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**OFFICE OF TAX APPEALS**

**STATE OF CALIFORNIA**

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| In the Matter of the Appeal of: | OTA Case No. 21067902 |
| **A. MARKOWSKI** | |

**OPINION**

Representing the Parties:

For Appellant: James Markowski, Attorney

For Respondent: Ellen Swain, Attorney

H. LE, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, A. Markowski (appellant) appeals an action by respondent Franchise Tax Board (FTB) denying appellant's claim for refund of $1,470.31 for the 2017 tax year.[1]

Appellant waived the right to an oral hearing; therefore, the Office of Tax Appeals (OTA) decides the matter based on the written record.

[1] The Office of Tax Appeals (OTA) acknowledged the amount at issue as $1,595.31. However, the correct amount at issue is $1,470.31 ($1,595.31 - $125.00) because appellant included a $125.00 processing fee imposed by Bank of America when FTB levied appellant's bank account. Appellant argues that FTB should be compelled to reimburse appellant for the processing fee "[a]s a matter of fundamental due process." However, OTA does not jurisdiction on whether appellant is entitled to a remedy for FTB's actual or alleged violation of any substantive or procedural right to due process under the law. (Cal. Code Regs., tit. 18, § 30104(e).) As relevant to this appeal, OTA's jurisdiction is limited to determining the correct amount of a taxpayer's California personal income tax liability. (*Ibid.*; *Appeal of Robinson*, 2018-OTA-059P.)

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## ISSUES[2]

1. Whether appellant was provided proper notice of tax due.
2. Whether FTB was required to obtain and review appellant's tax return before issuing its proposed assessment.
3. Whether appellant received taxable income from a California source in the 2017 tax year.

## FACTUAL FINDINGS

### Appellant's Background

1. For the 2017 tax year, appellant wrote computer codes for Derivative Technology, LLC (Derivative Technology). Derivative Technology registered with the California Secretary of State and reported its business address being located in San Mateo, California.
2. Derivative Technology issued the Forms 1099-MISC to appellant reporting that it paid appellant $37,857 of non-employee compensation for the 2017 tax year. The Forms 1099-MISC for the 2017 and 2018 tax years list appellant's address in Stamford, Connecticut (Stamford address). The Form 1099-MISC for the 2019 tax year lists appellant's address in Cambridge, Massachusetts (Cambridge address).
3. Appellant reported on his 2017 federal tax return the Form 1099-MISC income for his Schedule C business as a sole proprietor. Appellant did not file a 2017 California return.

### FTB's Assessment, Appellant's Claim for Refund, and Appeal

4. FTB issued a Request for Tax Return for the 2017 tax year to appellant because it received information showing that appellant received income from Derivative Technology to prompt a filing requirement.
5. When appellant did not respond, FTB issued a Notice of Proposed Assessment (NPA) for the 2017 tax year proposing to assess $814.00 of tax and a $203.50 late filing penalty, plus interest. FTB estimated appellant's income as $37,858.00 based on miscellaneous income reported on federal Form 1099-MISC for the 2017 tax year issued by Derivative Technology. The NPA required appellant to protest by December 20, 2019.
6. After appellant failed to file a protest, the NPA became final.

[2] OTA does not discuss the late filing penalty or the collection cost recovery fee because appellant does not dispute either the penalty or the fee.

7. On January 21, 2020, FTB issued a State Income Tax Balance Due Notice, and on March 4, 2020, FTB issued an Income Tax Due Notice. FTB addressed both notices to appellant's Stamford address, and the notices informed appellant that if FTB does not receive appellant's payment in full within 30 days, FTB may begin collection action.
8. On August 4, 2020, FTB updated its system according to the Form 1099-MISC information from the IRS that showed appellant's most current address as the Cambridge address.
9. Then, FTB issued a Final Notice Before Levy and Lien to appellant's Cambridge address.
10. Subsequently, FTB levied $1,470.31 from appellant's bank account and applied the payment to appellant's account.
11. FTB treated appellant's December 1, 2020, letter as a claim for refund and denied it.
12. Thereafter, appellant timely filed this appeal.
13. On appeal, FTB agrees "to modify its proposed assessment and apply the deductions from Schedule C," which includes "Total expenses" of $2,303[3] and "Exp for Business Use of Home" of $1,665.[4]

## DISCUSSION

Issue 1: Whether appellant was provided proper notice of tax due.

