State of California
Franchise Tax Board
Legal Division MS A260
P.O. Box 1720
Rancho Cordova CA 95741-1720
tel: (916) 845-7651 fax: (916) 855-5757
ftb.ca.gov

chair John Chiang | member Betty T. Yee | member Ana J. Matosantos

TAXPAYER EXHIBIT
B11
October 19, 2010
Haik and Alice Arakelian
442173

Date: 07.28.10

Case: 10810326445601576
Case Unit: 10810326445601580
In reply refer to 410:mb

TO: CHIEF, BOARD PROCEEDINGS DIVISION
STATE BOARD OF EQUALIZATION
450 N STREET, MIC: 81
SACRAMENTO, CA 95814

FROM: MARIA BROSTERHOUS

RE: Appeal of Haik and Alice Arakelian
Appeal Case ID No. 442173
Prehearing Conference Memorandum

RECEIVED
JUL 28 2010
Board Proceedings

MEMORANDUM

In preparation for the upcoming prehearing conference on this matter, a misstatement was discovered in respondent's opening brief dated July 24, 2008. Respondent stated the IRS audited appellants' 2003 return and revised their itemized deductions by $18,721, and that based upon federal information indicating this change, respondent issued the April 17, 2006 Notice of Proposed Assessment (NPA). However, upon further review of federal records (appellants' Individual Master Transcript (IMF) and a STARS data sheet, which contains information provided by the IRS), it is apparent the IRS did not audit appellants' return, but rather made math error adjustments during the processing of their return and issued an error correction notice. The adjustments did not have an impact on their federal tax due to the substantial loss appellants reported for the 2003 tax year, but would have impacted their charitable contribution carryforward for the following year.

After receipt of information about the federal processing adjustments from the IRS, respondent made corresponding adjustments to appellants' California tax liability as applicable under California law.[1] Respondent issued the April 17, 2006 NPA allowing only $17,231 of itemized deductions.[2] Appellants had reported total federal itemized deductions of $35,952 on page 2, line 37 of their 2003 Federal Income Tax return.[3] Per their Schedule

[1] See attached Stars Data Sheet showing the details of the federal adjustments.

[2] Exhibit C to respondent's opening brief.

[3] Exhibit A of respondent's opening brief.

A, line 18, appellants reported a charitable contribution deduction of $17,636.[4] Appellants reported $32,152 in itemized deductions on their California Income Tax return by subtracting their $3,800 state and local tax deduction from their total federal itemized deductions of $35,952.[5] As reflected on the documents respondent submitted on February 17, 2009 at your Board's request, the Record of Account shows that the IRS disallowed appellants' charitable contribution deduction in the amount of $17,636 (page 6). Column 2 of the Stars Data Sheet shows the IRS allowed total itemized deductions of $17,231 (see item 1), which is also the total amount allowable for California purposes.[6]

Respondent has attached a copy of a correctly completed Form 540 to demonstrate the proper calculation of appellants' tax liability for the appeal year. The corrected Schedule CA shows that the amount of the federal itemized deductions is $18,316 on line 35. Because no charitable deduction was allowed or allowable for federal purposes, this amount does not include the $17,636 of charitable contributions shown on appellants' federal return before adjustments by the IRS. The total California itemized deductions is $14,516 as shown on line 37 of Schedule CA. The $3,800 of state and local income tax must be deducted from the federal deductions because California law does not permit a deduction for state and local income taxes. This deduction results in additional tax of $1,636 as conceded by respondent in its briefing and reflected in your Board's decision dated February 26, 2009.

Respondent received federal information indicating appellants' federal itemized deductions had been adjusted due to their negative federal AGI. California conforms to Internal Revenue Code (IRC) section 170 regarding the limitation on charitable contribution deductions under Revenue and Tax Code section 17201. Under IRC section 170, subdivision (b)(1)(A), charitable contributions are limited to the extent they exceed 50 percent of a taxpayer's AGI for the year. Further, California Revenue and Taxation Code section 17024.5, subsection (h)(2) requires the use of federal AGI in determining all limitations based upon AGI. Here, appellants reported a negative federal AGI and as such, under both federal and state law, they are not entitled to a charitable contribution deduction.

