Mai C. Tran
Tax Counsel III
Board of Equalization, Appeals Division
450 N Street, MIC:85
PO Box 942879
Sacramento CA 95814
Tel: (916) 324-8244
Fax: (916) 324-2618

Attorney for the Appeals Division

BOARD OF EQUALIZATION

STATE OF CALIFORNIA

In the Matter of the Appeal of:	**HEARING SUMMARY**
	PERSONAL INCOME TAX APPEAL
FRANK SCHINE AND	Case No. 791858
STEPHANIE SCHINE	

Year	Amount at Issue
2009	$1,868[1]

Representing the Parties:

For Appellant: Frank Schine and Stephanie Schine

For Franchise Tax Board: Eric R. Brown, Tax Counsel III

QUESTIONS: (1) Whether appellants have shown error in the proposed assessment which is based on a federal action; and

(2) Whether appellants have established that a portion of their income is not subject to California income tax in 2009.

///

///

[1] The Notice of Action reflects an amount of additional tax of $1,868. However, based on a review of documents provided with appellants' opening brief, as discussed herein, respondent revised the proposed additional tax to $1,667.

HEARING SUMMARY

Background

Appellants filed a timely California nonresident tax return for 2009. Appellants reported California taxable income of $24,079 and California tax of $105. Appellants claimed $2,495 in California withholding, and reported an overpayment of $2,390. Respondent refunded this overpayment to appellants on April 16, 2010. On their Schedule CA, appellants reported wages earned or received if treated as a California resident of $88,827, and wages earned or received as a California resident and from California sources as a nonresident of $73,630. Appellants reported a business loss of $29,960, but did not report the same loss as a California amount. Appellants also reported a rental real estate loss of $25,000 for federal purposes, but did not report the same loss as a California amount. Appellants reported California itemized deductions of $49,551. On appellants' federal tax return for 2009, appellants reported total itemized deductions of $57,566, a Schedule C net loss of $29,960 from appellant-husband's business, Global Domain International, and a Schedule E loss of $25,000 for real estate rental property located at in San Jose, California.[2]

(ROB, pp. 1-2, Exhs. A & B.)

On June 20, 2012, respondent received information from the Internal Revenue Service (IRS) regarding a federal audit of appellants' 2009 federal tax return. According to the federal report, the IRS disallowed Schedule C deductions of $30,882, disallowed net Schedule E deductions of $22,161,[3] and disallowed Schedule A deductions of $26,418. The IRS allowed a $65 adjustment for one-half of the additional self-employment tax. As a result of the federal adjustments, the IRS assessed additional federal tax of $8,579. Appellants did not report the federal changes to respondent. (ROB, p. 2, Exh. C.)

Based on the federal information received, respondent issued a Notice of Proposed Assessment (NPA) dated February 26, 2013. Respondent followed the federal adjustments to the

---

[2] Appellants later explain that they rented out their home in San Jose after moving to Texas in early 2009.

[3] This amount includes an increase in rental income of $3,000. Appellants reported rental income of $16,000 as "other income" on their tax return instead of including this amount on the Schedule E. The additional $3,000 constituted a security deposit received by appellants during the tax year, in addition to rents received during the year of $16,000, for total rental income of $19,000.

extent that the federal changes were consistent with California law. Respondent increased appellants' total taxable income by $80,257, disallowing Schedule C expenses by $30,882, adjusting Schedule E expenses by $18,880, allowing a $65 adjustment for the one-half of the increased self-employment tax, allowing Schedule A employee business expenses of $7,853, and disallowing Schedule A personal property taxes of $3,281, medical expenses of $3,728, other taxes of $3,281, and home mortgage interest of $28,123. After apportioning for California-source income, respondent proposed additional tax of $2,553. (ROB, p. 2, Exh. D.)