When a deficiency is determined and the assessment becomes final (such as after the failure to file a protest), FTB shall mail notice and demand to the taxpayer for the payment thereof. (R&TC, § 19049(a).) Any notice mailed to a taxpayer shall be sufficient if mailed to the taxpayer's "last known address." (R&TC, § 18416(b).) The "last known address" shall be the address that appears on the taxpayer's last return filed with FTB, unless the taxpayer has provided FTB with clear and concise written or electronic notification of a different address, or FTB has an address it has reason to believe is the most current address for the taxpayer. (R&TC, § 18416(c).) Notice sent to the taxpayer's last known address is effective since it is the

[3] This consists of supplies of $400, utilities of $1,183, and interest expenses of $720.

[4] FTB submitted calculations that are not entirely clear possibly because it was based on appellant's IRS Tax Return Transcript. However, after FTB performed its calculations, appellant submitted his Form 1040, U.S. Individual Income Tax Return. As conceded, FTB must apply the deductions from Schedule C, i.e., "Total expenses" of $2,303 and "Exp for Business Use of Home" of $1,665, as listed on appellant's Form 1040.

taxpayer's responsibility to take reasonable steps to ensure that the taxpayer receives mail. (*Appeal of Floria* (83-SBE-003) 1983 WL 15390.)

Appellant argues that the March 4, 2020 tax due notice was sent to the Stamford address, which was not his last known address. However, FTB had reason to believe that the Stamford address was appellant's most current address because the Stamford address was listed on the Forms 1099-MISC for the 2017 and 2018 tax years. Appellant did not file a California tax return, and the record does not contain convincing evidence to show that appellant notified FTB of a different address. Accordingly, FTB properly issued a tax due notice to appellant's Stamford address on March 4, 2020.[5]

Appellant argues that Derivative Technology electronically filed appellant's 2019 Form 1099-MISC with FTB with the correct Cambridge address in January 2020. Appellant submits an email from E. Orhun, the CEO of Derivative Technology, that states "Electronically filed with FTB and sent to recipients sometime in the week of Jan 20, 2020 based on the cover letter from the accounting firm; do not have an exact date . . . ." However, appellant did not provide proof of electronic submission or records from the accounting firm that allegedly filed the Form 1099-MISC with either FTB or the IRS. Accordingly, OTA finds appellant's argument to be unpersuasive.[6]

Issue 2: Whether FTB was required to obtain and review appellant's federal tax return before issuing its proposed assessment.

R&TC section 19033 provides "If [FTB] determines that the tax disclosed by the taxpayer on an original or amended return, including an amended return reporting federal adjustments pursuant to [R&TC] [s]ection 18622, is less than the tax disclosed by its examination, it shall mail notice to the taxpayer of the deficiency proposed to be assessed. In no

[5] In addition, the March 4, 2020 tax due notice is a courtesy notice as the January 21, 2020 tax due notice has already met the requirement under R&TC section 19049(a).

[6] Appellant advances a plethora of additional arguments, some of which OTA will address in this footnote. Appellant argues that FTB should have requested appellant's IRS Tax Return Transcript to determine appellant's most current address. However, where a taxpayer does not file a return with FTB and does not provide FTB with a clear and concise written or electronic notification of a different address, R&TC section 18416 only requires FTB to issue notices to an address that it has reason to believe is the most current address, which in this case was the Stamford address. Appellant further argues that FTB violated "[a]ppellant's due process right to get notice and have an opportunity to challenge the tax assessment." However, appellant had the opportunity to challenge the tax assessment by responding to FTB's request for tax return on July 5, 2019, or protesting FTB's NPA on October 21, 2019—well before FTB received information concerning appellant's Cambridge address in 2020.

case shall the determination of the deficiency be arbitrary or without foundation." FTB, in connection with the determination, shall examine the original or amended return or related electronically stored return data. (R&TC, § 19033(b)(1).) If the return or return data has been destroyed or cannot be located after reasonable effort, FTB shall request the taxpayer to provide a paper or electronic copy of the return. (R&TC, § 19033(b)(2).) If the taxpayer fails to provide a copy of the return, FTB is not required to examine the original or amended return or related electronically stored return data. (*Ibid*.)

