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7 **BOARD OF EQUALIZATION**
8 **STATE OF CALIFORNIA**
9

10 In the Matter of the Appeal of:) **HEARING SUMMARY**
11) **PERSONAL INCOME TAX APPEAL**
12 **NEVILLE BOTHWELL AND**) Case No. 713600
13 **ILA BOTHWELL**)
14 _____)

15 Year Proposed
2008 Assessment
\$ 476

17 Representing the Parties:
18 For Appellants: Floyd C. Geis, Certified Public Accountant
19 For Franchise Tax Board: Maria Brosterhous, Tax Counsel
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21 QUESTION: Whether appellants have shown error in respondent's (Franchise Tax Board or
22 FTB) proposed assessment on a traditional Individual Retirement Account (IRA)
23 distribution.
24

25 HEARING SUMMARY
26 Background

27 Appellants filed their 2008 California tax return, in which they reported a federal
28 adjusted gross income (AGI) of \$274,127 and a California AGI of \$253,531. Appellants reported a

1 California taxable income of \$246,147. On their Schedule CA, appellants subtracted \$9,688 as a
2 California adjustment.¹ Appellants received a payment of \$5,122 from Diversified Investment
3 Advisors (DIA) as reported on a Form 1099-R. Appellants did not file a federal Form 8606 for
4 nondeductible contributions. Appellants also received a payment of \$5,072.88, as reflected on a
5 Canadian Form NR4 Statement of Amounts Paid or Credited to Nonresidents of California by
6 Service Canada Pension Plan. Based on federal information, respondent issued a Notice of Proposed
7 Assessment (NPA) dated March 29, 2012, which added \$9,688 to appellant's taxable income of
8 \$246,147 for a revised taxable income of \$255,835, which resulted in a proposed assessment of
9 additional tax of \$901, plus interest. (Resp. Op. Br., pp. 1-2, Exhs. A, B, C, D & E.)²

10 Appellants protested the NPA by letter dated May 21, 2012. Appellants contended that
11 the entire amount of the pension income was not subject to California tax because it was earned while
12 appellants were residents of another state. Appellants asserted that California is prohibited from taxing
13 a nonresident retired employee on his pension received and earned while he was a resident of a state
14 other than California pursuant to federal Public Law (P.L.) 109-264. Based on additional information
15 from appellants showing that \$4,566 of this income was a distribution from a Canadian pension plan,
16 respondent adjusted the assessment to remove the \$4,566 from the Service Canada Pension Plan³ and
17 tax only the \$5,122 (i.e., \$9,688 - \$4,566) from DIA. Respondent issued a Notice of Action (NOA)
18 dated December 28, 2012, sustaining the remaining proposed assessment of additional tax of \$476, plus
19 interest. This timely appeal then followed. (Resp. Op. Br., p. 2, Exhs. F & G.)

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23 ¹ This is composed of a \$5,122.00 payment from Diversified Investment Advisors and \$4,566.00 (of the \$5,072.88) payment
24 from Service Canada Pension Plan.

25 ² The first page of Exhibit E is respondent's NPA, dated March 29, 2012. However the second page of the exhibit, rather
26 than being page two of the NPA, is the second page of the Notice of Action dated December 28, 2012. The hand-written
27 notations on the first page of the NPA show the revisions that were later made by the Notice of Action, which revisions
reduced the proposed tax to \$476 as a result of allowing a deduction from income of \$4,566 for the Canada Pension Plan
based on substantiation provided by the taxpayers.

28 ³ Although the Canadian Form NR4 reflected receipt of \$5,072.88, appellants only excluded \$4,566 of this amount on their
Schedule CA.

1 Contentions

2 Appellants' Contentions

3 Appellants maintain their position as stated in their protest letter. Appellants contend
4 that the taxpayers were residents of another state at the time the pension was earned. Appellants
5 contend that the IRA distribution they received from DIA was rolled over from a pension
6 appellant-husband earned at his former Canadian employer, Genstar. Appellants contend that the
7 Genstar pension would not have been subject to California tax based on P.L. 109-264. As such,
8 appellants assert that any subsequent rollover and distribution of these same pension plan assets to a
9 United States (U.S.) Manager-based IRA would be treated the same way and taxed upon the same
10 basis. Appellants assert that they have detailed records and will present records establishing the
11 creation and ultimate disposition of the Canadian Genstar pension plan and assets. (Appeal Letter,
12 pp. 1-2.)

