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

10 In the Matter of the Appeal of:) **HEARING SUMMARY**
11) **PERSONAL INCOME TAX APPEAL**
12 **DENNIS E. MADDIX**) Case No. 552996
13 **AND MARTHA MADDIX¹**)

<u>Year</u>	<u>Proposed Assessment</u>
2007	\$1,025

18 Representing the Parties:

19 For Appellants: Wess Huffman
20 For Franchise Tax Board: David Lopez, Tax Counsel IV

23 QUESTION: Whether appellants have shown respondent erred in its proposed assessment on
24 distributions from an Individual Retirement Account (IRA) that appellants inherited
25 from a nonresident of California.

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28 ¹ Appellants reside in Tracy, San Joaquin County, California.

1 HEARING SUMMARY

2 Background²

3 Appellant-wife inherited an IRA from her uncle who lived in Texas.³ Franchise Tax
4 Board (FTB or respondent) determined appellant-wife received distributions from the IRA during the
5 2005, 2006, and 2007 tax years, but did not include the distributions as income on her California tax
6 returns for those years. Respondent audited those years and concluded the distributions were includible
7 in taxable income to appellants. Respondent issued a Notice of Proposed Assessment (NPA) for the
8 2007 taxable year.⁴ (Resp. Op. Br., exhibit B.) Appellants protested the NPA, contending the
9 distributions were from appellant-wife’s uncle’s IRA, based on funds earned in Texas, and therefore not
10 taxable since none of the funds were subject to state tax and no state tax was deferred. (*Id.* at exhibit A.)
11 Respondent reviewed the protest and issued a Notice of Action affirming the NPA. This timely appeal
12 followed.

13 Contentions

14 Appellants contend federal taxes were deferred on the money put into the IRA, and those
15 deferred taxes have been paid with the distributions, but no taxes were deferred for state purposes, and
16 therefore no state taxes are due when the money is distributed. Appellants assert since there was no
17 state tax benefit received when the money was placed in the IRA, there are no state taxes to pay when

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22 ² The following background is compiled from the documents provided on appeal by the parties. Since the information
23 provided on appeal (a combined five pages of briefing and six pages of exhibits) does not provide much detail of the facts,
24 the parties should be prepared to present at the hearing any stipulation of alternative facts and provide supporting evidence.

25 ³ No documentation has been provided to show how appellants received rights in the IRA distributions, or how the account
26 was transferred from the uncle to appellant-wife, through inheritance or otherwise. There is no dispute that appellants were
27 California residents for the tax years in issue and that appellant-wife’s uncle was never a California resident.

28 ⁴ Respondent indicates it issued NPAs for 2005 and 2006 as well. Respondent states it erroneously withdrew the 2006 NPA,
and for an unspecified reason will not be issuing a replacement one. Respondent asserts appellants paid the 2005 assessment
and claimed a refund, but that claim has not been acted upon. Respondent contends appellants will need to treat the refund
claim as being deemed denied and file an appeal if they wish to further pursue a refund for 2005.

1 the money is distributed.⁵

2 Respondent contends the IRA distributions are fully taxable by California since
3 appellants have not shown they have a California basis in the IRA funds. Respondent states IRAs are
4 inherited income, not property, and asserts appellants have the same basis in the pension or annuity as
5 the decedent and are required to report the income in the same manner. Respondent contends any
6 distribution from an IRA must be included in gross income in the year it was received, and are taxable to
7 the extent the distributions exceed the basis. Because appellants have the same basis in the IRA as the
8 uncle, and the uncle never lived in California, respondent contends that there is no evidence the IRA had
9 any California basis, and therefore the entirety of the distributions are taxable to California. (Resp.
10 Opening Br., pp. 1-3.)

11 Applicable Law

12 The initial findings of the FTB are presumptively correct if they have rational basis, and
13 the taxpayer bears the burden of proof to substantiate a contrary finding. (*Appeal of Richard Byrd*, 84-
14 SBE-167, Dec. 13, 1984; *Todd v. McColgan* (1949) 89 Cal.App.2d 509.) This presumption cannot be
15 overcome by unsupported statements by the taxpayer. (*Appeal of Robert C., Deceased, and Irene*
16 *Sherwood*, 65-SBE-046, Nov. 30, 1965.) To successfully rebut the FTB's presumption, the taxpayer
17 must present "uncontradicted, credible, competent, and relevant evidence to the issues in dispute."
18 (*Appeal of Oscar D. and Agatha E. Seltzer*, 80-SBE-154, Nov. 18, 1980.) The failure to produce
19 evidence within appellant's control will give rise to a presumption that such evidence is unfavorable to
20 his case. (*Appeal of Don A. Cookston*, 83-SBE-048, Jan. 3, 1983.) This presumption rule also applies to
21 determinations regarding basis. (*Appeal of Milton K. and Irene T. Harwood*, 80-SBE-76, June 30,
22 1980.)