Maria Bertucci

Tax Counsel

cc: Ara Hovanesian

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[4] Exhibit A, page 3.

[5] Exhibit B of respondent's opening brief.

[6] See Exhibit A, page 3 and Exhibit C. The IRS also disallowed a deduction of $1,085 for job and other miscellaneous expenses. The total deductions claimed of $35,592 - $17,636 (charitable deduction) - $1,085 (job and other expense) = $17,231 (total allowable itemized deductions).

TAXABLE YEAR

2003 California Adjustments – Residents

SCHEDULE

CA (540)

Important: Attach this schedule directly behind Form 540, Side 2.

Name(s) as shown on return: Haik & Alice Arakelian

Social security number:

Part I Income Adjustment Schedule

Section A – Income

		A Federal Amounts (taxable amounts from your federal return)	B Subtractions See instructions	C Additions See instructions
7 Wages, salaries, tips, etc. See instructions before making an entry in column B or C	7			
8 Taxable interest income	8	36,942.	31,450.	
9 Ordinary dividends. See instructions (b)	(a)			
10 Taxable refunds, credits, offsets of state and local income taxes	10			
11 Alimony received	11			
12 Business income or (loss)	12			
13 Capital gain or (loss). See instructions (b)	(a)	-3,000.		
14 Other gains or (losses)	14			
15 Total IRA distributions. See instructions (a)	(b)			
16 Total pensions and annuities. See instructions (a)	(b)	7,039.		
17 Rental real estate, royalties, partnerships, S corporations, trusts, etc	17	142,839.		
18 Farm income or (loss)	18			
19 Unemployment compensation. Enter the same amount in column A and column B	19			
20 Social security benefits (a)	(b)			
21 Other income.				
a California lottery winnings			a	a
b Disaster loss carryover from FTB 3805V			b	b
c Federal NOL (Form 1040, line 21)	21	-708,213.	c	c 708,213.
d NOL carryover from FTB 3805V			d SUSPENDED	d
e NOL from FTB 3805D, 3805Z, 3806, 3807, or 3809			e SUSPENDED	e
f Other (describe)			f	f
22 Total. Combine line 7 through line 21 in column A. Add line 7 through line 21f in column B and column C. Go to Section B	22	-524,393.	31,450.	708,213.

Section B – Adjustments to Income

23 Educator expense	23			
24 IRA deduction	24			
25 Student loan interest deduction	25			
26 Tuition and fees deduction	26			
27 Moving expenses	27			
28 One-half of self-employment tax	28			
29 Self-employed health insurance deduction	29			
30 Self-employed SEP, SIMPLE, and qualified plans	30			
31 Penalty on early withdrawal of savings	31			
32a Alimony paid. b Recipient's: SSN ... Last name ...	32a			
33 Add line 23 through line 32a in columns A, B, and C	33			
34 Total. Subtract line 33 from line 22 in columns A, B, and C. See instructions	34	-524,393.	31,450.	708,213.

Part II Adjustments to Federal Itemized Deductions

35 Federal itemized deductions. Add the amounts on federal Schedule A (Form 1040), lines 4, 9, 14, 18, 19, 26, and 27	35	18,316.
36 Enter total of federal Schedule A (form 1040), line 5 (state and local income tax and State Disability Insurance) and line 8 (foreign taxes only)	36	3,800.
37 Subtract line 36 from line 35	37	14,516.
38 Other adjustments including California lottery losses. See instructions. Specify ...	38	
39 Combine line 37 and line 38	39	14,516.

40 **Is your federal AGI (Form 540, line 13) more than the amount shown below for your filing status?**

Single or married filing separately – **$135,714** Head of household – **$203,574** Married filing jointly or qualifying widow(er) – **$271,432**

No. Transfer the amount on line 39 to line 40.

Yes. Complete the Itemized Deductions Worksheet in the instructions for Schedule CA (540), line 40. ..... 40 14,516.

41 **Enter the larger of the amount on line 40 or your standard deduction listed below**

Single or married filing separately – **$3,070** Married filing jointly, head of household, or qualifying widow(er) – **$6,140**

Transfer the amount on line 41 to Form 540, line 18 ..... 41 14,516.