13 In their reply brief, appellants dispute respondent's reference to appellants' lack of filing
14 a Federal Form 8606 for non-deductible contributions. Appellants state that they reported all income
15 from DIA of \$5,122 for both gross income and taxable income on their federal 2008 tax return.
16 Appellants state that they made no claim for any adjustment for non-deductible contributions. (App.
17 Reply Br., p. 1.)

18 Appellants further dispute respondent's statement that the taxpayers established a
19 traditional IRA after terminating a Canadian pension plan. Appellants contend that they did not
20 establish the pension plan or the IRA, rather, the pension plan and IRA roll over administration was the
21 work of Genstar and its successors in interest. Appellants contend that they did not make any IRA
22 rollovers on their own. Appellants contend that they received the first pension plan payment from
23 Genstar in 2004, that the normal retirement age for the Genstar pension plan was 65-years-old, and that
24 appellant-husband did not receive the pension benefit until he was at least 70-years-old. Appellants
25 also contend that the IRA distribution resulted from appellant-husband's employment as a Canadian
26 citizen while working for a Canadian company. Appellants contend that they presented a signed
27 statement under penalty of perjury indicating that they never took an IRA deduction or funded a
28 deductible or non-deductible IRA on any tax return from 1980 through 2012. Appellants assert that

1 they had no knowledge that they were plan beneficiaries until more than five years after the normal
2 retirement eligibility age. Appellants state that they submitted appellant-husband's employment history
3 demonstrating that he left Genstar in 1980. (App. Reply Br., pp. 1-2.)

4 Appellants further assert respondent accepted that appellants' income from the Service
5 Canada Pension Plan is exempt from California taxation pursuant to P.L. 109-264. Appellants contend
6 that the same reasoning should apply for the distribution from DIA. Appellants note that they did not
7 make any claims they were nonresidents of California during the protest process. (App. Reply Br.,
8 pp. 2-3.)

9 Appellants submitted an employment and tax history signed under penalty of perjury by
10 appellant-husband in which he indicates that the pension and IRA distribution were based upon
11 non-U.S. and non-California employment. He also indicates that appellants were originally Canadian
12 and Australian citizens and that they established residency in the United States in 1979. Appellant-
13 husband indicates that he was a participant in the Canadian Genstar pension as a result of his
14 employment in the Canadian company from 1970 to 1980. Appellant-husband also states that, in 1980,
15 he resigned from Genstar and became a self-employed real estate investor in California as of 1980. He
16 states that he has been self-employed since 1980 and was not a participant in any pension plan
17 established in the United States. Appellant-husband indicates that the Genstar pension was rolled over
18 to DIA by Genstar and its successors. As such, appellant-husband asserts that the assets within the IRA
19 are attributed to his Canadian employment at Genstar when he and his wife were residents of Canada.
20 (App. Reply Br., p. 3, Atth.)

21 In response to the Appeals Division's request for additional information, appellants
22 reiterate that the pension income was earned in Canada while appellants were Canadian residents and,
23 therefore, P.L. 109-264 precludes California from taxing the pension income. Appellants assert the fact
24 that they were Canadian residents at the time the pension was earned is unacknowledged by the
25 Appeals Division. Appellants state that they possess records showing the administration of the Genstar
26 pension plan was a Canadian Employer Pension Plan and, when Genstar terminated the pension plan,
27 the assets were rolled over into an IRA with DIA. Appellants point out that appellant-husband and
28 their tax representative submitted statements under penalty of perjury to establish the pension was

1 earned prior to appellants' residency in the United States and California. Appellants assert the fact that
2 they did not establish pension plans or IRAs or make contributions to such retirement plans while they
3 were California residents is also unacknowledged by the Appeals Division. Appellants did not address
4 the Appeals Division's request for documentation of their basis in the proceeds from DIA. (App. Addl.
5 Br., pp. 1-2.)

