

1 Carl Bessent
2 Tax Counsel III
3 Board of Equalization, Appeals Division
4 450 N Street, MIC: 85
5 PO Box 942879
6 Sacramento CA 95814
7 Tel: (916) 323-3116
8 Fax: (916) 324-2618

6 Attorney for the Appeals Division

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

10 In the Matter of the Appeal of:) **REHEARING SUMMARY**
11) **PERSONAL INCOME TAX APPEAL**
12 **HAIK ARAKELIAN AND**) Case No. 442173
13 **ALICE ARAKELIAN¹**)

14 _____)
15 Year Proposed
16 2003 Assessment²
17 \$1,636

18 Representing the Parties:

19 For Appellants: Ara Hovanesian, Attorney
20 For Franchise Tax Board: Maria Brosterhous, Tax Counsel
21

22 **QUESTION:** Whether respondent properly disallowed appellants' claimed charitable contribution
23 deduction for 2003.

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25 ¹ Appellant resides in Los Angeles County, California.

26 ² On February 25, 2009, the Board considered the above-entitled appeal and concluded that the Franchise Tax Board
27 (Respondent/FTB) properly disallowed appellants' claimed charitable contribution deduction. The FTB agreed to modify its
28 assessment to allow the deduction for job and other miscellaneous expenses. This allowed deduction reduced the assessment
from \$1,737 to \$1,636. Subsequently, appellants filed a petition for rehearing and on October 6, 2009, the Board concluded
that the petition for rehearing should be granted. After further briefing, the FTB requested a pre hearing conference which
was held by Appeals staff with the parties on August 5, 2010.

1 HEARING SUMMARY

2 Background

3 Appellants timely filed their 2003 California tax return. On the return, appellants
4 reported federal adjusted gross income (AGI) of negative (\$524,388) and California AGI of \$152,375.
5 Most of the disparity in the AGI numbers is that appellants had net operating loss (NOL) carryover
6 deductions on their federal return. Because California suspended NOL carryover deductions during
7 2002 and 2003, appellants did not take the NOL on their 2003 California return. (Rev. & Tax. Code,
8 § 24416.3, subd. (a).)

9 Subsequently, the Internal Revenue Service (IRS) made math error adjustments during
10 the processing of appellants' 2003 return and revised their itemized deductions.³ Specifically, the
11 charitable contribution deduction was reduced from \$17,636 to zero and the job and other miscellaneous
12 expenses deduction was reduced from \$1,085 to zero. Based on the federal changes, the FTB issued a
13 Notice of Proposed Assessment (NPA) on April 17, 2006. The NPA assessed additional tax of \$1,737,
14 plus accrued interest. Appellants protested the NPA, stating that the FTB did not use appellants'
15 California AGI in computing the charitable contribution base. On March 12, 2007, the FTB issued a
16 letter conceding that the job and miscellaneous expenses deduction of \$1,085 was improperly denied.

17 Later, the FTB held a protest hearing. According to the FTB, the protest officer allowed
18 the deduction for job and other miscellaneous expenses, but noted the deduction for state, local and
19 foreign taxes should have been disallowed. The FTB issued a Notice of Action (NOA) on February 21,
20 2008, affirming the NPA.⁴ Appellants filed this timely appeal.

21 After the Board heard the matter and concluded that the FTB properly disallowed appellants'
22 claimed charitable contribution deduction and reduced the overall assessment to \$1,636, appellants filed
23

24
25 ³ In a filing dated July 28, 2010, the FTB concedes that previously it, erroneously thought the IRS conducted an audit of
appellants' return instead of simply making a math error adjustment.

26 ⁴ Although the FTB's March 12, 2007 letter conceded that the job and miscellaneous expenses deduction was improperly
27 denied, the NOA sets forth the same amount of additional tax shown on the NPA (\$1,737), which reflects the denial of the
28 deduction for job and miscellaneous expenses. On page four of its opening brief, respondent states that its assessment will be
revised to allow the deduction for job and other miscellaneous expenses. Staff notes that neither the NPA nor NOA
disallowed the deduction for state, local and foreign taxes. As a result, those deductions are not at issue in this appeal. For
these reasons, the only deduction at issue in this appeal is the charitable contribution deduction.

1 and were granted a petition for rehearing. After further briefing and a prehearing conference, this matter
2 is before the Board again.

