



STATE OF CALIFORNIA

FRANCHISE TAX BOARD  
FILING ENFORCEMENT  
P.O. BOX 942840, Mail Stop J-40  
SACRAMENTO, CALIFORNIA 94240-0040  
February 10, 2005

DAVID R. [REDACTED]  
[REDACTED]  
LAGUNA BEACH, CA 92651

Re: Your correspondence dated 01/14/05  
[REDACTED]

Tax Year: 2003

Mr. [REDACTED],

We are unable to treat your correspondence as a valid protest and grant your request for a hearing. You cannot protest a Notice of Proposed Assessment before it is issued.

Section 19501 provides the Franchise Tax Board with the statutory authority to administer and to enforce the California Personal Income Tax Law. Please note that a written contract between you and this department is not required for the administration of the personal income tax laws, Parts 10, 10.2 and 10.7, Division 2, Revenue and Taxation Code sections 17000 through 21020. You can research these laws at your local public library.

Sections 17004 and 17005 provide that the term "taxpayer" includes any individual, and that "individual" means a natural person. The term "taxpayer" includes any individual subject to the Personal Income Tax Law, including individuals who are potentially liable, even when no tax is ultimately determined to be due. (See Appeal of Fred R. Dauberger, et al., Cal. St. Bd. of Equal., March 31, 1982; Fox v. Commissioner, T.C. Memo. 1993-37, 65 TCM 1831; and Internal Revenue Code Section 7701(a)(14).)

Revenue and Taxation Code Section 17071 defines gross income by reference to Internal Revenue Code (IRC) Section 61. IRC Section 61 provides as follows:

- (a) General definition. Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:
- (1) Compensation for services, including fees, commissions, fringe benefits, and similar items;
  - (2) Gross income derived from business;
  - (3) Gains derived from dealings in property;
  - (4) Interest;
  - (5) Rents;
  - (6) Royalties;

- (7) Dividends;
- (8) Alimony and separate maintenance payments;
- (9) Annuities;
- (10) Income from life insurance and endowment contracts;
- (11) Pensions;
- (12) Income from discharge of indebtedness;
- (13) Distributive share of partnership gross income;
- (14) Income in respect of a decedent; and
- (15) Income from an interest in an estate or trust.

Arguments implying that a taxpayer did not receive any income from a taxable source have been misconstrued. A reading of Section 61 reveals that taxable income includes all of the items listed there, as well as any other income from any "source". The word "source" is not defined in the statutory scheme. Thus, the rule of interpretation is to look to the ordinary meaning of the term. (See *Lennane v. Franchise Tax Board* (1994) 9 Cal.4<sup>th</sup> 263, 268.) The ordinary meaning of the word "source", as listed in the Merriam-Webster's Collegiate Dictionary, 10<sup>th</sup> ed. At page 1123 is "1 a: a generative force: CAUSE b (1): a point of origin or procurement: BEGINNING ...." Based upon these definitions, a taxpayer cannot argue that wages are not taxable income.

Revenue and Taxation Code section 17073 defines "taxable income" by reference, to IRC section 63; that IRC section defines "taxable income" as "gross income minus the deductions allowed by this chapter." Revenue and Taxation Code section 17073 also qualifies that adoption with the phrase "except as otherwise provided." California Revenue and Taxation Code sections 17951 – 17955 are those exceptions otherwise provided, so as to make IRC section 861 inapplicable to the California personal income tax. Revenue and Taxation Code sections 17951 – 17955 serve the purpose of applying the income tax to gross income earned by non-residents within California.

Compensation received in whatever form, including wages for services, constitutes taxable income (*Lonsdale v. Commissioner*, (5<sup>th</sup> Cir. 1981) 661 F. 2d 71). The narrow interpretation of the *Eisner* case is not a basis for all gross income tests (*Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 430-431 (99 L. Ed. 483) (1955)). Thus, income earned from your employer and any businesses or investments you own is considered in determining your requirement to file a state tax return.

