.)

R&TC section 17041(a) provides, in pertinent part, that tax shall be imposed upon the entire taxable income of every California resident. R&TC section 17071 incorporates IRC section 61, which defines "gross income" as including "all income from whatever source derived." Income includes any "accessions to wealth." (*Appeal of Balch*, 2018-OTA-159P; *Commissioner v. Glenshaw Glass Co*. (1955) 348 U.S. 426, 431.) Wages and compensation for services are gross income within the meaning of IRC section 61. (IRC, § 61(a); *Appeal of Balch*, *supra*; *U.S. v. Romero* (1981) 640 F.2d 1014, 1016; *Appeals of Wesley, et al*. (2005-SBE-002) 2005 WL 3106917.)

In this case, FTB obtained information from the IRS that appellant's 2014 federal tax return had been adjusted. FTB made conforming adjustments to appellant's California Form 540 2EZ for the 2014 tax year. Therefore, FTB's deficiency assessment is presumed correct, and it is appellant's burden of proof to show that the proposed assessment is erroneous. On appeal, appellant argues that the federal adjustment was based on "bad payer data" contained in an erroneous Form W-2. Appellant further argues that he had no wages as defined by IRC sections 3401(a) or 3121(a) and appears to claim that because he "exercised no federal powers, prerogatives, or privileges," the payments he received from Datasat were not taxable. Appellant

argues that the payments to him were the result of "private sector activity" and therefore not taxable income.

Appellant does not dispute having received payment from Datasat, nor does he dispute the amount of payment reported to the IRS. Appellant's argument is centered in his belief that private sector activity is not taxable and that the payments from Datasat were not taxable income. Appellant's argument that his income is not a form of wages or taxable income is a frivolous argument that OTA, the IRS, and the courts have consistently and emphatically rejected. (See, e.g., *Appeal of Balch, supra*; *United States v. Buras* (9th Cir. 1980) 633 F.2d 1356; *Fox v. Commissioner,* T.C. Memo. 1996-79; *United States v. Buras* (9th Cir. 1980) 633 F.2d 1356; *Fox v. Commissioner,* T.C. Memo. 1996-79; *U.S. v. Latham,* (7th Cir. 1985) 754 F.2d 747, 750.)[1]

With regard to appellant's contention that private sector activity is not taxable, the courts have consistently held that this argument is frivolous and without merit. (See, e.g., *Briggs v. Commissioner*, T.C. Memo. 2016-86; *Sullivan v. U.S.* (1st Cir. 1986) 788 F.2d 813; *Waltner v. Commissioner*, T.C. Memo. 2014-35.) The IRS has concluded that this argument is based on a misinterpretation of IRC section 3401, which relates to income tax withholding, and has warned taxpayers that this argument is frivolous.[2] Section 3401(c) defines "employee" and states that the term "includes an officer, employee or elected official of the United States....." Section 7701(c) states that the use of the word "includes" "shall not be deemed to exclude other things otherwise within the meaning of the term defined." The IRS explains that the word "includes" as used in the definition of "employee" makes federal employees and officials a part of the definition of "employee," which generally includes private citizens.[3] 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. The terms 'employee' and 'wages' as used by the Internal Revenue

[1] The IRS published a list of identified frivolous positions, which includes the arguments asserted by appellant, in IRS Notice 2010-33 (Int. Rev. Bull. 2010-17, Apr. 26, 2010), and the IRS publication, "The Truth About Frivolous Tax Arguments" (http://www.irs.gov/Tax-Professionals/The-Truth-About-Frivolous-Tax-Arguments-Introduction).

[2] See Section B of the IRS publication, "The Truth About Frivolous Arguments" (https://www.irs.gov/privacy-disclosure/the-truth-about-frivolous-tax-arguments-section-i-a-to-c).

[3] *Ibid.*

Code. 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 money he received from Datasat from his taxable income for the 2014 tax year.

