

**OFFICE OF TAX APPEALS
STATE OF CALIFORNIA**

In the Matter of the Appeal of:)
J. LIN AND D. LIN) OTA Case No. 240215364
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OPINION

Representing the Parties:

For Appellants: J. Lin And D. Lin

For Respondent: Eric R. Brown, Attorney

S. ELSOM, Hearing Officer: Pursuant to Revenue and Taxation Code (R&TC) section 19324, J. Lin and D. Lin (appellants) appeal an action by the Franchise Tax Board (respondent) denying appellants' claim for refund of \$91,716 for the 2020 tax year.

Appellants waived the right to an oral hearing; therefore, the matter was submitted to the Office of Tax Appeals (OTA) on the written record pursuant to California Code of Regulations, title 18, (Regulation) section 30209(a).

ISSUES¹

1. Have appellants established error in respondent's denial of appellants' claim for refund for the 2020 tax year?
2. Should OTA impose the frivolous appeal penalty?

¹ Respondent imposed a \$5,000 frivolous filing penalty for the 2020 tax year under R&TC section 19179. OTA has no authority to review frivolous return penalties imposed under R&TC section 19179. (R&TC, § 19179(c); *Appeal of Balch*, 2018-OTA-159P.) As a result, OTA does not address the frivolous filing penalty in this Opinion.

FACTUAL FINDINGS

1. Appellants timely filed a 2020 California Resident Income Tax Return (Form 540 2EZ) reporting a filing status of married filing jointly. Appellants' return reported total wages of \$0, no deductions or credits, total tax of \$0, total tax withheld of \$91,716, and a refund of \$91,716.
2. Appellants attached two Forms 3525 to their return as substitutes for the W-2 statements that Trinet HR II, INC (Trinet) and The Board of Trustees of The Leland Stanford Junior University (Stanford University) issued to appellants. On the Forms 3525, appellants reported total withholdings of \$91,715.92² and total wages of \$0. Appellants also included explanatory statements, including the following: "Erroneous 'wages' on lines 1, 3, & 5 of W-2 provided by 'Payer' are hereby rebutted;" and "'Payer' incorrectly reported 'wages'. I was strictly a private sector worker with non-federal pay."
3. Respondent processed appellants' return and remitted a Form 1099-G, Report of State Income Tax Refund, to appellants and the IRS to report income from the refund of taxes for the 2020 tax year in the amount of \$91,716. However, respondent did not actually refund any amount to appellants for the 2020 tax year.
4. Appellants subsequently filed two additional 540 2EZ returns for the 2020 tax year on November 3, 2022, and September 25, 2023, that were each substantially the same as the original filing. With the return filed on September 25, 2023, appellants provided a letter which states that the income paid by Trinet and Stanford University to appellants is not taxable under Internal Revenue Code (IRC) sections 3121(a), (b), and (d) and 3401(a), (c), (d), and (f), because the income payments were not made by an "agency or instrumentality of the State or United States," and appellants "were not in a 'trade or business', but were private sector workers."
5. Respondent subsequently obtained IRS Wage and Income Transcripts and withholding information from the California Employment Development Department (EDD) showing that in the 2020 tax year, appellant J. Lin received wage income of \$512,651.04 from Vital Proteins, LLC³ and appellant D. Lin received wage income of \$365,934.58 from Stanford University.

² The Forms 3525 reported the following tax withholding amounts: for appellant J. Lin, tax withholdings of \$58,396.65 made by payer Trinet, and for appellant D. Lin, tax withholdings of \$33,319.27 made by Stanford University. The sum of these withholding amounts total \$91,715.92.

6. On November 15, 2023, respondent sent a letter to appellants denying their claim for refund because it was based on a frivolous return.
7. This timely appeal followed.
8. On February 23, 2024, OTA issued a letter acknowledging appellants' appeal and advising them that they may be raising arguments similar to those that OTA and the Board of Equalization (BOE) found to be frivolous. Appellants were further advised that if their appeal was determined to be frivolous, they may be subject to a frivolous appeal penalty of up to \$5,000. Additionally, in its opening brief, respondent fully discussed the potential imposition of a frivolous appeal penalty and attached a four-page Law Summary listing several positions that have previously been held to be frivolous.