Appellants protested the NPA by a letter dated April 23, 2013. Appellants stated that appellant-husband was a part-year resident of California during 2009, having moved to Texas on April 1, 2009. According to their protest and the lease agreement provided with the protest letter, appellants rented out the house in San Jose beginning on May 1, 2009. Appellants further stated that appellant-wife was a nonresident of California for the entire 2009 tax year. Appellants provided documents to substantiate the rental of the San Jose house, as well as information from the property management company. Appellants disputed the error in the California AGI determined by respondent. Appellants further stated that they claimed home mortgage interest for two homes on the federal tax return, but were limited to claiming mortgage interest of $22,000 for California. Appellants also indicated that the business expenses claimed were incurred in Texas. Appellants provided various documents to support these contentions. (ROB, pp. 2-3. Exh. E.)

Respondent acknowledged appellants' protest by a letter dated June 13, 2013. Respondent discussed California's taxation method for nonresidents and part-year residents and requested that appellants provide additional information by July 19, 2013. Appellants responded by a letter dated July 12, 2013, requesting an additional explanation as to how appellants erred in preparing their California income tax return and why they owed additional tax. (ROB, p. 3, Exhs. F & G.)

Respondent responded by a letter dated September 23, 2013, in which respondent provided a copy of the federal audit report. Respondent explained that, upon further review, respondent determined that the adjustment of Schedule E total expenses of $18,880 should not have been

///

///

assessed.[4] Respondent stated that, if appellants had any additional information that they wanted considered, they should provide it by October 30, 2013. Respondent subsequently issued a Notice of Action (NOA) dated December 26, 2013, which reduced the proposed assessment,[5] consistent with respondent's September 23, 2013 letter, and proposed the assessment of $1,868 in additional tax. This timely appeal then followed. (ROB, p. 3, Exh. H; Appeal Letter, Atth.)

Contentions

Appellant's Contentions

Federal Assessment

Appellants state that their attorney contacted the IRS concerning the FTB's claim to reevaluate their California taxes paid in 2009 based on the federal adjustments. Appellants contend that that they are waiting for those results to prove that the AGI reported was not based on revenue received, but revenue that was already accounted for in their return. Appellants state that, although the findings by the IRS were inaccurate, it was their choice to end the proceedings with a settlement. (Appeal Letter, p. 1; AOB, p. 1.)

Appellants dispute respondent's belief that appellants were not truthful in disclosing their taxable income. Appellants rely on a Form W-2 which reflects that appellant-husband was given $27,264.74 as severance pay from his employer in February of 2009 and assert that appellant-husband was taxed at the 48 percent rate even though he was not employed in California in 2009. Appellants contend that they cannot determine how respondent calculated the additional tax. Appellants contend that the calculation of the property tax and other taxes is incorrect as they paid much more than the amounts stated. (Appeal Letter, pp. 1-2, Atths.)

Appellants contend that the federal audit should not be used by California to propose the assessment. Appellants contend that the federal audit was caused by an inexperienced tax preparation company whose business practice has since been revoked by the IRS. Appellants state that, "if there

[4] Respondent reversed this adjustment because appellants had not previously claimed any Schedule E loss either in total California income or as California-source income on the Schedule CA attached to their original return.

[5] The assessment was revised to reflect the elimination of the $18,880 Schedule E adjustment, resulting in a revised increase in total taxable income of $61,377 (i.e., 80,257 - $18,880).

are errors in [their] 2009 State tax preparation, then it should be solely based on the $43,415.85 severance payment and that amount only. And if doing so perhaps an over-payment was made." (ARB, p. 2.)