Section 18501 provides that every "individual" realizing a specified amount of gross income or adjusted gross income must make a return to the Franchise Tax Board. Section 18621 provides that a return shall contain, or be verified by, a written declaration that it is made under the penalty of perjury. Section 18621 also provides that the required return "shall be in any form as the Franchise Tax Board may from time to time prescribe, . . .," that the Franchise Tax Board shall prepare blank forms for the return, and that failure to receive or secure the forms does not relieve a taxpayer from making any return.

Revenue and Taxation Code Section 17041 imposes taxes on every individual who is in California for more than a temporary or transitory purpose, i.e., residents, and those individuals who derive income from sources located in this state (*Appeal of Beldon Katleman*, SBE, Oct. 17, 1980). Every individual, subject to applicable California filing requirements, whether a state citizen, sovereign California citizen, self-stated freeborn American, nonresident, nonimmigrant nontaxpayer, nonfranchised individual, nonresident alien residing in this state, or domiciled inhabitant, is required to file a tax return under Revenue and Taxation Code Section 18501. A claim of exemption from personal state income tax is invalid. There is an explicit requirement for filing of tax returns and paying the tax. As a taxpayer, defined under Revenue and Taxation Code Section 17004, you may be held liable for state income taxes as well as interest and penalties for noncompliance.

As stated above, California law defines who is required to file a tax return, as well as tax liability obligations. Attempts to portray oneself as a 'nontaxpayer', 'sovereign citizen', or 'freeborn and natural individual' with immunity from taxation lack legal support, and are ineffective claims against the proper assessment and collection of taxes. (See, *U.S. v. Studley* (9<sup>th</sup> Cir. 1986) 783 F. 2d 934.) California tax liability is dependent upon California contacts and/or California source income, and California will continue to enforce tax obligations notwithstanding self-characterizations of no-taxpayer status or sovereign citizenship.

Respondent is empowered under Section 19087 (formerly Section 18648) to determine an individual's tax liability, from any available information, in the absence of a taxpayer's filing of a return, which provides the information necessary to accurately determine a tax liability. This section empowers respondent to propose the assessment of an amount of tax, penalties and interest due. When a taxpayer fails to file a required return and refuses to submit requested information, he or she is not in a good position to criticize respondent's proposed assessment. (*Appeal of Fred R. Dauberger, et al.*, Cal. St. Bd. of Equal., March 31, 1982.)

Section 17551 provides that for the taxable years beginning on or after January 1, 1993, accounting periods and methods of accounting shall be the same as those allowed by the Internal Revenue Code (IRC) Section 446. Each taxpayer is required to maintain such accounting records as will enable him, or her, to file an accurate return. (See IRC Regulation Section 1.446-1(a)(4) and *Appeal of Robert A. Von Merta*, Cal. St. Bd. of Equal., December 3, 1986.) In the absence of such records, or in the case of inadequate or incomplete records, the existence of unreported income may be demonstrated by any practical method of proof that is available. (*Davis v. U.S.* (6<sup>th</sup> Cir. 1955) 226 F. 331, cert. denied, 350 U.S. 965 [100 L.Ed. 838].) The courts have consistently upheld the estimation of federal income tax liabilities by the use of United States Bureau of Labor Statistics and the Consumer Price Index. (See *Pollard v. Commissioner* (11<sup>th</sup> Cir. 1986) 786 F.2d 1063; *Edwards v. Commissioner* (9<sup>th</sup> Cir. 1982) 680 F.2d 1268; *Wadsworth v. Commissioner*, T.C. Memo. 1997-238 [73 TCM 1119]; *Wallace v. Commissioner*, T.C. Memo. 1997-28 [73 TCM 1766]; *Wisden v. Commissioner*, T.C. Memo. 1996-557 [72 TCM 1555]; *Martin v. Commissioner*, T.C. Memo. 1988-461 [56 TCM 302]; and *Wagner v. Commissioner*, T.C. Memo. 1987-601 [54 TCM 1263].) As stated in the case of *Palmer v. U.S.* (9<sup>th</sup> Cir. 1997) 116 F.3d 1309, there are no statutorily specified methods or evidentiary burdens on choosing a method for reconstructing a taxpayer's income, and using average local income statistics for a particular profession is a reasonable method of income reconstruction. Where the method of calculating income is rationally based, courts have afforded a presumption of correctness to the income determination. (*Palmer, supra, Pollard, supra, and Edwards, supra.*)