DISCUSSION

Issue 1: Have appellants established error in respondent's denial of appellants' claim for refund for the 2020 tax year?

A taxpayer bears the burden of proving entitlement to a claimed refund. (*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 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.

Appellants argue that, under IRC sections 3121 and 3041, Trinet and Stanford University are not federal employers and appellants are not in a trade or business. As a result, appellants assert that the wages paid by Trinet and Stanford University to appellants are not considered taxable income. During this appeal, appellants appear to argue *only* that the W-2 statements issued to them by Trinet and Stanford University are erroneous. Appellants specifically state that they "did not receive U.S. source income from the payers and thus their [W-2 statements]

³ The EDD information shows Vital Proteins, LLC reported withholdings of \$58,396.65 for appellant J. Lin, which matches the withholding amount appellants reported on Form 3525 for Trinet. The parties do not explain the cause of the name difference and it is not material issue under appeal.

The IRS Wage and Income Transcript for J. Lin dated February 28, 2024, reports wage income that is \$7,439.04 less than the amount reported by the EDD for California purposes. This difference is not material to the issue under appeal.

are erroneous.” Appellants further contend that “Respondent falsely claims that [their] position is based on ‘because they were not employees of the federal government or California government, and therefore, they argue they earned no taxable wages, upon which California tax can be collected.’” (Italics omitted.) Appellants contend, “This is an incorrect representation.” Appellants argue further that their position is supported by: (1) respondent’s issuance of a 1099-G statement to appellants and the IRS for the 2020 tax year which reflected that the requested refund of \$91,716 had been issued to appellants by respondent; and (2) the IRS’s processing and issuance of appellants’ claimed refunds for other years where appellants similarly omitted W-2 wage income from their taxable income.

IRC sections 3121 and 3401 define wages for the purpose of determining withholdings and employment taxes. Neither section permits a taxpayer to exclude W-2 wage income received from a private sector employer from taxable income, as asserted by appellants. As explained 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 Code apply to all employees, unless specifically exempted by the Internal Revenue 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.) Appellants’ argument that their W-2 wages do not constitute income is a frivolous argument that the IRS,⁴ OTA, BOE and the courts have consistently and emphatically rejected. (See e.g., *Appeal of Balch*, 2018-OTA-159P; *Appeal of Myers* (2001-SBE-001) 2001 WL 37126924; *U.S. v. Buras* (9th Cir.1980) 633 F.2d 1356; *Fox v. Commissioner*, T.C. Memo. 1996-79.) With regard to the contention that wages from private-sector employers are not income, the courts have consistently held that this argument is frivolous and without merit. (*Appeal of Balch, supra.*)

During this appeal, appellants apply the same misinterpretations of IRC sections 3121 and 3401 stated above to argue *only* that the W-2 statements they received from Trinet and Stanford University are erroneous because neither paid appellants “U.S. Source Income,” and thus, the wage income is excludable from taxable income. The legal basis for this argument is the same as appellants’ original argument per the returns filed with respondent and is also considered frivolous for the same reasons stated above. Additionally, though appellants argue that respondent’s issuance of a 1099-G statement for the 2020 tax year and the IRS’s

⁴ 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 in the IRS publication, “The Truth About Frivolous Tax Arguments” available at: <http://www.irs.gov/Tax-Professionals/The-Truth-About-Frivolous-Tax-Arguments-Introduction>.

issuance of refunds for other years supports their position that their W-2 wage income is not taxable, the record in this appeal does not establish that respondent or the IRS examined appellants' returns or issued a final determination to exclude appellants' W-2 wage income prior to issuing the refunds.⁵ In any event, even if the IRS had examined appellants' returns in prior years and made a final federal determination favorable to appellants' position, respondent would not be bound to follow it, and may separately conduct its own independent investigation. (*Appeal of Black*, 2023-OTA-023P.) For the foregoing reasons, appellants have not established that their W-2 wage income is excludable from taxable income, and appellants have failed to show error in FTB's denial of their claim for refund for the 2020 tax year.