California-Source Income

Appellants state that, during the filing of their tax returns, they were obligated to enter the total amount of income for the year on the nonresident tax form regardless of its origin. Appellants state that their tax preparer used the Form 540NR and calculated the refund based on the total year's income which may have been incorrect. Appellants contend that they were both nonresidents of California in 2009. Appellants assert that appellant-husband's "wages" reported to California by Philips Lumileds Lighting Company, LLC (Philips) were amounts paid in 2009 for severance pay. Appellants state that the $43,415.85 severance payout was taxed at a different rate than usual, and that $2,494.71 was withheld for California taxes. Appellants state that appellant-husband was laid off from Philips in December of 2008. Appellants contend that, because they had dual residences in both Texas and California, it was necessary for them to move back to Texas permanently. Appellants contend that appellant-husband was unemployed and unable to file for unemployment benefits due to the way Philips had structured the conditions for receiving the severance payout. Appellants contend that appellant-husband was not able to collect unemployment insurance until February 8, 2009. Appellants assert that there are no taxes paid to California from the unemployment insurance benefits and that only federal taxes were paid because the claim was sent to Houston, Texas. Appellants contend that respondent errs in relying on the protest letter, in which appellants stated that appellant-husband moved to Texas on April 1, 2009, when appellants provided documentation that they were preparing to move out of California in 2008 and did so in early 2009. Appellants state that appellant-husband was required to travel back and forth to rent out their home in San Jose, California, in May of 2009. Appellants contend that, after reviewing all Forms W-2 for 2009, it is clear that there was no income generated in California other than $43,415.85, which was a severance payout that was delayed until 2009. (ARB, p. 1.)

With regard to the Unum Insurance Company of America (Unum) payments to appellant-wife, appellants contend that this was sick pay income related to appellant-wife's former

employment at Kaneka Corporation in Pasadena, Texas. Appellants contend that California continued to incorrectly issue the payments with a California tax ID. Appellants state that they find it odd that the FTB would want to tax that income once she moved back to Texas, where state taxes are not required. Appellants dispute respondent's contention that appellants were residents of California for four months in 2009 until the home they owned was rented out. Appellants contend that all Form W-2 statements for 2009 indicate mailing addresses in Texas, except for the severance payout from Philips. Appellants point to the Forms W-2 for 2009 which reflect their mailing address in Houston, Texas, and to the California Employment Development Department (EDD), that show the year and month the payments were made to appellant-wife and the address reported to Unum for 2009 that was their Texas address shown on the Form W-2. (AOB, p. 1, Atths; ARB, pp. 1-2, Atths.)

Appellants contend that they have tried, without success, to contact Philips to acquire some sort of validation and documentation that appellant-husband was terminated in 2008 from actual employment (meaning that he was not to report to the premises any longer), but that his benefits would continue into 2009, giving him the freedom to relocate to find employment, but that he could not claim unemployment insurance until January 2009 after the payout from Philips. Appellants contend that appellant-husband filed for unemployment insurance in February 2009 from Houston, Texas, and that he listed the end of his employment as February 9, 2009, as a condition to receive severance pay. Appellants contend that the evidence shows that they moved out of California due to the state's failing economy, which led to appellant-husband being laid off. (ARB, p. 2.)

In response to the Appeals Division's request for additional briefing, appellants first contend that they already paid taxes on the severance payments.[6] Appellants clarify that they are disputing their residency during 2009. Appellants contend that, because they were not California residents, California may not tax any income appellants received as nonresidents. Appellants contend that the third party sick pay from Unum was "rendered" in Texas. Appellants assert that California has taxed this income for several years, even when appellant-wife did not reside in California. Appellants state that they were told that, because appellant-husband resided in California, appellant-wife's income

[6] It appears that appellants may be referring to the income tax withholding of $2,494.71 reflected on appellant-husband's Form W-2 from Philips.

was considered California income. Appellants provided a copy of their marriage license from Houston, Texas as support for their contention that appellant-wife lived in Houston, Texas until 2004, when she joined appellant-husband in California.[7] (AAB, p. 1, Atth.)

With regard to appellant-wife's employment at Kaneka, appellants provided a letter from Kaneka North America LLC dated August 26, 2015, stating that appellant-wife was employed at Kaneka from December 6, 1993 through September 27, 2001. Appellants also provided a copy of a letter from Unum dated January 19, 2004, which appears to be a cover letter for a Form W-2 for sick pay (disability) benefits paid in 2003.[8] The Unum letter includes a questions section discussing claimant questions. Appellants also provided a copy of a letter from GreenTree Administrators, Inc. to appellant-wife dated October 12, 2001, in which appellant-wife was informed that Kaneka will pay for her Cobra premiums for 12 months. Appellants provided a copy of a Form W-2 for the 2001 tax year to appellant-wife from Kaneka reflecting appellant-wife's address in Texas. (AAB, Atths.)