3 Contentions

4 On appeal, appellants contend they are entitled to a charitable contribution deduction in
5 California. Appellants argue that any limitation on their ability to take this deduction should be based
6 on their positive California AGI instead of their negative federal AGI. Although California suspended
7 the NOL deduction, appellants argue they should not be deprived of a deduction for charitable
8 contributions. Appellants assert that California law provides that federal AGI must be adjusted to arrive
9 at California AGI.

10 Appellants assert that the FTB misstates the language of Revenue and Taxation Code
11 (R&TC) section 17072 by inserting the words “in the statute”. (Appellants’ Reply Brief, (ARB) filed
12 Jan. 21, 2010, P.4.) Appellants claim that they complied with the FTB instructions in filing their 2003
13 California return. (ARB, pp. 5-8.) Appellants argue that R&TC section 18622 does not preclude the
14 deduction for charitable contributions because the purported action by the IRS had no affect on taxes.
15 (Appellants’ Opening Brief, Rehearing, (AOBR) pp. 5-10.) Appellants assert the FTB contention that
16 California AGI must be the same as federal AGI is erroneous. (AOBR, pp. 10-19.) Appellants claim
17 that they “took no itemized deduction on their [f]ederal return for 2003.” (AOBR, p. 20.)

18 The FTB asserts that its assessment regarding the charitable contribution deduction
19 should be upheld because appellants have not met their burden of proof that the FTB improperly denied
20 this deduction based on the IRS processing adjustment. The FTB argues that California law requires
21 taxpayers to use the AGI taxpayers reported on their federal return when computing limitations based
22 upon AGI. Thus, appellants are required to use their negative federal AGI when determining their
23 charitable contribution base for 2003.

24 The FTB contends that California law, as specified in R&TC section 17024.5,
25 subdivision (h)(2), specifically requires taxpayers to use the AGI reported on the federal return when
26 computing limitations based upon AGI. (Respondent’s Opening Brief, Rehearing (ROBR) p. 2.) The
27 FTB states that many taxpayers do not report the same AGI for federal and states purposes. (ROBR, p.
28 2.) The FTB argues that the plain language of R&TC section 17024.5, subdivision (h)(2) is sufficient to

1 support its position. (ROBR, pp. 3-4.)

2 Pre Hearing Conference

3 Appellants' representative did not clearly state whether the federal return reported to the
4 IRS claimed the charitable contributions despite the fact that itemized deductions appear to be claimed
5 on appellants' federal return at Schedule A and Form 1040 on page 2 at line 37. (See Resp. Opening
6 Br., exhibit A, pp. 2-3.) FTB pointed out that the federal record of account also indicates appellants
7 claimed federal itemized deductions on their 2003 federal return. Appellants' representative then
8 indicated the IRS may have made an error.

9 In regards to the R&TC section 17024.5, subdivision (h)(2), appellants' representative asserts
10 that the FTB's forms and instructions are misleading and do not reference that statute. In response, the
11 FTB read instructions for Form CA for 2003, line 35 which state the following:

12 Line 35 – Federal Itemized Deductions

13 Enter the total amount of itemized deductions from your federal Form 1040, Schedule A,
14 lines 4, 9, 14, 18, 19, 26, and 27. Important: If you did not itemize deductions on your
15 federal tax return but will itemize deductions on your California tax return, first complete
16 federal, Schedule A. Then complete CA (540), Part II, line 35 through line 41.

17 The FTB also contended that R&TC section 18622 does not require an audit for a
18 math change but the effect is the same. It is not clear following the pre-hearing
19 conference whether appellant still contends that R&TC section 17042.5, subdivision
20 (h)(2), does not apply here; appellants appear to now contend that the section is hard to
21 understand and FTB's instructions do not adequately explain how to compute limitations
22 based on adjusted gross income.

23 Applicable Law

24 R&TC section 17201, by way of incorporating Internal Revenue Code (IRC) section 170
25 into California tax law, allows a deduction for any charitable contribution made during the income year.
26 IRC Section 170(b)(1) limits the available deduction to either 50 percent or 30 percent of the taxpayer's
27 contribution base, depending upon the categorization of the recipient of the contribution. IRC section
28 170(b)(1)(G) defines "contribution base" as "adjusted gross income (computed without regard to any net
operating loss carryback to the taxable year under section 172)." R&TC section 17024.5,
subdivision (h), as in effect for the year at issue, provides in relevant part as follows:

1 When applying, for purposes of this part, any section of the Internal Revenue Code or
2 any applicable regulation thereunder, all of the following shall apply:

3 (1) References to “adjusted gross income” shall mean the amount computed in
4 accordance with Section 17072, except as provided in paragraph (2).