Issue 2: Should OTA impose the frivolous appeal penalty?

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 appellant's position is frivolous or groundless, OTA shall impose a penalty of up to \$5,000. (See also Cal. Code Regs., tit. 18, § 30217(a).) 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' arguments, that Trinet and Stanford University are not employers, and that

⁵ In its opening brief, respondent states that its issuance of a 1099-G statement is erroneous, and respondent did not pay a refund to appellants for the 2020 tax year: "Appellants correctly indicate that respondent erroneously reported payment of a refund in the amount of \$91,716, as 'prior year refund' to the IRS on Form 1099-G. However, notwithstanding the erroneous report, no refund was ever paid."

The IRS Return Transcripts for appellants 2020 tax year dated March 19, 2024, report an adjustment "per computer" to reduce appellants taxable income by a charitable donation deduction of \$300, but do not report that the IRS examined appellants' return. The charitable donation deduction is not material to this appeal and OTA does not address it in this Opinion.

appellants are private sector workers and thus did not earn taxable income, are similar to arguments that have been clearly and consistently rejected as frivolous by the IRS, OTA, BOE, and federal courts. (See, e.g., *Appeal of Balch, supra*; *Appeal of Myers, supra*; *Appeal of Castillo* (92-SBE-020) 1992 WL 202571; *U.S. v. Buras, supra*; *Briggs v. Commissioner*, T.C. Memo. 2016-86; *Waltner v. Commissioner*, T.C. Memo. 2014-35.) In OTA's acknowledgement letter to appellants referencing *Appeal of Balch* and respondent's opening brief,⁶ OTA and respondent each notified appellants that they may be subject to a frivolous appeal penalty of up to \$5,000. Although appellants do not have a history of filing prior appeals, appellants have concurrently appealed respondent's claim denial for the 2017, 2018, and 2021 tax years under a frivolous argument identical to the argument in this appeal. This appeal concerns a claim for refund for amounts already paid by appellants (or appellants' employers) and it is unlikely that this appeal has been instituted or maintained primarily for delay. Nonetheless, appellants maintained this appeal despite being notified that the frivolous appeal penalty may be applied against appellants who maintain frivolous or groundless appeals.

In determining the amount of the frivolous appeal penalty to impose in this case, OTA considers fairness to appellants, as well as to the public, which is impacted by the cost of adjudicating frivolous and groundless appeals. (*Appeal of Balch, supra*.) In this case, appellants were informed prior to and during this appeal that the positions advanced may be frivolous, yet appellants continued with this appeal and filed separate appeals for three other tax years under an identical frivolous position. Therefore, pursuant to R&TC section 19714 and Regulation section 30217(a), OTA imposes a frivolous appeal penalty of \$1,000.⁷ 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 similar frivolous arguments.

⁶ Exhibit D, attached to respondent's opening brief, contain citations of law with respect to arguments made by appellants in this appeal which have consistently been held to be frivolous.

⁷ OTA determined that a \$1,000 penalty, which is on the lower end of the potential penalty amount, is fair. OTA believes this amount is appropriate as a deterrent for future frivolous appeals, while not being too high as to be unduly punitive to appellants.

HOLDINGS

1. Appellants have not established error in respondent's denial of appellants' claim for refund for the 2020 tax year.
2. A frivolous appeal penalty of \$1,000 is imposed.

DISPOSITION

Respondent's denial of appellants' claim for refund for the 2020 tax year is sustained. In addition, a frivolous appeal penalty in the amount of \$1,000 is hereby imposed.

Signed by:

Seth Elsom

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Seth Elsom
Hearing Officer

We concur:

DocuSigned by:

Steven Kim

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Steven Kim
Administrative Law Judge

Signed by:

Natasha Ralston

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Natasha Ralston
Administrative Law Judge

Date Issued: 2/4/2025