23 R&TC section 17041 imposes a tax "upon the entire taxable income of every resident of
24 this state." Taxable income is gross income minus allowed deductions. (Rev. & Tax. Code, § 17073;
25 Int.Rev. Code, § 63.) R&TC sections 17071 and 17072 define "gross income" and "adjusted gross
26 income" by references to IRC sections 61 and 62, respectively. IRC section 61 provides that unless
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28 ⁵ Appellants finish their appeal letter by stating, "We do concede any part of the amount at issue..." but from the rest of the document it is clear that appellants do *not* concede any portion of the proposed assessment. (App. Op. Br., p. 2.)

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1 otherwise provided, “gross income means all income from whatever source derived.” IRC section
2 61(a)(11) includes pensions in gross income. Distributions of tax-deferred contributions from retirement
3 accounts are includable in taxable income for the year of distribution.⁶ (Rev. & Tax. Code, § 17507;
4 Int.Rev. Code § 408(d).)

5 STAFF COMMENTS

6 Distributions from an IRA made to California residents are generally taxable.
7 Determining the extent to which, if any, appellants’ IRA distributions are excludable from their
8 California taxable income depends on whether they have a California basis in the IRA. In this regard,
9 appellants have the burden of presenting uncontradicted, credible, competent, and relevant evidence to
10 show that they have a California basis in the distributions. Although there is more than one means of
11 acquiring basis in a retirement account,⁷ generally a taxpayer only has basis in a retirement account if
12 the taxpayer paid income tax upon the amount contributed to the retirement account. Thus, to prove
13 they had California basis in the IRA, appellants must provide documentation evidencing the amounts
14 contributed to the IRA and the amounts that composed the distributions for the year at issue.

15 Since appellant-wife inherited the IRA from her uncle, she will also have inherited any
16 California basis in those amounts. From the record, it appears the uncle lived and made the
17 contributions in Texas, and therefore it is unlikely that he would have earned a California basis in the
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19 ⁶Although IRC section 102, incorporated by R&TC section 17131, states that gross income does not include the value of
20 property acquired by inheritance, the distributions from the “inherited” IRA are taxable. IRC section 102 states that where
21 the inheritance is income from property, it is not excluded from gross income. It further elaborates that when the terms of the
22 inherited property indicate distributions of income are to be made at intervals, it is not excluded from gross income.

23 ⁷ For example, IRC section 401, incorporated with modifications by R&TC section 17501, provides the rules for
24 deferral of income tax on pensions, including 401(k) accounts. R&TC section 17551 incorporates, with modifications, IRC
25 section 457 which includes the rules for the 457(b) deferred compensation plan. Both 401(k) and 457(b) plans provide for
26 the deferral of the taxation of income until distributions are made from the retirement accounts. These plans limit the amount
27 of tax-deferred contributions in each year. If taxpayers submit excess contributions, they are considered taxable income in
28 the year of submittal, and if they are not returned to the taxpayers they are considered after-tax contributions which increases
the taxpayers’ basis in the retirement account and reduce the amount of taxable income upon future distributions.

29 Taxpayers can also acquire basis in their IRA accounts in the amount that the taxpayers would not have been able to
30 take a deduction against California gross income in the year of the contributions had they been residents. This may happen if
31 the maximum allowable federal contribution is higher than the maximum allowable California contribution. (See Rev. &
32 Tax. Code, § 17507, subd. (b)(1).) These contributions essentially become after-tax contributions due to the inability to take
33 the deduction, and thus lead to an increase in basis for California purposes. There is nothing presented thus far to indicate
34 appellant-wife’s uncle would not have been allowed a California deduction on the amounts contributed to the IRA had he
35 been a California resident at the time he made the contributions.

1 amounts. Appellants should provide any available documentation and legal analysis supporting a
2 California basis in the distributions, or that the distributions are otherwise not taxable.

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