Appellants also provided various bills reflecting appellant-wife's change of address from Texas to California in 2004. Appellants state that appellant-wife was unemployed and did not receive any utility bills in her name although they shared responsibilities. Appellants assert that appellant-wife obtained a California driver's license. Appellants also contend that documentation, including the renewal of DirecTV services at the Texas address, new mailing address for bank documents, Texas registration form from California to Texas, utility bills, appellant-wife's Texas driver's license issued in 2009, shows that appellant-wife relocated from California to Texas. Appellants further point to documents, such as car rental, moving truck rental and other documents to support their position that they moved out of California in December of 2008 through February of 2009. (AAB, Atths.)

In response to respondent's contentions regarding the additional documents provided by appellants, appellants contend that the documents support a finding that appellant-wife did not reside in California for the entire year of 2009. Appellants state that appellant-wife maintained two residences in Texas and point to the bank statements and utility bills dated through until December 31, 2009 and

---

[7] The marriage license, issued by Harris County, Texas, lists a Milpitas, California address for appellants. (AAB, Atths.)

[8] The letter does not specify appellant-wife as the claimant.

appellant-wife's Texas property taxes paid for one of the residences for the 2009 tax year. Appellants contend that the evidence they provided should support their position that neither appellant-wife nor appellant-husband lived in California in 2009. Appellants further contend that Unum erred by not changing the state of taxation from California to Texas on the Form W-2 when appellants requested the change of address. Appellants point out that mailing address listed on the Form W-2 lists the correct Texas address. As for the connection between Kaneka and Unum, appellants maintain that the employment records show the connection between appellant-wife's employment at Kaneka and the payments by Unum. Appellants further provide a Form W-2 from Unum to appellant-wife for the 2007 tax year listing appellant-wife's address in Texas and California as the state of taxation. Appellants also provide a copy of an NPA to appellants dated August 23, 2004, for the 2001 tax year, in which respondent applied the California method and community income rules to appellants' 2001 tax year. Appellants also provided correspondence postmarked February 19, 2009, addressed to appellant-husband with a change of address notification to appellants' Texas residence. (ASB, p. 1, Atths.)

Respondent's Contentions

Federal Assessment

Citing R&TC section 18622, respondent contends that appellants are required to concede the accuracy of the federal determination or show that the federal determination is erroneous. Respondent contends that appellants have the burden of proof in establishing error. Respondent contends that it followed the federal adjustments to the extent allowable under California law, citing the *Appeal of Edwin R. and Joyce E. Breitman*, 75-SBE-018, decided by the Board on March 18, 1975. Respondent contends that it is not necessarily bound to follow a federal action, citing the *Appeal of Der Wienerschnitzel International, Inc.*, 79-SBE-063, decided by the Board on April 10, 1979. Respondent contends that its proposed assessment is based on the changes reflected in the federal report provided by the IRS. Respondent notes that the federal adjustments resulted in the assessment of federal additional tax and points to the IRS Account Transcript reflecting that appellants were assessed additional federal tax of $8,579 on or about June 4, 2012. Respondent contends that, while the IRS Account Transcript does not show any further reconsideration by the IRS of appellants' 2009 account, respondent accepted appellants' documentation of the claimed Schedule E expenses of $18,880.

Respondent asserts that the numerous documents provided by appellants do not support any further adjustment to respondent's revised proposed assessment. (ROB, p. 4, Exhs. C & L.)