Appellant argues the NPA is not valid because FTB did not obtain and review appellant's federal tax return or any electronically stored return information. However, the language in R&TC section 19033 regarding "the tax disclosed by the taxpayer on an original or amended return . . . is less than the tax disclosed by its examination" refers to a California return, not a federal tax return.[7] Since appellant did not file a California tax return, there was no "tax disclosed by the taxpayer on an original or amended return," making R&TC section 19033 inapplicable to this appeal. The applicable governing provision is R&TC section 19087, which applies "[i]f any taxpayer fails to file a return . . ." and is discussed below.

Issue 3: Whether appellant received taxable income from a California source in the 2017 tax year.

As relevant to this appeal, "[i]f any taxpayer fails to file a return," then FTB, at any time, "may make an estimate of the net income, from any available information, and may propose to assess the amount of tax, interest, and penalties due." (R&TC, § 19087(a).) When FTB makes a proposed assessment of additional tax based on an estimate of income, FTB's initial burden is to show why its proposed assessment is reasonable and rational. (*Appeal of Bindley*, 2019-OTA-179P.) An assessment based on unreported income is presumed correct when the taxing agency introduces a minimal factual foundation to support the assessment. (*Ibid*.) The taxing agency need only introduce some evidence linking the taxpayer with the unreported income. (*Rapp v. Commissioner* (9th Cir. 1985) 774 F.2d 932, 935.) FTB's use of the Form 1099-MISC to estimate a taxpayer's taxable income is both reasonable and rational. (*Appeal of Bindley*, *supra*.)

Here, appellant failed to file a 2017 California tax return, even after FTB issued a request. As a result, FTB estimated appellant's income to be $37,858 based on a Form 1099-MISC from

[7] A taxpayer does not disclose on a federal return the amount of California tax it owes.

Derivative Technology.[8] Public records from the California Secretary of State provided by FTB show that Derivative Technology is registered and located in California. This evidence sufficiently links appellant with income-producing activity in California, and FTB has met its initial burden to show its proposed assessment is reasonable and rational.

Once FTB has met its initial burden, FTB's proposed assessment is presumed correct and the taxpayer has the burden of proving it to be wrong. (*Appeal of Bindley*, *supra*.) FTB's determination must be upheld in the absence of credible, competent, and relevant evidence showing error in its determination. (*Ibid*.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid*.)

Appellant's central argument is that he was an employee of Derivative Technology whose income should not be sourced to California.

California Taxation of Nonresidents and Application of California Code of Regulations, title 18, (Regulation) section 17951-4.

California imposes a tax on the taxable income of every nonresident, such as appellant, to the extent it is derived from sources within California. (R&TC, §§ 17041(b) & (i), 17951(a).) Taxable income of nonresidents from sources within and without California "shall be allocated and apportioned under rules and regulations prescribed by [FTB]." (R&TC, § 17954.) Regulation section 17951-4 provides income sourcing provisions applicable to a nonresident's business, trade, or profession. Under Regulation section 17951-4(c), if a nonresident's business, trade, or profession is a sole proprietorship which carries on a unitary business, trade, or profession within and without California (partly in California and partly outside of California), its business income is apportioned to California under the statutory apportionment provisions of the Uniform Division of Income for Tax Purposes Act (UDITPA), as codified in R&TC sections 25120 through 25139. Thus, the requirements for application of Regulation section 17951-4(c) are as follows: (1) the taxpayer must be a nonresident; (2) the taxpayer must be conducting business as a sole proprietorship; (3) the taxpayer must be carrying on a unitary

[8] Appellant argues that FTB did not have appellant's Form 1099-MISC at the time FTB issued its NPA. However, the NPA noted that FTB estimated appellant's income as $37,858 based on miscellaneous income from Derivative Technology reported on federal Form 1099, W-2G and/or California Form 592 or 593 for the 2017 tax year. The income amount listed on the NPA nearly matches the non-employee compensation amount of $37,857 as listed on the Form 1099-MISC as reported on appellant's IRS Wage and Income Transcript. OTA finds this is sufficient to show that FTB appropriately made an estimate of income on its NPA from available Form 1099-MISC information.

business, trade, or profession; and (4) the taxpayer's unitary business, trade, or profession must be conducted within and without California. (*Appeal of Bindley*, *supra*.)