6 Respondent's Contentions

7 Respondent contends that, as appellants were California residents in the tax year at
8 issue, all income earned by appellants, regardless of source, is subject to California taxation pursuant to
9 R&TC section 17041. As to appellants' argument that the IRA distribution is exempt from California
10 taxation under P.L. 109-264, respondent contends that this federal limitation, and the related California
11 law found in R&TC section 17952.5,⁴ only protects nonresident taxpayers who worked and earned their
12 pension or retirement income in one state and later became residents of a second state from being taxed
13 by the nonresident state. Respondent argues that these provisions do not exempt taxpayers from being
14 taxed on their pension income by the state of which they are residents at the time of their receipt of the
15 income. Respondent contends that, as the taxpayers filed a California resident return for the 2008 tax
16 year and have not disputed their California residency for this year, they are subject to tax on all income
17 from all sources and their income from a traditional IRA which may have originated from the
18 contribution of income previously earned outside California is not exempt from California taxation.
19 (Resp. Op. Br., pp. 2-3.)

20 Respondent further contends that appellants have not demonstrated their basis in any
21 portion of the IRA distribution. Respondent acknowledges that Internal Revenue Code (IRC)
22 section 408(d) provides a general exemption from tax for IRA distributions to the extent that the
23 taxpayer is recovering a basis in the IRA, such as the amount of nondeductible contributions to the IRA
24 account. Respondent acknowledges that California conforms to the current federal treatment of IRA
25 distributions with some exceptions for IRAs with a pre-1987 basis, citing R&TC section 17507.
26 Respondent contends that appellants have not asserted they have a basis in the IRA and notes that
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28 ⁴ Respondent sometimes refers to this statute erroneously as R&TC section 17592.5.

1 appellants have not filed a Form 8606 as required to report and establish a basis in an IRA. As such,
2 respondent contends that appellants have not met their burden of proof in demonstrating that the FTB
3 improperly imposed tax on the distribution from their traditional IRA. (Resp. Op. Br., pp. 3-4.)

4 The Appeals Division requested that respondent provide an explanation of respondent's
5 determination the income received from the Canada Pension Plan is not taxable by California while
6 respondent determined the income received from DIA is taxable by California. In response, respondent
7 states that it erroneously subtracted the income appellants received from their Canada Pension Plan
8 from the proposed assessment. Respondent asserts that, absent its action, the income from the Canada
9 Pension Plan is properly taxable by California pursuant to R&TC section 17041. Respondent contends
10 that, as appellants were California residents in 2008, all income, including income from a pension plan
11 initiated in Canada, is taxable in California. Respondent states that, due to respondent's error, the only
12 income remaining at issue is the income received from DIA. Respondent contends that appellants have
13 not demonstrated that this income is not taxable in California and they have not met their burden of
14 proof in showing error in its assessment, which is based on a federal determination. (Resp. Addl. Br.,
15 pp. 1-2.)

16 Applicable Law

17 The FTB's determination is presumed correct and appellants have the burden of proving
18 it to be wrong. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Michael E. Myers*,
19 2001-SBE-001, May 31, 2001.) In the absence of uncontradicted, credible, competent, and relevant
20 evidence showing an error in the FTB's determinations, respondent's determinations will be upheld.
21 (*Appeal of Oscar D. and Agatha E. Seltzer*, 80-SBE-154, Nov. 18, 1980.)

22 California residents are taxed upon their entire taxable income regardless of source.
23 (Rev. & Tax. Code, § 17041.) IRC section 61, as incorporated into California law by R&TC
24 section 17071, provides that gross income means all income from whatever source derived, including
25 pensions. (Int.Rev. Code, § 61(a)(11).) Distributions of tax-deferred contributions from retirement
26 accounts are generally includable in taxable income for the year of distribution. (Rev. & Tax. Code,
27 § 17507; Int.Rev. Code, § 408(d).) For California purposes, this federal provision is modified by
28 R&TC section 17507, subdivision (b), to provide that an individual has a basis for annuity computation

1 purposes in any contributions to an IRA not allowed as a deduction for California purposes pursuant to
2 former R&TC section 17272, subdivisions (a),(e), or (g) (in effect prior to 1987). For certain
3 contributions made prior to 1987, the excess contributions made over the lesser allowable California
4 contributions becomes the basis which, when distributed, is not taxed.⁵