Respondent notes that many of the adjustments made by the IRS involved deductions claimed relating to the San Jose rental property. Although respondent initially followed the federal actions, after a review of additional documentation provided at protest and appeal, respondent made additional adjustments that resulted in reducing the proposed additional tax from $1,868 to $1,667. Respondent notes that appellant stated in their protest letter that, after they moved to Texas on April 1, 2009, appellants rented out their San Jose home. Respondent notes that appellants originally reported $16,000 of rental income as "other income" rather than on their Schedule E, which reflected no rents received. Respondent notes that appellants provided a Form 1099-MISC reflecting $16,000 in rents received from the KRC Group, Inc. (KRC).[9] Respondent notes that, according to the rental agreement dated April 22, 2009, appellants rented out the San Jose house beginning on May 1, 2009, for $2,000 per month payable to KRC. The agreement also reflected a total of $3,000 in security deposits paid to appellants. As such, respondent contends that appellants received a total of $19,000 (i.e., $16,000 + $3,000) as rental income from the San Jose rental property. Respondent further notes that appellants reported various expenses on their Schedule E totaling a loss of $29,530 and appellants limited their rental real estate loss to $25,000 in accordance with the passive activity rules relating to rental real estate. (ROB, pp. 4-5.)

Respondent notes that, on their Schedule CA, appellants subtracted from California AGI the reported rental income of $16,000 and added back the claimed rental loss of $25,000. Thus, respondent states that appellants did not include the net loss on their San Jose rental property in either their total California AGI or California source income. Respondent states that, on the correctly prepared return, attached to respondent's opening brief, respondent corrects the Schedule E by listing the rental income ($19,000) and subtracting the rental expenses ($18,986) for net rental income of $14. Respondent states that the $14 rental income is correctly reported on California Form 540NR, Schedule CA, line 17, columns A, D, and E. (ROB, p. 5, Exhs. A & J.)

[9] KRC provided property management services with respect to the San Jose house.

Respondent further notes that appellants deducted property taxes of $3,281 twice: (1) on Schedule A as "property taxes"; and (2) on Schedule E as "taxes." Respondent notes that both amounts were disallowed at audit by the IRS. Respondent contends that, upon a review of the property tax bill from Santa Clara County, appellants paid $5,607, which included property tax of $4,948 and special assessments of $659. Respondent states that it allowed the deduction for property tax of $4,948 (but not special assessments),[10] and allocated $3,299 as taxes on the Schedule E (representing 8 months when the property was rented) and $1,649 as property taxes on the Schedule A. (ROB, p. 5, Exh. J; AOB, Atths.)

Respondent also notes that appellants reported $4,824 twice: (1) as "points not reported to you on Form 1098" on the Schedule A; and (2) as "Mortgage (paid to banks, etc.)" on the Schedule C. Respondent notes that appellants also reported and deducted $20,477 of "Mortgage interest paid to banks, etc." on the Schedule E. Respondent contends that the IRS disallowed the $4,824 deduction from Schedule A and Schedule C and reduced the mortgage interest claimed on appellants' Schedule E from $20,477 to $13,650. Respondent states that appellants provided two Forms 1098 with their April 24, 2013 protest letter to substantiate mortgage interest paid to lenders of $4,824.06 and $15,652.93 (totaling $20,476.99). Respondent states that it adjusted appellants' mortgage interest paid amount to $20,477 and allocated $13,650 to rental expenses on the Schedule E and $6,826 as mortgage interest to the Schedule A. Respondent states that the allocation corresponds to eight months of rental income and four months of interest paid during the time appellants lived in California. (ROB, p. 5, Exhs. A, C, E, & J.)

Respondent also made additional adjustments to the Schedule E in appellants' favor by allowing $750 for commissions to the property management firm, $1,280 for management fees, and $7 for repairs. Respondent states that the effect of the federal adjustments to Schedule E resulted in income in the amount of $9,880. However, respondent contends that its adjustments reduced the $9,880 rental income amount to $14. Respondent states that this reduced appellants' taxable income

---

[10] Respondent states that real estate taxes are imposed upon the value of the real property, but no deduction is allowed when the taxes are imposed for local benefit, such as special assessments for property improvements, citing Treasury Regulation 1.164-3(b). (ROB, p. 5.)

for appellants' California tax, and reduced the proposed additional tax to $1,667. (ROB, p. 6, Ex. J.)