**Penalty of Perjury** - The Fifth Amendment to the United States Constitution provides, in part, that "No person . . . shall be compelled in any criminal case to be a witness against himself . . ." The courts have consistently held that the privilege against self-incrimination does not justify a refusal to file a valid income tax return. (See: *United States v. Sullivan* (1927) 274 U.S. 259; *United States v. Neff* (9<sup>th</sup> Cir. 1980) 615 F.2d 1235.) The courts have held that the Fifth Amendment may be claimed only if there are "substantial hazards of self-incrimination" that are "real and appreciable" and not merely "imaginary and unsubstantial." (*United States v. Rendahl* (9<sup>th</sup> Cir. 1984) 746 F.2d 553, 555, quoting *Neff, supra*, at p. 1239). (See footnote 3, *supra*.)

Under section 19041, a taxpayer may protest against the proposed deficiency assessment that is issued against the taxpayer. It is the proposed deficiency, or the correct tax amount minus previously assessed tax amounts, that is the subject of the statutorily allowed protest. There is no statutory authority that allows a taxpayer to question the validity of the statutory assessment procedure. As noted by your Board

in the Appeal of Fred R. Dauberger, *et al.*, *supra*, sections 19045 and 19047 give taxpayers the right to appeal to your Board from respondent's action on protest solely for the purpose of determining the correct amount of tax. Thus, the only contention that appellant may bring to the forum of your Board is an argument that the tax amount proposed is incorrect.

It is well settled that the Franchise Tax Board's determinations of tax and penalties are presumptively correct, and the burden rests upon the taxpayer to prove them erroneous. (Todd v. McColgan (1949) 89 Cal.App.2d 509, 201 P.2d 414; Appeal of Robert v. Eriane, Cal. St. Bd. of Equal, November 17, 1974.) In order to carry that burden, a taxpayer must point to an applicable statute and show by credible evidence that he or she comes within its terms. (Appeal of Robert R. Telles, Cal. St. Bd. of Equal., March 4, 1986.) Unsupported assertions are not sufficient to satisfy that burden. (Appeal of Aaron and Eloise Magidow, Cal. St. Bd. of Equal., November 17, 1983.)

The Franchise Tax Board has a wide discretion in choosing an income-reconstruction method. Where the method is rationally based, courts afford a presumption of correctness to the determination and the taxpayer has the burden of proving the method to be wrong. Courts have long held that statistics may rationally be used to reconstruct income where taxpayers fail to offer accurate records. Reasonable methods include the use of cost-of-living statistics for a particular locale, or average local income statistics for a particular profession. (See Palmer v. Internal Revenue Service, *supra*; Horner v. Commissioner (1985) ¶85,319 P-H Memo TC; Wheeling v. Commissioner (1982) ¶82,246 P-H Memo TC.)

IRC Section 861 and its regulations merely assist in determining whether income is from within or without the United States for certain federal purposes. (See Appeal of Michael E. Myers, 2001-SBE-001, May 31, 2001.) More importantly, IRC Section 861 and its implementing regulations do not apply to the determination of taxable income under California law. California is not concerned with whether the income of a California resident is from a source within or without the United States – it is all subject to California personal income tax. (See Rev. & Tax. Code, §17041.)

