

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 19085163
P. OFFUTT AND)
N. OFFUTT)
_____)

OPINION

Representing the Parties:

For Appellants: P. Offutt
For Respondent: Angelina Yermolich, Legal Assistant

T. STANLEY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, P. Offutt and N. Offutt (appellants) appeal an action by respondent Franchise Tax Board (FTB) proposing \$4,381 of additional tax, and applicable interest, for the 2014 taxable year.

Appellants waived the right to an oral hearing; therefore, the matter is being decided based on the written record.

ISSUE

Have appellants shown that they are entitled to exclude \$45,211 from taxable income?

FACTUAL FINDINGS

1. Appellants timely filed a 2014 California Income Tax Return reporting federal adjusted gross income (AGI), including income of \$45,211 received from Hyperquest, Inc. which was reported as wages on a Wage and Tax Statement (Form W-2).¹ Appellants’ Form W-2, box 13, does not indicate that the \$45,211 was for third-party sick pay benefits. As

¹ Appellants’ AGI included: 1) wage income earned by P. Offutt and reported on a Form W-2; 2) \$45,211 in wage income earned by N. Offutt and reported on a Form W-2; 3) taxable refunds; and 4) \$5,670 of paid family leave benefits reported by the California Employment Development Department (EDD). Appellants’ AGI did not include other benefit payments that were deposited into appellants’ bank account by EDD, nor were these amounts reported by EDD on Form 1099-G.

- relevant to this appeal, appellants subtracted from income the \$45,211 in wages and \$5,670 in unemployment compensation (on Form CA 540), thereby reducing their California taxable income.
2. FTB issued a Notice of Proposed Assessment (NPA) proposing to increase appellants' taxable income by the \$45,211 (by the same amount appellants adjusted their federal AGI to reduce California taxable income), and by \$1,899 of disallowed deductions, resulting in proposed additional tax of \$4,381, plus interest.²
 3. Appellants protested the NPA, claiming that the \$45,211 income was for nontaxable paid family leave (PFL) benefits received after the birth of their child late June in 2014. In support, appellants submitted bank records showing deposits during the 12 weeks following the birth of their child, totaling \$10,665, paid by EDD.
 4. EDD reported on a Form 1099-G (used to report "certain government payments") that it paid \$5,670 to appellants as PFL.
 5. FTB denied appellants' protest and issued a Notice of Action affirming its NPA. This timely appeal followed.

DISCUSSION

The law requires FTB to examine returns and determine the correct amount of tax due. (R&TC, § 19032.) When FTB determines that the tax disclosed in the original return is less than the tax disclosed by its examination, it must propose a deficiency assessment. (R&TC, § 19033.) A taxpayer who claims a deduction or exclusion must prove by competent evidence that he or she is entitled to such. (See *New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435; *Appeal of Myers* (2001-SBE-001) 2001 WL 37126924.) Taxpayers have the burden of establishing entitlement to exclude disability income, including paid family leave. (*Appeal of Huber* (82-SBE-222) 1982 WL 11969; *Holt v. Comm'r* (1999) T.C. Memo. 1999-348.)

At issue in this appeal is the propriety of appellants' exclusion of \$45,211 from gross income reported on a Form W-2. Appellants assert that the income was for PFL benefits received following the birth of their child. Under California law, PFL is a family temporary disability insurance program that provides up to six weeks of wage replacement benefits in a 12-month period for individuals to care for a seriously ill family member or bonding with a new

² Appellants did not dispute the disallowance of deductions totaling \$1,899, and we do not address it further.

child. (Unemp. Ins. Code, § 3301(a)(1), (d).) The purpose of PFL is to compensate in part for wage loss sustained by an individual who is unable to work due to certain circumstances, including the birth of a new child. (Unemp. Ins. Code, § 2601.) PFL payments are treated as unemployment compensation paid pursuant to a governmental program and are excluded from gross income for California purposes, but not for federal purposes. (R&TC, § 17083.) Internal Revenue Code (IRC) section 85 provides that certain unemployment compensation is taxable at the federal level. According to Treasury Regulation section 1.85-1(b)(1)(i), the compensation contemplated by IRC section 85 is “unemployment compensation paid pursuant to governmental programs and does not apply to amounts paid pursuant to private nongovernmental unemployment compensation plans (which are includible in income without regard to [IRC] section 85).” California law specifically does not follow IRC section 85, and therefore excludes from taxation unemployment compensation that is paid pursuant to a governmental program. (R&TC, § 17083.) The EDD will issue a Form 1099-G for paid family leave payments, or for disability insurance payments made as a substitution for unemployment benefits.³

To determine what may be excluded under appellants’ circumstances, we start with the reported federal AGI. PFL benefits are subtracted from that federal AGI to compute California AGI. This means that to exclude an item of income on the return, it must first be included in federal AGI. In the instant case, appellants were issued a Form 1099-G from EDD that reports a total of \$5,670 in PFL benefits for 2014. That amount was properly included in appellants’ federal AGI and subtracted from reported federal AGI on their Form 540. On appeal, appellants submitted evidence of additional payments made to them by EDD. Bank records show that \$10,665 was paid by EDD and deposited into appellants’ account over the 12-week period following the birth of their child. Appellants assert that this evidence shows that the amount they excluded (\$45,211) was PFL benefits paid by EDD. We disagree for the following reasons.

First, the \$45,211 at issue was clearly reported as wages paid to N. Offutt by HyperQuest Inc., not as PFL benefits paid by EDD. Box 13 on that Form W-2 has a place to indicate when reported wages are for third-party sick pay. That box is not checked. Second, EDD did report on a Form 1099-G that it paid PFL benefits totaling \$5,670 to N. Offutt. Finally, as noted above, appellants may only subtract income from federal AGI for California taxable income purposes if

³ See <https://www.edd.ca.gov/disability/faq_employers_benefits.htm> [as of February 6, 2020].

they first included it in their federal AGI. Appellants' reported federal AGI did not include any amounts received from EDD in excess of the reported \$5,670.⁴ PFL is limited to 6 weeks of wage replacement to care for a new child. (See Unemp. Ins. Code, § 3301(a)(1).)


Appellants did not prove that the \$45,211 paid by HyperQuest Inc. was PFL benefits instead of wages, as reported by the payor.⁵ Appellants also did not prove that the total of \$10,665 paid by EDD was for PFL, nor that the excess over the reported \$5,670 was included in their AGI.

HOLDING


Appellants improperly subtracted \$45,211 from their AGI.

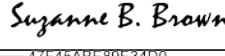
DISPOSITION

FTB's action is sustained.

DocuSigned by:

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Teresa A. Stanley
Administrative Law Judge

We concur:

DocuSigned by:

4D465973FB44469
Nguyen Dang
Administrative Law Judge

DocuSigned by:

47F45ABE89E34D0
Suzanne B. Brown
Administrative Law Judge

Date Issued: 4/22/2020

⁴ EDD did make payments to appellants for a period encompassing 12 weeks following the birth of their baby. To the extent that these amounts were for disability insurance benefits, the benefits would not be included on the Form 1099-G because those benefits are not taxable for either federal or state purposes. (See IRC, § 104(a)(3); R&TC, § 17083.)

⁵ We note that if \$45,211 were paid for PFL, as alleged, it would amount to payments of \$7,535 per week (\$45,211 ÷ 6 weeks), which greatly exceeds the maximum weekly amount for 2014 of \$1,075. (EDD, 2014 California Employer's Guide, p. 2 <https://www.edd.ca.gov/pdf_pub_ctr/de44-14.pdf>.)