Here, there is no dispute that appellant was a California nonresident during the 2017 tax year. Thus, the first requirement of Regulation section 17951-4(c) has been met.

*A. Whether Appellant Was Conducting Business as a Sole Proprietorship.*

The term "sole proprietorship" is not defined in Regulation section 17951-4(c), or in the R&TC. (*Appeal of Bindley*, *supra*.) A dictionary definition of a "sole proprietorship" is "[a] business in which one person owns all the assets, owes all the liabilities, and operates in his or her personal capacity." (*Ibid.*, citing Black's Law Dict. (10th ed. 2014).) For federal and California income tax purposes, a sole proprietorship neither files income tax returns nor pays income tax. (*Ibid*.) Rather, the owner of the sole proprietorship reports all items of income on the individual tax return (i.e., on federal Schedule C) and must pay any taxes due. (*Ibid*.)

Here, Derivative Technology issued the Form 1099-MISC for the 2017 tax year reporting that appellant received nonemployee compensation. Appellant self-reported this income on Schedule C of his 2017 federal income tax return. Accordingly, appellant was conducting business as a sole proprietorship.

Appellant argues that he was not conducting business as a sole proprietorship because he was an employee according to *Dynamex Operations West, Inc. v. Superior Court* (2018) 4 Cal.5th 903 (*Dynamex*). However, appellant has the burden of proving that he was an employee of Derivative Technology and did not conduct business as a sole proprietorship. Appellant has not provided credible evidence to establish that he was an employee. Without more, declarations from appellant and his father are not sufficient in this case to satisfy appellant's burden of proving that he was an employee.

Appellant argues that FTB has the burden to show that appellant was an independent contractor based on the language in *Dynamex* that places "the burden on the hiring entity to establish that the worker is an independent contractor" by establishing the ABC test—namely:

> (A) that the worker is free from the control and direction of the hiring entity in connection with the performance of the work, both under the contract for the performance of the work and in fact; *and* (B) that the worker performs work that is outside the usual course of the hiring entity's business; *and* (C) that the worker is customarily engaged in an

> independently established trade, occupation, or business of the same nature as the work performed.

(*Dynamex*, *supra*, 4 Cal.5th at p. 957.) However, FTB is not the hiring entity in this case and cannot be placed in the same position as a hiring entity. Unlike appellant's hiring entity, FTB is not in control or possession of evidence to establish the ABC test. Furthermore, as noted above, after FTB has already shown that its proposed assessment is reasonable and rational based on appellant's Form 1099-MISC, the burden shifts to appellant to prove the assessment is incorrect. Therefore, OTA finds that appellant was conducting business as sole proprietorship, and the second requirement has been met.[9]

*B. Whether Appellant was Carrying on a Unitary Business, Trade, or Profession*

A business is "unitary" if it is a business, trade, or profession conducted both within and without the state, where the part conducted within the state and the part conducted without the state are not so separate and distinct from and unconnected to each other to be separate businesses, trades, or professions. (Cal. Code. Regs., tit. 18, § 17951-4(b).) The essence of what constitutes a unitary business is sufficiently interrelated and dependent in-state and out-of-state business activities that render it appropriate for the income and losses to be combined and taxed as one unit. (*Appeal of Bindley*, *supra*.)

Here, the evidence shows that Derivative Technology hired appellant to write computer codes in his capacity as an owner of a sole proprietorship. Appellant, thus, conducted a one-service business, which only he controlled and managed. As far as OTA can tell from the record, the business was "one interrelated and interdependent business employing and consuming the same resources." (*Appeal of Bindley*, *supra*.) Therefore, the third requirement has been met.