5 In the *Appeal of Roy and Phyllis Watts, 97-SBE-011*, decided by the Board on
6 May 8, 1998,⁶ the Board considered whether the lump sum distribution from a pension plan, which was
7 rolled over to an IRA, while the recipient was a non-resident of California, could be included in the
8 recipient's California basis in the IRA when the recipient became a California resident. The FTB had a
9 practice of allowing taxpayers to treat as basis the annual contributions made to an IRA (up to a
10 maximum of \$2,000 per year) and the earnings thereon, which were made while the taxpayers were
11 residents of another state. The Board declined to extend this treatment by the FTB to the rollover of
12 pension plans to IRAs by nonresidents. The Board instead reasoned that the distribution which the
13 taxpayers received from their employer pension plan was taxable income, which the taxpayers deferred
14 from tax by rolling over the pension plan into an IRA, and they had escaped taxation by Illinois on the
15 income when the taxpayers became California residents.

16 Section 114(a) of Title 4, Chapter 4 of the United States Code provides that no state may
17 impose an income tax on any retirement income of an individual who is not a resident or domiciliary of

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22 ⁵ In 1975, the maximum allowable contribution under federal law was \$1,500, but the maximum allowable contribution
23 under California law was zero. From 1976 to 1981, the maximum allowable contribution under federal and California law
24 was \$1,500. From 1982 to 1986, the maximum allowable contribution under federal law was \$2,000, but the maximum
25 allowable contribution in California was \$1,500. The difference between the maximum allowable contributions under
26 federal law and under California law was treated as the taxpayer's California basis in the IRA. When the distributions were
27 made, the distributions were not taxable to the extent of the taxpayer's California basis. (See former Rev. & Tax. Code,
28 § 17520 (repealed in 1983).) This treatment was extended to taxpayers who made contributions while they were
nonresidents of California. (Former Rev. & Tax. Code, § 17530 (repealed in 1983).) From 1976 to its repeal in 1983,
former R&TC section 17530 provided that taxpayers may treat as basis the amount of "annual contributions" to an IRA (up
to a maximum amount of \$2,000 per year) and the earnings thereon, which were made while the taxpayer was a resident of
another state.

⁶ Board of Equalization cases are generally available for viewing on the Board's website
(<http://www.boe.ca.gov/legal/legalopcont.htm>).

1 such state, as determined under the laws of such state. P.L. 109-264⁷ amended section 114(b)(1)(I) of
2 Title 4, Chapter 4 of the United States Code to clarify the treatment of self-employment for purposes of
3 the limitation on State taxation of retirement income by expanding the definition of “retirement
4 income” to include any plan, program, or arrangement in writing that provides retirement payments for
5 prior service to a retired partner and that is in effect immediately before retirement. The related
6 California statute, R&TC section 17952.5, provides that qualified retirement income received on or
7 after January 1, 1996, for any part of the year during which a taxpayer was not a resident of California,
8 is excluded from the taxable income of the nonresident or part-year resident.

9 STAFF COMMENTS

10 Appellants were residents of Canada prior to 1980 and, while they were in Canada,
11 appellant-husband earned a Canadian pension from Genstar and a pension from Service Canada
12 Pension Plan. Appellant-husband’s funds in the Genstar pension were rolled over to DIA, a traditional
13 IRA. In 2008, appellant-husband received a distribution from DIA, which is the income at issue in this
14 appeal. Appellants acknowledge that they became California residents beginning in 1980 and that they
15 were California residents during the 2008 tax year at issue. California residents are taxed on all income
16 received from whatever source. (Rev. & Tax. Code, § 17041.) Distributions from an IRA made to
17 California residents are generally taxable in the year the distribution is made. (Rev. & Tax. Code,
18 § 17507; Int. Rev. Code, § 408(d).) It appears to staff that, as appellants were California residents in
19 2008, the IRA distributions they received are taxable by California. It appears to staff the fact that
20 appellant-husband earned the pension in Canada is irrelevant. It appears to staff that the relevant
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22 ⁷ P.L. 109-264 provided the following:

23 (a) IN GENERAL.—Section 114(b)(1)(I) of title 4, United States Code, is amended— (1) by inserting “(or any
24 plan, program, or arrangement that is in writing, that provides for retirement payments in recognition of prior
25 service to be made to a retired partner, and that is in effect immediately before retirement begins)” after
26 “section 3121(v)(2)(C) of such Code”, (2) by inserting “which may include income described in subparagraphs
27 (A) through (H)” after “(not less frequently than annually”, (3) by adding at the end the following: “The fact that
28 payments may be adjusted from time to time pursuant to such plan, program, or arrangement to limit total
disbursements under a predetermined formula, or to provide cost of living or similar adjustments, will not cause the
periodic payments provided under such plan, program, or arrangement to fail the ‘substantially equal periodic
payments’ test.”, and (4) by adding at the end the following: “(4) For purposes of this section, the term ‘retired
partner’ is an individual who is described as a partner in section 7701(a)(2) of the Internal Revenue Code of 1986
and who is retired under such individual’s partnership agreement.”.

(b) APPLICATION.—The amendments made by this section apply to amounts received after December 31, 1995.

1 inquiry is whether appellants were California residents in 2008 when the funds were distributed.

2 Appellants' reliance on P.L. 109-264 to support their contention that the Genstar pension
3 would not have been subject to California tax appears to be misplaced. This federal limitation only
4 protects nonresident taxpayers who worked and earned their pension or retirement income in one state
5 and later became residents of a second state from being taxed by the prior state. Here, as appellants
6 were California residents at the time of their receipt of the income, it appears that this provision does
7 not exempt appellants from being taxed by California on their pension income earned outside of
8 California.

9 Respondent acknowledges that the FTB erroneously determined that the income
10 received from Service Canada Pension Plan is not taxable by California. Respondent contends that the
11 income received from both the Service Canada Pension Plan and DIA is taxable by California.
12 Appellants assert that, because respondent determined that the income from the Service Canada
13 Pension Plan is exempt from California taxation, the same reasoning should apply for the distribution
14 from DIA. The parties should be prepared to provide legal authority and analysis supporting their
15 arguments.

16 Generally, all income from an IRA is taxable when distributed. (Int.Rev. Code,
17 § 408(d).) However, for certain pre-1987 contributions to an IRA, taxpayers are allowed a basis in the
18 amount of the difference between the deductible contributions for federal purposes and the amount of
19 deductible contributions for California purposes. (Rev. & Tax. Code, § 17507, subd. (b).) It appears
20 that appellants' contributions were made prior to 1980, during appellant-husband's residency and
21 employment in Canada. Staff notes that appellants did not establish pension plans or IRAs or make
22 contributions to such retirement plans while they were California residents. In order to determine the
23 extent to which, if any, appellants' IRA distributions are excludable from their California taxable
24 income, appellants will need to demonstrate their basis in the IRA. Appellants have the burden of
25 presenting uncontradicted, credible, competent, and relevant evidence to show that they have a basis in
26 the distributions. A taxpayer may demonstrate their basis in a retirement account if, for example, the
27 taxpayer made nondeductible contributions to the retirement account or the taxpayer was taxed on the
28 contribution made by his employer. Appellants will need to show whether they made nondeductible

1 contributions into the retirement account or whether they had to pay tax on the contributions made by
2 appellant-husband's employer while he was employed by the Canadian company and a resident of
3 Canada. It appears that, as appellant-husband did not make any further contributions to the retirement
4 account once he became a California resident, he could not have made any nondeductible contributions
5 in the retirement account after 1980. In addition, pursuant to the Board's decision in the *Appeal of Roy*
6 *and Phyllis Watts, supra*, it appears to staff that the rollover of the assets in the Genstar pension to the
7 IRA held by DIA may not be treated as an increase in appellants' California basis.

8 If either party has any additional evidence to present, they should provide their evidence
9 to the Board Proceedings Division at least 14 days prior to the oral hearing pursuant to California Code
10 of Regulations, title 18, section 5523.6.⁸

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⁸ Evidence exhibits should be sent to: Khaaliq Abd'Allah, Appeals Analyst, Board Proceedings Division, State Board of Equalization, P.O. Box 942879 MIC: 80, Sacramento, California, 94279-0080.