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7 **BOARD OF EQUALIZATION**

8 **STATE OF CALIFORNIA**

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10 In the Matter of the Appeal of:) **HEARING SUMMARY**
11) **PERSONAL INCOME TAX APPEAL**
12 **KAREN EATON AND LESTER E. EATON**¹) Case No. 481267
13

<u>Year</u>	<u>Proposed Assessment</u> ²
2005	\$407

17 Representing the Parties:

18 For Appellants: Karen Eaton

19 For Franchise Tax Board: Claudia L. Cross, Legal Analyst
20

21 **QUESTION:** Whether appellants have shown error in respondent's proposed assessment.
22

23 **HEARING SUMMARY**

24 Background

25 Appellants filed a timely 2005 California resident income tax return (Form 540) using the
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27 ¹ Appellants reside in Yuba City, in Sutter County, California.

28 ² Respondent should be prepared to provide the amount of interest that has accrued as of the date of the hearing.

1 married filing jointly status. Appellants' Form 540 reported a federal adjusted gross income (AGI) of
2 \$51,215, subtracted California adjustments of \$18,989 and a standard deduction for joint filers of \$6,508
3 to reach a taxable income of \$25,718, and tax of \$388. After applying \$174 in exemption credits, a
4 \$120 renter's credit, \$252 in other taxes, and \$295 in withholding credit, appellants reported a total tax
5 of \$346, and a final amount due of \$51, which they paid with the return.

6 After subsequent review, respondent determined that appellants had incorrectly
7 subtracted out-of-state income from their California AGI. Respondent issued a Notice of Proposed
8 Assessment (NPA) on April 17, 2008, disallowing the California subtraction of \$18,989, and proposed
9 an additional tax of \$674. Appellants protested the NPA, and provided an amended individual tax return
10 and part-year resident return in which they stated that while Lester Eaton was a resident of California for
11 the entire 2005 tax year, Karen Eaton was a part-year resident and her Indiana sourced income was not
12 taxable in California. Appellants' amended return reported a tax due of \$61 (an increase of \$10 over the
13 tax due amount from the original return), and sent in a \$10 payment on April 15, 2008.

14 On December 19, 2008, respondent sent a letter informing appellants that it received their
15 protest but was unable to accept the part-year resident return because appellants incorrectly subtracted
16 \$18,989 in wages from their California AGI; respondent provided an explanation of how to calculate the
17 tax liability of part-year residents. Respondent also indicated that appellants could only get one half of
18 their claimed renter's credit since Karen Eaton was not a resident of California for more than six months
19 during 2005. Respondent indicated that appellants' 2005 tax liability should have been calculated to be
20 \$753, an increase of \$407 over their originally reported and paid liability. On February 17, 2009,
21 respondent issued a Notice of Action (NOA) that amended the NPA by reflecting Karen Eaton's part-
22 year resident status. The NOA reflected a proposed additional tax liability of \$407, plus interest, and
23 was accompanied by a computation schedule. This timely appeal followed.

24 Contentions

25 Appellants contend that respondent has incorrectly calculated their tax liability.
26 Appellants assert that Karen Eaton was a resident of Indiana for most of 2005 and did not become a
27 resident of California until October 1, 2005, after their marriage on September 30, 2005. Appellants
28 contend that respondent has erroneously taxed them on their Indiana sourced income, and that they paid

1 taxes to Indiana for nine months. Appellants indicate that they had a representative, H&R Block,
2 prepare all their tax returns for the 2005 tax year.

3 Respondent concedes that Karen Eaton was a part-year resident for 2005, but asserts that
4 appellants incorrectly calculated their 2005 tax liability. Respondent contends that it has properly
5 proposed appellants' tax liability according to Revenue and Taxation Code (R&TC) section 17041,
6 subdivision (b), for part-year residents. Respondent contends that its proposed assessment does not tax
7 out-of-state income, but rather uses total income to determine the *rate* of tax, and that appellants
8 incorrectly excluded the Indiana sourced income of \$18,989 from the calculation of their tax liability
9 altogether. Respondent also asserts that since only one spouse was a resident of California for more than
10 six months during 2005, appellants are entitled to only half of the renter's credit for a married couple.

11 Applicable Law

12 R&TC section 17041, subdivision (a), imposes a tax upon the entire income, from all
13 sources, of every California resident. For part-year residents, R&TC section 17041, subdivision (b),
14 imposes a tax upon their California sourced income. The tax on part-year residents is determined first
15 by calculating the tax on all income, regardless of source, as though the taxpayer were a full-year
16 resident. (*Appeal of Louis N. Million*, 87-SBE-036, May 7, 1987.) The actual California tax liability is
17 then factored out by applying the ratio of California AGI to total AGI from all sources. (Rev. & Tax.
18 Code, § 17041, subd. (b).) The purpose of the method is to apply the graduated tax rates to all
19 persons—not just those who live in California for the full year; the method does not tax out-of-state
20 sources of income, but merely takes the out-of-state income into consideration when determining the tax
21 rate that should apply to California sourced income.³ (*Appeal of Louis N. Million*, supra.)