(2) References to “adjusted gross income” for purposes of computing limitations based
upon adjusted gross income, shall mean the amount required to be shown as adjusted
gross income on the federal tax return for the same taxable year.

5 With respect to California’s adoption of federal tax statutes (like IRC section 170) for use in California,
6 R&TC section 17024.5, subdivision (h)(7) provides that, “due account shall be made for differences in
7 federal and state terminology . . . and other obvious differences.”

8 IRC section 170 and its implementing regulations address the interplay between
9 charitable contribution deductions and any available NOL carryovers. In essence, carryovers are
10 deducted before charitable contribution deductions. To the extent a taxpayer would have an allowable
11 charitable contribution deduction in the absence of the taxpayer’s NOL carryover that reduced his or her
12 federal AGI to zero in that year, the excess charitable contribution amount that could not be utilized in
13 that year (due to the NOL carryover) is itself converted to NOL carryover. IRC section 170(d)(1)(B)
14 provides that in applying the charitable excess carryover provisions, the excess determined for the
15 contribution year must be reduced to the extent that such excess reduces taxable income (as computed
16 for purposes of the second sentence of IRC section 172(b)(2), which deals with NOL carryovers) and
17 thus increases the NOL deduction for tax years after the contribution year.

18 R&TC section 18622 provides that the taxpayer shall either concede the accuracy of the
19 federal determination or state wherein it is erroneous. It is well settled that a deficiency assessment
20 based on a federal math change is presumptively correct, and the taxpayer bears the burden of proving
21 that the determination is erroneous. (See *Appeal of Sheldon I. and Helen E. Brockett*, 86-SBE-109,
22 June 18, 1986; *Todd v. McColgan* (1949) 89 Cal.App.2d 509.) Income tax deductions are a matter of
23 legislative grace, and the burden is on appellants to show by competent evidence that they are entitled to
24 the deductions claimed. (*Appeal of James E. and Monablance A. Walshe*, 75-SBE-073, Oct. 20, 1975;
25 *New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435, 436.)

26 STAFF COMMENTS

27 The parties should be prepared to discuss whether, in the circumstances in this appeal and
28 in other circumstances where federal AGI and California AGI differ, California law uses federal AGI.

1 In this connection, the parties should be prepared to explain their interpretation of R&TC section
2 17024.5, subdivision (h)(2). Specifically, appellants will need to clearly explain why R&TC section
3 17024.5 (h)(2) does not apply to this matter, where appellants are computing the charitable contribution
4 deduction limitation, and R&TC section 17024.5, subdivision (h)(2), specifically provides that the
5 references to “adjusted gross income” for purposes of computing limitations based upon adjusted gross
6 income *shall* mean the amount required to be shown as adjusted gross income on the federal return for
7 the taxable year.

8 With respect to whether the instructions to line 35 of Form CA (540) were misleading,
9 staff notes that even should the instructions be found to be misleading, there is no statutory authority to
10 abate tax for allegedly misleading instructions, except in the case of erroneous written advice contained
11 in a legal ruling by the chief counsel of the FTB pursuant to R&TC section 21012, subdivision (a)(1).
12 That circumstance is not present here. It appears that appellants may be raising an estoppel-type
13 argument; i.e., respondent’s instructions were purportedly inadequate to explain how to properly
14 calculate their charitable contribution deduction for their 2003 return. Although appellants may have
15 been confused by the instructions, that fact alone is insufficient to warrant application of the estoppel
16 doctrine. (See *Appeal of Priscilla L. Campbell*, 79-SBE-035, Feb. 8, 1979.)

17 The parties may wish to discuss whether appellants (and/or other taxpayers in a similar
18 situation) would be able to carryover a disallowed charitable deduction to another year. Staff notes that,
19 once the amount of the potential charitable contribution is determined, the taxpayer’s federal NOL
20 deduction is subtracted from the contribution base. If any amount remains of the contribution base after
21 subtracting the amount of the federal NOL deduction, then a charitable contribution in that amount is
22 allowed. If nothing remains of the contribution base after subtracting the amount of the NOL deduction,
23 then no charitable contribution is allowed for that year. However, the claimed charitable contribution
24 may be carried over to future years. (See Treas. Reg. § 1.170A-10(d).)

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