OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **C. SUURS**	OTA Case No. 230814168

OPINION

Representing the Parties:

For Appellant: C. Suurs

For Respondent: Mina Mohaddess, Attorney

T. STANLEY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, C. Suurs (appellant) appeals an action by respondent Franchise Tax Board (FTB) proposing additional tax of $11,472, a late-filing penalty of $2,868, and applicable interest, for the 2020 taxable year.[1]

Appellant 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).

ISSUES

1. Has appellant established error in FTB's proposed assessment for 2020 (as revised by FTB on appeal)?
2. Has appellant established reasonable cause to abate the late-filing penalty?

FACTUAL FINDINGS

1. Appellant was a California nonresident who resided in the Netherlands for the entire 2020 taxable year and operated a consulting business.
2. Pan-Pacific Mechanical, LLC (PPM) retained appellant to provide various subcontract services relating to construction projects, some of which were in Hawaii and some in

[1] As discussed below, FTB concedes on appeal that the proposed assessment of tax based on its estimated income of $160,169 should be modified based on appellant's California source income of $105,816.53 in the 2020 taxable year.

California. The Master Subcontract Agreement identified appellant as a subcontractor and stated that appellant was bound to PPM's customers to the same extent that PPM was bound to its customers.

3. In total, appellant worked on 22 projects for PPM including five projects located in Hawaii and 17 projects located in California during 2020. For these 22 projects, appellant earned $105,816.53 (72.3 percent) for projects located in California and $40,545.47 (27.7 percent) for projects located in Hawaii.
4. PPM issued appellant a Form 1099-NEC for nonemployee compensation of $146,362 for the 2020 taxable year.
5. FTB received information showing that appellant earned sufficient income to prompt a filing requirement and issued appellant a Request for Tax Return (Request) because FTB did not have a record of appellant's tax return for the 2020 taxable year.[2]
6. After appellant did not respond to the Request, FTB issued a Notice of Proposed Assessment (NPA) that estimated appellant's income as $160,169.[3] The NPA proposed to assess tax of $11,472 and a late-filing penalty of $2,868, plus interest.
7. Appellant protested the NPA. Appellant argued that he was a resident of the Netherlands, and California could not tax his income according to the United States – Netherlands Tax Convention (Tax Convention).
8. FTB issued a Notice of Action affirming the NPA.
9. Appellant filed this timely appeal. On appeal, appellant produced a copy of a schedule and invoices related to the work he performed for PPM in California and Hawaii during 2022 and a copy of the Tax Convention.
10. Based on the information appellant provided on appeal, FTB agrees to revise its proposed assessment to include California source income of $105,816.53 instead of the estimated income of $160,169 per the NPA.
11. As of the date briefing for this appeal closed, appellant had not filed a 2020 California income tax return.

[2] For 2020, a single individual, under age 65 with no dependents had a filing requirement if the taxpayer's California gross income totaled at least $18,496.

[3] The NPA estimated appellant's California-source income as $160,169 based on appellant's 2020 federal Wage and Income Transcript, which shows that appellant received $146,362 of income from PPM, $11,912 of income from Reliance Trust Company, and $1,894 of income reported on Forms 1099-B.

DISCUSSION

Issue 1: Has appellant established error in FTB's proposed assessment for 2020 (as revised by FTB on appeal)?

If a 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).) FTB is given "great latitude" in estimating income when a taxpayer fails to file a return or provide the information necessary to ascertain their tax liability. (*Appeal of Shanahan*, 2024-OTA-039P.) If FTB proposes tax based on an estimate of income, then FTB's initial burden is to show that 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.*) Once FTB has met its initial burden, FTB's proposed assessment is presumed correct, and the taxpayer has the burden of proving that the assessment is incorrect. (*Ibid.*) FTB's determination must be upheld in the absence of credible, competent, and relevant evidence showing error in its determination. (*Ibid.*)

Here, FTB estimated appellant's income as $160,169 based on third-party reports because appellant did not file a tax return for the 2020 taxable year. FTB provided appellant's federal Wage and Income transcript confirming that appellant earned $160,169 from various sources, including PPM. However, FTB concedes on appeal that it will exclude income of $11,912 received from Reliance Trust Company, income of $1,894 reported on Forms 1099-B, and income of $40,545.47 received from PPM for services appellant performed for projects in Hawaii. FTB argues that appellant is liable for California income tax on the remaining $105,816.53 of unreported income he received from PPM for work performed for California customers, which exceeded the 2020 California income tax return filing threshold. FTB's estimate, which is based on federal third-party reports and modified based on evidence submitted by appellant on appeal, is reasonable and rational. Accordingly, FTB has met its initial burden of proof, and appellant has the burden of proving error in FTB's proposed assessment as modified.