[9] Appellant also cites to FTB Publication 1017 to argue that an independent contractor must perform services with more than one business. However, taxpayers are required to follow authoritative sources of law, such as statutes, regulations and judicial decisions, not informal publications put out by FTB. (*Appeal of Dandridge*, 2019-OTA-458P.) Taxpayers who rely on FTB's publications do so at their own peril. (*Ibid*.)

*C. Whether Appellant's Business, Trade, or Profession was Conducted Within and Without California.*

The final requirement is that appellant must have been conducting business within and without California. The record shows that appellant received income from Derivative Technology, an LLC located in California, for services rendered as a sole proprietor. Although appellant argues that he did not conduct his business within California because he was never physically present in this state during 2017, the statute does not require a physical presence in California for the state to impose an income tax. (*Appeal of Bindley*, *supra*.) Consequently, because appellant performed services in Connecticut and derived California source income, as discussed next, from a company located in California, OTA concludes that appellant was carrying on his business within and without California.

Whether Appellant's Income from Derivative Technology is Sourced to California.

The amount of such business income derived from sources within California shall be determined in accordance with the provisions of the apportionment rules of UDITPA, contained in R&TC sections 25120 to 25139, and the regulations thereunder. (Cal. Code Regs., tit. 18, § 17951-4(c).)

"Notwithstanding [R&TC] [s]ection 38006, for taxable years beginning on or after January 1, 2013, all business income of an apportioning trade or business ... shall be apportioned to this state by multiplying the business income by the sales factor." (R&TC, § 25128.7.) The sales factor is a fraction, where the numerator is the taxpayer's total sales in California during the tax year and the denominator is the taxpayer's total sales everywhere during the tax year. (R&TC, § 25134; see also Cal. Code Regs., tit. 18, § 25134.)

To determine what amount to include in the numerator of the sales factor, R&TC section 25136 governs the assignment of receipts from sales other than sales of tangible personal property, such as receipts from services. Sales from services are assigned to this state to the extent the customer of the taxpayer receives the benefit of the service in this state. (Cal. Code Regs., tit. 18, § 25136-2(c).) "Service' means a commodity consisting of activities engaged in by a person for another person for consideration. The term 'service' does not include activities performed by a person who is not in a regular trade or business offering its services to the public . . . ." (Cal. Code Regs., tit. 18, § 25136-2(b)(8).)

Here, appellant's activities met the definition of "service" because he wrote computer codes for Derivative Technology for consideration. Appellant argues that the work he provided for Derivative Technology is not a "service" because he did not have a regular trade or business of offering his services to the public; instead, appellant argues he was an employee of Derivative Technology. However, as noted above, appellant has failed to show that he was an employee of Derivative Technology under California law. Where appellant, as a sole proprietor, wrote computer codes for Derivative Technology for meaningful consideration throughout the 2017 tax year, OTA finds that he was in a regular trade or business of offering his services to the public. Furthermore, despite appellant's contention, the term "service" does not require a person to have more than one customer.

In the case where a corporation or other business entity is the taxpayer's customer, then receipt of the "benefit of the services" shall be determined under the following cascading rules:

> (A) The location of the benefit of the services shall be presumed to be received in California to the extent the contract between the taxpayer and the taxpayer's customer or the taxpayer's books and records kept in the normal course of business, notwithstanding the billing address of the customer, indicate the benefit of the services is in California. This presumption may be overcome by the taxpayer or FTB by showing, based on a preponderance of the evidence, that the location (or locations) indicated by the contract or the taxpayer's books and records was not the actual location where the benefit of the service was received.
>
> (B) If neither the contract nor the taxpayer's books and records provide the location where the benefit of the service is received, or the presumption in subparagraph (A) is overcome, then the location (or locations) where the benefit is received shall be reasonably approximated.
>
> (C) If the location where the benefit of the service is received cannot be determined under subparagraph (A) or reasonably approximated under subparagraph (B), then the location where the benefit of the service is received shall be presumed to be in this state if the location from which the taxpayer's customer placed the order for the service is in this state.
>
> (D) If the location where the benefit of the service is received cannot

> be determined pursuant to subparagraphs (A), (B), or (C), then the benefit of the service shall be in this state if the taxpayer's customer's billing address is in this state.