The attempts to use IRC 861 and its implementing regulations to exclude income of an individual while living and working within the United States, or attempts to apply IRC 861 and its implementing regulations to income for California personal income tax purposes are “groundless and frivolous contentions of the kind being sold by charlatans to both unsuspecting taxpayers and those willing to be duped.” (Appeal of Michael E. Myers, *supra*.) In *Coleman v. Commissioner* (7<sup>th</sup> Cir. 1986) 791 F.2d 68, 69, the court noted:

“Some people believe with great fervor preposterous things that just happen to coincide with their self-interest.... The government may not prohibit the holdings of these beliefs, but it may penalize people who act on them.”

On June 25, 2001, the Internal Revenue Service (IRS) issued a formal warning concerning the misapplication of IRC Section 861. In its Notice 2001-40 (2001-26 I.R. B. 1355), the IRS warns that:

“... certain persons are promoting the view that U.S. citizens and residents are not subject to tax on wages and other income earned or derived within the United States based on the claim that the Internal Revenue Code imposes taxes only on income derived from certain foreign-based activities. The Service and Treasury are issuing this notice to inform taxpayers that this reporting position has no basis in law.”

Since this IRS warning was issued, certain internet sites have argued that their version of the "IRC Section 861 argument" is not covered by this warning. As noted above, this is not true. Persons choosing to ignore the warning do so at their own risk. The arguments being sold by the charlatans concerning IRC Section 861 and its implementing regulations may continue to evolve. But it does not matter from what angle a taxpayer approaches the subject.

IRC Section 861 and its implementing regulations simply have no application in determining gross income for California personal income tax purposes.

The State Board of Equalization held in the Appeal of Walter R. Bailey, 92-SBE-001, Feb. 20, 1992 that "due process is satisfied with respect to tax matters so long as an opportunity is given to question the validity of a tax at some stage of the proceedings. (Cal. Const., art. III, §3.5; Appeal of Aimor Corporation, Cal. St. Bd. Of Equal., Oct. 26, 1983.

The California Franchise Tax Board is not an "agency" as described in Government Code Section 11501(b) authorized to provide administrative hearings before an administrative judge pursuant to Government Code Section 11500.

California Revenue and Taxation Code (R&TC) Section 19044 only provides for an oral hearing if the request is made within the time period allowed for filing a protest pursuant to R&TC Section 19041. This hearing may be an undocketed hearing conducted by a hearing officer authorized by the Franchise Tax Board to conduct such hearings.

If you wish to have a hearing before a judge, you may pay the amount due and file a claim for refund with the Franchise Tax Board. If the claim for refund is denied, you may file an action with the Superior Court of California.

Your contentions are the same type as those heard and uniformly rejected by the State Board of Equalization on numerous occasions, and which both California and United States courts have rejected for many years (see, e.g., Appeal of Michael E. Myers, 2001-SBE-001 May 31, 2001, Appeal of Alfons Castillo, 92-SBE-020, July 20, 1992; Appeal of Walter R. Bailey, supra; Appeals of Fred R. Dauberger, et al., supra). When a taxpayer fails to present credible, competent, relevant, and uncontradicted evidence as to the issues in dispute, the Franchise Tax Board's determination cannot be successfully rebutted. (Appeal of James C. and Monablanche A. Walshe, Cal. St. Bd. of Equal., Oct. 20, 1975.)

Please note that the failure to timely file required tax returns will result in assessment and collection actions, which may include legal actions pursuant to Revenue and Taxation Code section 19701, along with criminal sanctions. Conviction for tax evasion carries a maximum three years prison term and/or a \$20,000 fine. Conviction for failure to file a tax return carries a maximum one-year jail term and/or \$5,000 fine.

David [REDACTED]  
[REDACTED]  
Tax Year 2003  
February 10, 2005  
Page 6

Please send your completed tax return by 03/10/05 to:

Franchise Tax Board  
P.O. Box 942840, Mail Stop J-40  
Sacramento, CA 94240-0040

Thank you for your cooperation.

Leslie R.  
Filing Compliance Bureau  
(916) 845-7650

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