

FACTUAL FINDINGS2020 Taxable Year

1. Appellants timely filed a 2020 California Resident Income Tax Return (Form 540) reporting an overpayment of \$1,938, which FTB refunded to appellants, plus interest.
2. On January 27, 2023, appellants filed an amended return reporting taxable income of \$0, a total tax of \$0, and payments³ of \$9,469 in withholdings, resulting in a claimed refund due of \$7,531. FTB considered the amended return to be a claim for refund.
3. An IRS Wage and Income Transcript for the 2020 taxable year shows that appellant- husband received wages of \$155,277.
4. On February 27, 2023, FTB issued appellants a letter denying the claim for refund because it was based on a frivolous amended return.

2021 Taxable Year

5. Appellants timely filed a 2021 Form 540 reporting an overpayment of \$1,406, which FTB refunded to appellants.
6. On January 27, 2023, appellants filed an amended return reporting taxable income of \$0, a total tax of \$0, and payments⁴ of \$10,798, resulting in a claimed refund due of \$9,392. FTB considered the amended return to be a claim for refund.
7. An IRS Wage and Income Transcript for the 2021 taxable year shows that appellant- husband received \$165,280 in wages.
8. On February 27, 2023, FTB issued appellants a letter denying the claim for refund because it was based on a frivolous amended return.
9. Appellants filed this timely appeal for taxable years 2020 and 2021.

³ Appellants claimed withholdings of tax and excess withholding of State disability insurance (SDI).

⁴ Appellants claimed withholdings of tax and excess withholding of SDI.

DISCUSSION

Issue 1: Have appellants shown error in FTB's denial of their claims for refund for the 2020 and 2021 taxable years?

A taxpayer bears the burden of proving entitlement to a refund claim. (*Appeal of Estate of Gillespie*, 2018-OTA-052P; Cal. Code Regs., tit. 18, § 30219(a).) Except as otherwise provided by law, the burden of proof requires proof by a preponderance of the evidence. (Cal. Code Regs., tit. 18, § 30219(b).)

R&TC section 17041(a) provides, in pertinent part, that tax shall be imposed upon the entire taxable income of every resident of California. R&TC section 17071 defines “gross income” by referring to and incorporating Internal Revenue Code (IRC) section 61 into California law. IRC section 61 states that, unless otherwise provided, “gross income means all income from whatever source derived,” including compensation for services.

Appellant-husband's employer reported on federal Forms W-2 that appellant-husband was an “employee” who earned wages of \$155,277 in 2020, and \$165,280 in 2021. Wages are expressly includable in appellants' gross income pursuant to IRC section 61. Therefore, appellants must include these wages as gross income for 2020 and 2021.

Here, appellants contend they do not fall within the definition of “employee” under IRC section 3401(c), and thus, they are not taxpayers, as defined by law, and did not receive any taxable income in 2020 and 2021. Appellants contend that “employee,” as used in IRC section 3401(c) “includes an officer, employee, or elected official of the United States, a State, or political subdivision thereof.” Because they are not in the listed categories, appellants assert that their income is not taxable.

However, appellants rely on a misreading of the IRC in concluding that private sector employees are not employees whose wages are taxable income. The terms “employee” and “wages,” as used in the IRC, apply to all employees, unless specifically exempted. (*Appeal of Balch*, 2018-OTA-159P.) Appellants fail to recognize that IRC section 3401(a) states that *all* remuneration for services performed by an employee for an employer constitutes wages. IRC section 3401(c) simply clarifies that the term “employee” as used in IRC section 3401(a) *includes* an officer, employee, or elected official of the United States, a State, or any political subdivision thereof. The statute simply clarifies that public officials, government workers, *and* other employees receive wages that are subject to taxation. Moreover, appellants' arguments

that wages do not constitute income and that payments to private-sector employers are not income are frivolous arguments that OTA's predecessor, the State Board of Equalization (BOE), the IRS, and the courts have consistently and emphatically rejected. (*Appeal of Balch, supra.*) Therefore, appellants arguments have no merit, and appellants have failed to prove that any additional refunds are warranted.

Appellants also allege that appellant-husband's employer is not an employer carrying on a "trade or business" as defined by IRC section 7701(a)(26), which defines "trade or business" as *including* the performance of a public office. As previously discussed, appellants fail to recognize the critical word "*includes*" found in IRC section 7701(a)(26), which means that public officials are *included* in the definition of employers operating a trade or business; it does not mean that only those who operate in the performance of a public office are conducting a trade or business.

