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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 **HAIK ARAKELIAN AND**) Case No. 442173
13 **ALICE ARAKELIAN¹**)
14 _____)

	<u>Year</u>	<u>Proposed Assessment²</u>
	2003	\$1,737

17 Representing the Parties:

18 For Appellant: Ara Hovanesian, Attorney
19 For Franchise Tax Board: Maria Brosterhous, Tax Counsel

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

23 **HEARING SUMMARY**

24 Background

25 Appellants timely filed their 2003 California tax return. On the return, appellants
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27 ¹ Appellants reside in Los Angeles County, California.

28 ² At the hearing, respondent should be prepared to provide the amount of accrued interest, as of the hearing date.

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

6 Subsequently, the Internal Revenue Service (IRS) audited appellants' 2003 return and
7 revised their itemized deductions. Specifically, the charitable contribution deduction was reduced from
8 \$17,636 to zero and the job and other miscellaneous expenses deduction was reduced from \$1,085 to
9 zero. Based on the federal information, the FTB issued a Notice of Proposed Assessment (NPA) on
10 April 17, 2006. The NPA assessed additional tax of \$1,737, plus accrued interest. Appellants protested
11 the NPA, stating that the FTB did not use appellants' California AGI in computing the charitable
12 contribution base. On March 12, 2007, the FTB issued a letter conceding that the job and miscellaneous
13 expenses deduction of \$1,085 was improperly denied.

14 Later, the FTB held a protest hearing. According to the FTB, the protest officer allowed
15 the deduction for job and other miscellaneous expenses, but noted the deduction for state, local and
16 foreign taxes should have been disallowed. The FTB issued a Notice of Action (NOA) on February 21,
17 2008, affirming the NPA.³ Appellants filed this timely appeal.

18 Contentions

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

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27 ³ Although the FTB's March 12, 2007 letter conceded that the job and miscellaneous expenses deduction was improperly
28 denied, the NOA sets forth the same amount of additional tax shown on the NPA (\$1,737), which reflects the denial of the
deduction for job and miscellaneous expenses. On page four of its 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 The FTB asserts that its assessment regarding the charitable contribution deduction
2 should be upheld because appellants have not met their burden of proof that the FTB improperly denied
3 this deduction based on a final federal determination. The FTB argues that California law requires
4 taxpayers to use the AGI taxpayers reported on their federal return when computing limitations based
5 upon AGI. Thus, appellants are required to use their negative federal AGI when determining their
6 charitable contribution base for 2003.

7 The FTB agrees to revise its assessment to allow the deduction for job and other
8 miscellaneous expenses of \$1,085. On appellants' 2003 Schedule A, they reported a deduction of
9 \$3,800 for state and local taxes. The IRS allowed the \$3,800 deduction along with additional
10 deductions. The FTB concedes that it initially, erroneously, accepted this \$3,800 deduction, but
11 discovered the error during protest. However, because the FTB failed to assess additional tax on this
12 claimed deduction in either the NPA or the NOA, the FTB agrees that it is bound by the assessment
13 allowing the erroneous tax deduction.

14 Applicable Law

15 Revenue and Taxation Code (R&TC) section 17201, by way of incorporating Internal
16 Revenue Code (IRC) section 170 into California tax law, allows a deduction for any charitable
17 contribution made during the income year. IRC Section 170(b)(1) limits the available deduction to
18 either 50 percent or 30 percent of the taxpayer's contribution base, depending upon the categorization of
19 the recipient of the contribution. R&TC section 17024.5, subdivision (h), as in effect for the year at
20 issue, provides in relevant part as follows:

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

23 (1) References to "adjusted gross income" shall mean the amount computed in
24 accordance with Section 17072, except as provided in paragraph (2).

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

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

 IRC section 170 and its implementing regulations address the interplay between

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

10 R&TC section 18622 provides that the taxpayer shall either concede the accuracy of the
11 federal determination or state wherein it is erroneous. It is well settled that a deficiency assessment
12 based on a federal audit report is presumptively correct, and the taxpayer bears the burden of proving
13 that the determination is erroneous. (*Appeal of Sheldon I. and Helen E. Brockett*, 86-SBE-109, June 18,
14 1986; *Todd v. McColgan* (1949) 89 Cal.App.2d 509.) Income tax deductions are a matter of legislative
15 grace, and the burden is on appellant to show by competent evidence that he or she is entitled to the
16 deductions claimed. (*Appeal of James E. and Monablance A. Walshe*, 75-SBE-073, Oct. 20, 1975;
17 *New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435, 436.)

18 STAFF COMMENTS

19 The parties should be prepared to discuss whether, in the circumstances in this appeal and
20 in other circumstances where federal AGI and California AGI differ, California law uses federal AGI.
21 In this connection, the parties should be prepared to explain their interpretation of R&TC section
22 17024.5, subdivision (h).

23 The parties may wish to discuss whether appellants (and/or other taxpayers in a similar
24 situation) would be able to carryover a disallowed charitable deduction to another year. Staff notes that,
25 once the amount of the potential charitable contribution is determined, the taxpayer's federal NOL
26 deduction is subtracted from the contribution base. If any amount remains of the contribution base after
27 subtracting the amount of the federal NOL deduction, then a charitable contribution in that amount is
28 allowed. If nothing remains of the contribution base after subtracting the amount of the NOL deduction,

1 then no charitable contribution is allowed for that year. However, the claimed charitable contribution
2 may be carried over to future years. (See Treas. Reg. § 1.170A-10(d).)

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