California-Source Income

Respondent contends that appellants have not shown any error in respondent's calculation of appellant's California tax pursuant to the California method formula provided by R&TC section 17041. As for appellants' contention that the $27,264.74 of severance pay from appellant-husband's California employer should not be considered California-sourced income, respondent notes that appellants do not dispute that the severance pay was itemized as compensation on the Form W-2 issued to appellant-husband from Philips Lumileds Lighting Company, LLC (Philips). Respondent notes that the Form W-2 reflects appellants' mailing address as the San Jose, California address. Further, respondent notes that the $27,264.74 item is described as "lump sum severance." Respondent contends that appellants do not dispute that the severance pay was compensation for work performed in California. Respondent further contends that information from the EDD pertaining to appellant-husband for 2009 corroborates the California wage information stated in the Form W-2 from Philips. (ROB, p. 6, Exhs. J, K, & M.)

Citing R&TC section 17041, subdivisions (b) and (i), respondent contends that nonresidents and part-year residents of California are taxed on income derived from a California source. Respondent contends that the taxable income of a nonresident is to be determined using only the gross income from sources within California pursuant to R&TC section 17951. Respondent contends that it is well settled that the source of income is determined by examining the location in which services are performed without regard for taxpayer's state of residency, citing the *Appeal of Robert C. Thomas and Marian Thomas*, 55-SBE-006, decided by the Board on April 20, 1955, and the *Appeal of Charles W. and Mary D. Perelle*, 58-SBE-057, decided by the Board on December 17, 1958. (ROB, p. 6.)

Respondent contends that gross income includes compensation for services, including severance pay, citing R&TC section 17071, IRC section 61(a)(1), and Treasury Regulation section 1.61-2(a)(1). Respondent contends that appellants do not dispute that appellant-husband worked for Philips in California before moving to Texas in 2009. Respondent argues that benefits, such as sick leave, vacation pay, and severance, are a direct result of his California employment and are, therefore,

includable in California income, citing the *Appeal of Edwin O. and Wanda L Stevens*, 86-SBE-100, decided by the Board on May 6, 1986. As for appellants' contention that appellant-wife's income from Unum are not California wages, respondent contends that appellants have not provided any evidence to dispute the reporting of her California wages of $32,960 on her Form W-2, which lists her income as California wages.[11] Respondent states that the Form W-2 is also corroborated by information from the EDD. (ROB, p. 7, Ex. N.)

In response to the Appeals Division's request for additional briefing, respondent reviewed appellants' additional documentation and addresses whether sick pay income from Unum was not taxable California source income. With regard to the Form W-2 from Kaneka for 2001 and the Kaneka employment verification letter dated August 26, 2015, respondent contends that these documents demonstrate that appellant-wife was employed by Kaneka during the 2001 tax year. However, respondent contends that the October 12, 2001 letter from GreenTree Administrators discussing appellant-wife's Cobra election does not make any reference to sick pay or a disability claim under a Unum policy. Respondent argues that the January 19, 2004 letter from Unum does not specifically address appellant-wife and, significantly, the letter does not indicate whether the disability claim or sick pay was related to appellant-wife's employment at Kaneka. (RAB, pp. 1-2.)

As to the Form W-2 from Kaneka for 2001, respondent notes that the information on the form shows that the income was earned in Texas. Respondent contends, however, that the 2009 Form W-2 from Unum shows that all of the amounts appellant-wife received from Unum in 2009 were paid to her while she was a resident of California. Respondent contends that appellant-wife's 2009 Form W-2 bears more weight as to her residence in 2009, than the Form W-2 issued by Kaneka in 2001. Respondent also notes that appellants provided: (1) bills from DirecTV dated April 10, 2004 and December 10, 2004, both addressed to appellants' San Jose address; (2) a third correspondence from DirecTV dated February 21, 2009, addressed to appellant-wife at a Houston address; (3) a statement from Chase Bank dated March 26, 2004 to April 14, 2004, addressed to appellant-wife at a Fremont, California address; and (4) a statement from Community Resource Credit Union for the period

[11] According to the Unum Form W-2, the information indicates that the amounts paid were third-party sick pay. (AAB, Atths.)