Market-Based Sourcing

California imposes a tax on the taxable income of every nonresident to the extent it is derived from sources within California. (R&TC, §§ 17041(b), 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.) California source income

includes income from a business, trade, or profession carried on within California. (Cal. Code Regs., tit. 18, § 17951-2.)

Regulation section 17951-4 provides income sourcing provisions applicable to a nonresident's business, trade, or profession. If a nonresident's business, trade, or profession is carried on entirely outside of (without) California, then no portion of the net income therefrom is derived from sources within this state. (Cal. Code Regs., tit. 18, § 17951-4(a).) However, if a nonresident's business, trade, or profession is a sole proprietorship that carries on a "unitary" business, trade, or profession within and without California, then the amount of net income derived from sources within California shall be determined by California's Uniform Division of Income for Tax Purposes Act (UDITPA), as codified in R&TC sections 25120 to 25139. (Cal. Code Regs., tit. 18, § 17951-4(c).) 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 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*.)

A business is "unitary" if it is a business, trade, or profession conducted both within and outside of (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).) A taxpayer carried on a unitary business, trade, or profession within and without California when a taxpayer was self-employed, operated entirely outside of California, and had customers located in California. (*Appeal of Bindley*, *supra*.)

Appellant does not dispute that he was a California nonresident who conducted business as a sole proprietorship, carried on a unitary business, trade, or profession, and performed services for customers located in California. Appellant argues, however, that his income is not taxable under Regulation section 17951-4(a) because he operated his business entirely without California, in the Netherlands. However, a taxpayer carries on a unitary business, trade, or profession within and without California when a taxpayer is self-employed, operates entirely outside of California, and has customers located in California. (*Appeal of Bindley*, *supra*.)

Appellant's 2020 federal Wage and Income Transcript shows that he received income from PPM, a company located in California, for services rendered as a sole proprietor. In additional briefing, appellant provides a chart showing the address of the projects on which he worked in 2020, the number of hours worked on each project, and the corresponding income from those projects. Pursuant to that chart, which was accepted by FTB when it revised

appellant's California source income to $105,816.53, appellant worked on 22 projects for PPM in 2020. Of the 22 projects, 17 reflect projects for California customers with compensation totaling $105,816.53 (72.3 percent of the total PPM remuneration). The remaining five reflect projects for Hawaii customers with compensation totaling $40,545.47 (27.7 percent of the total PPM remuneration). Appellant does not dispute that he provided services for the specified California customers, and that those customers received the benefit of appellant's services at their California locations.

R&TC section 17954 does not require a physical presence in California for California to impose an income tax. (*Appeal of Bindley*, *supra*.) Accordingly, appellant was carrying on his business within and without California, and his net income from PPM will be apportioned according to California's UDITPA.

Apportionment

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, which are contained in R&TC sections 25120 to 25139, and the regulations thereunder. (Cal Code Regs., tit. 18, § 17951-4(c).) A taxpayer who has income from business activity that is taxable both within and without the state must apportion business income according to the UDITPA. (R&TC, § 25121; Cal. Code Regs., tit., 18, § 25121.)

"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 taxable year and the denominator is the taxpayer's total sales everywhere during the taxable year. (R&TC, § 25134; 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 California to the extent the purchasers of the services received the "benefit of the services" in California. (R&TC, § 25136(a)(1); see also Cal. Code Regs., tit. 18, § 25136-2(c).)

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.
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> (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.
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> (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.
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> (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).)[4]

In FTB Legal Ruling 2022-01, FTB discussed the relevant considerations and proper analysis to determine the assignment of gross receipts from the sales of services under R&TC section 25136(a)(1) and Regulation section 25136-2. FTB explained that when the service provided by the taxpayer is directed at the customer's customers, the benefit received by the customer is likely located at the customer's customers' location. This is most common when the taxpayer's services directly engage or principally concern the customer's customer, such as subcontracting arrangements. (*Ibid*.) In particular, subcontracting arrangements by a business entity with a corporate subcontractor may involve the location of the customer's customer because the service provided is directed towards persons or things other than the subcontractor's customer. (*Ibid*.) There should be no difference in where gross receipts are assigned when the service is performed by a subcontractor instead of directly by the subcontractor's customer. (*Ibid*.)

FTB argues that the benefit of appellant's services should be the location of the projects for PPM's customers because the Master Subcontract Agreement identifies appellant as a subcontractor and appellant was bound to PPM's customers to the same extent that PPM was

[4] Regulation section 25136-2 was revised effective October 1, 2025; however, OTA applies the version effective during the 2020 taxable year.

bound to its customers. The parties agree that during 2020, appellant worked on behalf of PPM on 17 projects located in California and received from PPM income of $105,816.53 for this work.