(Cal. Code Regs., tit. 18, § 25136-2(c)(2).) The "benefit of the services" is reasonably approximated to California if the taxpayer's customer is a business that is registered with the California Secretary of State and located in California. (*Appeal of Bindley*, *supra*.)

Here, OTA is unable to apply the first cascading rule under subparagraph (A) because the record does not contain the contract between appellant and Derivative Technology nor appellant's book and records. Under subparagraph (B), OTA can reasonably approximate the location where Derivative Technology received the benefit of appellant's services. "Reasonably approximated" means, in relevant part, "considering all sources of information other than the terms of the contract and the taxpayer's books and records kept in the normal course of business, the location of the market for the benefit of the services . . . is determined in a manner that is consistent with the activities of [Derivative Technology] to the extent such information is available to [appellant]." (Cal. Code Regs., tit. 18, § 25136-2(b)(7).) Public records from the California Secretary of State show that Derivative Technology is registered and located in California. Moreover, Derivative Technology listed a California address on the Form 1099-MISC that it issued to appellant in the 2017 tax year. Thus, Derivative Technology received the benefit of appellant's services within California. Accordingly, the entire $37,858 appellant received from Derivative Technology in 2017 is sourced to California.

Appellant argues that FTB may only tax income based on whether appellant was working within California and appellant cites to *Newman v. FTB* (1989) 208 Cal.App.3d 972 (*Newman*). However, *Newman* is not relevant to this appeal because *Newman* involved the application of Cal. Code Regs., title 18, section 17951-5 for nonresident salesperson, performers, professions, and so forth who performed services in California, and appellant did not perform services in California.

Appellant also appears to argue that the market-based sourcing rules under Regulation section 25136-2 is unconstitutional because it sources income to California from appellant who has worked from Connecticut and who has never been in California. Regulation section 25136-2 is based on a statute, R&TC section 25136(a)(1), which provides that "[s]ales from services are

in this state to the extent the purchaser of the service received the benefit of the services in this state." Under this market-based sourcing approach, R&TC section 25136(a)(1) focuses on where the benefit of a service is received, not where the service is performed. If OTA were to accept appellant's constitutional objections to the application of Regulation section 25136-2 to taxpayers such as himself, that would, in essence, invalidate R&TC section 25136 market-based sourcing approach as unconstitutional. Moreover, OTA does not have jurisdiction to determine "[w]hether a California statute is invalid or unenforceable under the United States or California Constitutions, unless a federal or California appellate court has already made such a determination." (Cal. Code Regs., tit. 18, § 30104(a).) In addition, OTA's predecessor, the Board of Equalization (BOE), had a long-established policy of abstaining from deciding constitutional issues. (*Appeal of Aimor Corp*. (83-SBE-221) 1983 WL 15592.) "This policy is based upon the absence of any specific statutory authority which would allow [FTB] to obtain judicial review of a decision in such cases and upon our belief that judicial review should be available for questions of constitutional importance." (*Ibid*.)

## HOLDINGS[10]

1. Appellant was provided proper notice of income tax due.
2. FTB was not required to obtain and review appellant's tax return before issuing its proposed assessment.
3. Appellant received taxable income from a California source in the 2017 tax year.

## DISPOSITION

As conceded on appeal, FTB's assessment is modified to allow business expense deductions from Schedule C. Also, appellant's penalty and interest are correspondingly recomputed and reduced based on the allowed business expense. Otherwise, FTB's assessment is sustained.

DocuSigned by:
Huy "Mike" Le
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Huy "Mike" Le
Administrative Law Judge

We concur:

DocuSigned by:
Andrea LH Long
272945E7B372445...
Andrea L.H. Long
Administrative Law Judge

DocuSigned by:
Sheriene Anne Ridenour
67F043D83EF547C...
Sheriene Anne Ridenour
Administrative Law Judge

Date Issued: 12/14/2023

[10] Appellant raises a plethora of arguments in this appeal but also notes that appellant's status as an employee or independent contractor is the "central issue" that will "determine the outcome in this appeal." This Opinion addresses appellant's main arguments. As to other arguments not addressed herein, OTA has considered them all and concludes that they are groundless or without merit.