Issue 2: Is a frivolous appeal penalty warranted?

R&TC section 19714 provides that, whenever it appears to OTA that appeal proceedings have been instituted or maintained primarily for delay, or that an appellants' position is frivolous or groundless, OTA shall impose a penalty of up to \$5,000. (See Cal. Code Regs., tit. 18, § 30217(a).)

Appellants assert that the frivolous appeal penalty may not be imposed because "[i]n order for a return containing -0- entries to be frivolous, it must also contain Tax Protest Arguments." Appellants contend that they are not protesting the laws but rather are following them. In support, appellants cite IRC section 6702, which does not address tax protestor arguments at all, much less make it a requirement for imposing a frivolous appeal penalty.⁵

An appeal is frivolous when it is brought or maintained by taxpayers primarily for delay or when taxpayers' position in the proceedings is frivolous or groundless. (R&TC, § 19714.) The statute does not support appellants' position that in order to be frivolous, taxpayers must make "tax protest arguments," which appellants have not defined.

⁵ California does not conform to IRC section 6702 for purposes of the frivolous appeal penalty in R&TC section 19714 (as distinguished from the frivolous return penalty imposed by FTB pursuant to R&TC section 19179).

When determining whether to impose a frivolous appeal penalty, OTA may consider any relevant factors, including, but not limited to, the following:

- (1) Whether the appellant is making arguments that OTA, in a precedential Opinion, or BOE, in a precedential Opinion, or courts have rejected;
- (2) Whether the appellant is making the same arguments that the same appellant made in prior appeals;
- (3) Whether the appellant submitted the appeal with the intent of delaying legitimate tax proceedings or the legitimate collection of tax owed;
- (4) Whether the appellant has a history of submitting frivolous appeals or failing to comply with California's tax law; or
- (5) Whether the appellant has been notified, in a current or prior appeal, that a frivolous appeal penalty may apply.

(Cal. Code Regs., tit. 18, § 30217(b).)

Appellants' argument, that they are not employees and thus do not earn taxable income, has been clearly and consistently rejected as frivolous by the IRS, federal courts, FTB, BOE, and OTA. (See, e.g., *Appeal of Balch, supra*; *Appeal of Myers* (2001-SBE-001) 2001 WL 37126924; *Appeal of Castillo* (92-SBE-020) 1992 WL 202571; *U.S. v. Buras* (9th Cir. 1980) 633 F.2d 1356; *Briggs v. Commissioner*, T.C. Memo. 2016-86; *Waltner v. Commissioner*, T.C. Memo. 2014-35.) Moreover, appellants were put on notice by OTA, in its letter acknowledging appellants' appeal, and by FTB, in its opening brief, that they may be subject to a frivolous appeal penalty of up to \$5,000.


On the other hand, this is appellants' first appeal before OTA, and there is no evidence in OTA's record showing that appellants had previously used the same frivolous arguments in prior appeals, or that appellants have a history of submitting frivolous appeals. Additionally, appellants were filing claims for refund of amounts already paid to FTB, and thus, it is unlikely that the appeal has been instituted or maintained primarily for delay. However, OTA finds that appellants advanced frivolous arguments in this appeal, and pursuant to R&TC section 19714 and California Code of Regulations, title 18, section 30217(a), a frivolous appeal penalty shall be imposed. Therefore, OTA imposes a frivolous appeal penalty of \$250. Appellants are on notice that they may be subject to a frivolous appeal penalty of up to \$5,000 if they file any future appeal raising frivolous arguments.

HOLDINGS

1. Appellants have failed to show error in FTB’s denial of their claims for refund for the 2020 and 2021 taxable years.
2. A frivolous appeal penalty of \$250 is imposed.


DISPOSITION

FTB’s action is sustained. In addition, a frivolous appeal penalty is imposed in the amount of \$250.


DocuSigned by:

 0CC6C6ACCC6A44D...

 Teresa A. Stanley
 Administrative Law Judge

We concur:

DocuSigned by:

 CB1F7DA37831416...

 Josh Lambert
 Administrative Law Judge

DocuSigned by:

 7B17E958B7C14AC...

 Amanda Vassigh
 Administrative Law Judge

Date Issued: 3/7/2024