Appellant argues that Regulation section 25136-2 does not apply and instead Regulation section 17951-4 should apply because appellant operated a sole proprietorship, not a corporation to which Regulation section 25136-2 applies. However, Regulation section 17951-4(c) provides that if a nonresident's business, trade, or profession is a sole proprietorship that carries on a "unitary" business, trade, or profession within and without California, then the amount of net income derived from sources within California shall be determined by California's UDITPA, as codified in R&TC sections 25120 to 25139. As explained above, Regulation section 17951-4 is used to determine whether taxpayers are subject to apportioning their income. Only the amount of the apportioned income is determined according to UDITPA, including Regulation section 25136-2.

Therefore, FTB properly determined on appeal that $105,816.53 of the $146,362 of appellant's income from PPM is California source income subject to California tax.

Tax Convention

The United States Supreme Court has held United States tax treaties generally do not prohibit the taxing activities of sub-national governments, such as states. (*Container Corp. v. Franchise Tax Bd.* (1983) 463 U.S. 159, 196; *Appeal of Stabile*, 2020-OTA-198P.) Generally, treaties between the United States and foreign countries refer to federal income taxes only and not to state income taxes. (*Appeal of de Mey van Streefkerk* (85-SBE-135) 1985 WL 15915 [United States – Netherlands treaty defines the term "taxes" to include only federal income taxes].)

Appellant argues that the Tax Convention precludes California from taxing his income as an independent contractor. Specifically, appellant points to Article 15, paragraph 1 of the Tax Convention that states, "Income derived by an individual who is a resident of one of the States from the performance of personal services in an independent capacity shall be taxable only in that State, unless such services are not performed in that State . . . ."

However, Article 3, paragraph 1(a) of the Tax Convention defines the term "State" as the Netherlands or the United States. Moreover, Article 2, paragraph 1(b) provides that the existing taxes in the United States to which the Tax Convention shall apply are "the Federal income taxes imposed by the Internal Revenue Service (but excluding social security taxes), and the excise taxes imposed on insurance premiums paid to foreign insurers and with respect to private foundations[.]" There is no provision in the Tax Convention that bars the State of

California from assessing and collecting state income taxes. Therefore, the Tax Convention does not preclude California from taxing appellant's California source income.

Issue 2: Has appellant established reasonable cause to abate the late-filing penalty?

California imposes a penalty for failing to file a required return on or before the due date, unless the taxpayer shows that the failure is due to reasonable cause and not due to willful neglect. (R&TC, § 19131.) To establish reasonable cause to abate the late-filing penalty, the taxpayer must show that the failure to file a timely return occurred despite the exercise of ordinary business care and prudence or that such cause existed as would prompt an ordinarily prudent businessperson to have so acted under similar circumstances. (*Appeal of Head and Feliciano*, 2020-OTA-127P.)

Here, appellant did not file a return for the 2020 taxable year, which was due on April 15, 2021.[5] FTB therefore properly imposed the late-filing penalty. Appellant does not dispute the imposition or the calculation of the late-filing penalty. Instead, appellant argues that he did not file a California return because he paid taxes to his country of residence, including taxes on income received from PPM for California projects. Appellant alleges that because he worked entirely outside of California, paid taxes to the Netherlands, and was protected from taxation by a United States treaty, he has no filing requirement and owes no tax to California.[6]

Appellant has not established what steps he took, if any, to determine whether he had a California filing requirement. As appellant noted, "International tax matters are complex, and I, like many, am not a tax specialist." That acknowledgement, along with the fact that appellant resided in California and paid California tax in the years prior to moving back to the Netherlands, should have at least caused appellant to seek the help of someone with tax expertise to determine if he had a California tax filing requirement. OTA notes that appellant worked for PPM while he resided in California and paid taxes on income he earned for PPM projects. Appellant does not appear to have taken any steps to determine if he had a California tax filing requirement until after FTB issued its NOA. Therefore, appellant has not established reasonable cause to abate the late-filing penalty.

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[5] In response to COVID-19, pursuant to R&TC section 18572, FTB postponed the 2020 individual tax filing due date from April 15, 2021, to May 17, 2021. (See https://www.ftb.ca.gov/about-ftb/newsroom/news-releases/2021-03-state-tax-deadline-for-individuals-postponed-until-may-17-2021.html.)

[6] Appellant also argues that he did not timely file a tax return because he did not receive the Request. However, FTB is under no obligation to issue the Request so even if appellant did not receive the Request, his argument is without merit.

HOLDINGS

1. Appellant has not established error in FTB's proposed assessment for 2020 (as revised by FTB on appeal).
2. Appellant has not established reasonable cause to abate the late-filing penalty.

DISPOSITION

As conceded on appeal, FTB's proposed assessment of tax is modified to include $105,816.53 of California source income. The late-filing penalty and interest are also revised based on the revised tax. OTA otherwise sustains FTB's action.

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Teresa A. Stanley
Administrative Law Judge

We concur:

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Hans Famularo
Administrative Law Judge

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Sara A. Hosey
Administrative Law Judge

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