There is no evidence, other than appellant's own unsupported assertions, that the IRS determination that he received taxable income during the 2014 tax year is erroneous. (See R&TC, § 18622(a).) Appellant has not overcome the presumption that FTB's deficiency assessment, which is based on a final federal determination, is correct.

Issue 2: Whether a penalty for instituting and maintaining a proceeding based upon a frivolous or groundless position should be imposed on appellant pursuant to R&TC section 19714.

Section 19714 provides that a penalty of up to $5,000 shall be imposed whenever it appears to OTA that proceedings before it have been instituted or maintained primarily for delay, or that an appellant's position is frivolous or groundless. (*Appeal of Balch, supra*.) California Code of Regulations, title 18, (Regulation) section 30217(a), provides that OTA shall impose a frivolous appeal penalty pursuant to section 19714 "[i]f a Panel determines that a franchise or income tax appeal is frivolous or has been filed or maintained primarily for the purpose of delay . . . ." Regulation section 30217(b) includes as a factor to be considered in determining whether, and in what amount, to impose a frivolous appeal penalty under section 19714, whether the appellant is making arguments that OTA, in a precedential Opinion, or the State Board of Equalization (BOE), in a precedential Opinion, or courts have rejected. OTA may consider any relevant factors in determining whether to impose a frivolous appeal penalty.

Appellant's argument that his income is not taxable because it was generated in the private sector relies on a misreading of the IRC and is similar to arguments that have been clearly and consistently rejected by the IRS, the federal courts, OTA, and the BOE. (See, e.g., *Appeal of Balch, supra; Briggs v. Commissioner, supra; Appeals of Bailey* (92-SBE-001) 1992 WL 44503; *Appeals of Dauberger, et al.* (82-SBE-082) 1982 WL 11759.) In the present appeal, the Law Summary FTB sent to appellant detailed how such arguments have been consistently refuted by the courts, the BOE, and OTA. The Law Summary also explained how California law, as well as federal law, define taxable income. As such, appellant has been informed on several occasions that the arguments he was making in this appeal had been determined to be frivolous arguments. Appellant was also provided a copy of OTA's precedential Opinion in *Appeal of Balch*, and participated in a prehearing conference during

which frivolous arguments and the frivolous appeal penalty were discussed. Appellant was provided with notice that the frivolous appeal penalty may be applied against appellants who maintain frivolous or groundless appeals. Nevertheless, appellant continued to present the frivolous arguments at the hearing. In light of that fact, we find that appellant has maintained a frivolous and groundless position before this body, and hereby impose a frivolous appeal penalty of $750.[4]

[4] 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. In this case, appellant was provided with notice about a possible penalty and information about frivolous arguments, and was given the opportunity to reassess his argument when his request for a hearing postponement was granted. However, we have no indication that appellant has submitted frivolous appeals in the past and take that mitigating factor into consideration. We determine that a $750 penalty, which is on the lower end of the potential penalty amount, is fair. We believe this amount is appropriate as a deterrent for future frivolous appeals, while not being too high as to be unduly punitive to appellant. Subsequent frivolous appeals may be subject to increased penalty amounts, up to the maximum penalty of $5,000.

HOLDINGS

1. Appellant has not met his burden to establish error in FTB's proposed assessment of additional tax for 2014, or the federal adjustments upon which it is based.
2. A $750 penalty for instituting and maintaining a proceeding based upon a frivolous or groundless position shall be imposed on appellant pursuant to R&TC section 19714.

DISPOSITION

FTB's actions are sustained in full. In addition, a frivolous appeal penalty in the amount of $750 is hereby imposed on appellant.

DocuSigned by:
Amanda Vassigh
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Amanda Vassigh
Administrative Law Judge

We concur:

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John O Johnson
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John O. Johnson
Administrative Law Judge

DocuSigned by:
Tommy Leung
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Tommy Leung
Administrative Law Judge

Date Issued: 2/22/2022