22 To properly assess a part-year resident's tax liability, that taxpayer is required to calculate
23 three ratios in accordance with R&TC section 17041, subdivision (b). These ratios and the way they

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26 ³ The fundamental fairness and constitutionality of the above-described method of taxing the California-source income of
27 part-year residents has been upheld by New York's highest court, and the United States Supreme Court refused to hear an
28 appeal from the New York decision. (*Brady v. New York* (1992) 80 N.Y.2d 596, cert. den. (1993) 509 U.S. 905.) The *Brady*
court reasoned that similarly situated taxpayers were those with the same total income. For example, a nonresident earning
\$20,000 in New York, but with \$100,000 reported total income, should be taxed on the \$20,000 New York-source income at
the same rate as a New York resident with \$100,000 total income (and not at the same rate as a New York resident with
\$20,000 total income).

1 were calculated and applied by respondent to appellants' 2005 income is shown below:

- 2 1. Prorated Deductions. To calculate the percentage of itemized deductions or a prorated
3 standard deduction, a part-time resident's California AGI is divided by the total AGI. The
4 resulting rate is then applied to the itemized deductions to find the prorated deductions.

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$$\$32,226 \text{ (California AGI)} / \$51,215 \text{ (federal AGI)} = .6292$$

6
$$\$6,508 \text{ (itemized deductions)} \times .6292 = \$4,095 \text{ (prorated deductions)}$$

- 7 2. Tax Rate. To calculate the tax rate for California, a part-time resident's tax on the total
8 income is calculated as if the taxpayer was a California resident, and then divided by the
9 taxpayer's total taxable income as if the taxpayer was a California resident. The resulting
10 rate is then applied to the part-time resident's California taxable income to determine the
11 taxpayer's California tax.

12
$$\$1,062 \text{ (tax on total income)} / \$44,707 \text{ (federal taxable income)} = .0238$$

13
$$\$28,131 \text{ (California taxable income)} \times .0238 = \$670 \text{ (California prorated tax)}$$

14 Appellants also had \$252 in other tax.

- 15 3. Prorated Credits. To calculate the percentage of credits allowed on a part-time resident's
16 California return, the California taxable income is divided by the total taxable income. The
17 resulting rate is then applied to the total exemption amount to find the prorated credits.

18
$$\$28,131 \text{ (California taxable income)} / \$44,707 \text{ (federal taxable income)} = .6292$$

19
$$\$174 \text{ (total exemption amount)} \times .6292 = \$109 \text{ (prorated credits)}$$

20 Appellants claimed a \$120 renter's credit and respondent instead allowed a \$60 credit.⁴

21 Respondent's determinations with regard to the imposition of taxes are presumed correct,
22 and the taxpayer has the burden of showing error in those determinations. (*Appeal of K. L. Durham*, 80-
23 SBE-024, Mar. 4, 1980; *Appeal of Myron E. and Alice Z. Gire*, 69-SBE-0029, Sept. 10, 1969.)

24 A renter's credit is available to some residents of California. (Rev. & Tax. Code,
25 § 17053.5.) The credit equals \$60 for individual claimants and \$120 for spouses filing jointly. (*Id.* at
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27
28 ⁴ Appellants' prorated tax of \$670, when added to appellants' other tax of \$252, creates an amount due of \$922. When the \$109 of prorated credits and the allowed \$60 renter's credit are applied to this amount due, the remaining amount due is \$753. Appellants have already satisfied \$346 worth of tax, leaving \$407 plus interest still due according to respondent's calculations.

1 subd. (a)(1)(A) & (B).) However, when one spouse is a nonresident for all or part of the year, the
2 resident spouse is entitled to one half of the award, and the nonresident or part-year resident is entitled to
3 any applicable prorated portion of the other half of the award. (*Id.* at subd. (a)(2)(A).) To be entitled to
4 a credit, even a prorated portion, a taxpayer must have been a resident of California for at least six
5 months during the year. (*Id.* at subd. (c)(2).)

6 STAFF COMMENTS

7 At the hearing, appellants should be prepared to provide any evidence that shows that
8 respondent has erred in its calculation of their tax obligation for the 2005 tax year. Respondent has
9 agreed that Lester Eaton qualified for the renter's credit for 2005, and this credit is reflected in the NOA.
10 It appears from the facts that Karen Eaton was not a resident for at least six months of 2005, and
11 therefore not eligible for renter's credit.

12 It appears from the record that appellants paid taxes to Indiana for their Indiana sourced
13 income and paid taxes to California for their California sourced income. Therefore, the Other State Tax
14 Credit (OSTC) does not appear to apply here. However, if appellants paid taxes to Indiana for any
15 Indiana sourced income earned while a resident of California, and California also taxed this income,
16 then the OSTC may be an issue. California law provides a tax credit to resident taxpayers for taxes paid
17 to another state on income derived from sources within that other state. (Rev. & Tax. Code § 18001,
18 subd. (a)(1).) However, subdivision (a)(2) of R&TC section 18001 provides that this credit will not be
19 allowed if the other state “allows residents of [California] a credit against the taxes imposed by that
20 state” for taxes paid or payable in California. These states are referred to as “Reverse Credit States.”
21 This subdivision prevents double tax credits. Indiana allows Reverse Credits for nonresidents. (Burns
22 Ind. Code Ann. § 6-3-3-3, subd. (b).) Therefore, any attempt at applying California OSTC to the
23 proposed assessment in this instance is improper since Indiana is a Reverse Credit State. The proper
24 process for avoiding any possible double-taxation in this instance would be to receive a credit from
25 Indiana for any taxes properly paid to California for Indiana sourced income.

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