February 1, 2009 to March 31, 2009, that was mailed to appellant-wife at a Houston, Texas, address. Respondent contends that these documents show that appellant-wife moved from Texas to California on or before March of 2004. (RAB, pp. 2-3.)

As to the evidence appellants provided in support of showing that appellant-wife was not a California resident in 2009, respondent notes that appellant provided the following bills and statements dated at various times in 2009 and which were addressed to appellants' Texas address: (1) a DirecTV statement dated February 21, 2009; (2) a statement from Community Resource Credit Union for the period February 1, 2009 to March 31, 2009; (3) a receipt from the Texas Department of Transportation dated June 4, 2009; (4) a receipt from CenterPoint Energy with a handwritten notation of June 3, 2009, and a due date of June 17, 2009; (5) a statement from the City of Houston Water Department indicating a payment due date of July 6, 2009; and (6) a copy of appellant-wife's Texas driver's license with an expiration date of June 16, 2011, but no issuance date. Respondent contends that these items establish that appellant-wife relocated to Texas from California at some point before February 1, 2009, but argues that appellants have not established the exact date of relocation based on these items. As such, respondent contends that appellants have not established that appellant-wife was not a California resident during 2009, if only for January 2009 and perhaps additional days in February 2009. (RAB, pp. 3-4.)

Respondent further contends that appellants have not provided any additional evidence to show error in respondent's determination. Respondent notes that appellant was requested to provide information to establish that the disability income appellant-wife received from Unum was not California-source income. Respondent contends that the evidence appellants produced, including the Form W-2 from Unum for 2009, shows California as the state of taxation and is corroborated by the EDD information showing California personal income tax wages withheld from the Unum payments.[12] Respondent further notes that appellants were requested to provide documentation showing a link between the disability claim and appellant-wife's Texas employment with Kaneka. Respondent contends that the documents provided by appellants do not establish such connection. (RAB, p. 4.)

[12] Contrary to respondent's contention, according to the EDD letter dated January 21, 2015, no income tax was withheld from the Unum payments. (ROB, Exh. N.)

Applicable Law

Burden of Proof

The FTB's determination is presumed correct and a taxpayer has the burden of proving it to be wrong. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Michael E. Myers*, 2001-SBE-001, May 31, 2001.) Unsupported assertions are not sufficient to carry a taxpayer's burden of proof. (*Appeal of Aaron and Eloise Magidow*, 82-SBE-274, Nov. 17, 1982.)

Assessment Based on Federal Action

R&TC section 18622, subdivision (a), provides, in pertinent part, that if the IRS makes any changes or corrections to any item required to be shown on a taxpayer's federal tax return that would increase a taxpayer's California tax liability, that taxpayer is required to report each change or correction within six months after the final federal determination of the change or correction and concede the accuracy of the determination or state why it is erroneous.

California Method

R&TC section 17041, subdivision (a), imposes a tax upon the entire income, from all sources, of every California resident. R&TC section 17041, subdivision (b), imposes a tax upon the California-source income of part-year residents and nonresidents. The tax on part-year residents and nonresidents is determined first by calculating the tax on all income, regardless of source, as though the taxpayer were a full-year resident. (*Appeal of Louis N. Million*, 87-SBE-036, May 7, 1987.) The actual California tax liability is then factored out by applying the ratio of California AGI to total AGI from all sources. (*Id.*) The purpose of the method is to apply the graduated tax rates to all persons not just those who live in California for the full year; the method does not tax out-of-state sources of income, but merely takes the out-of-state income into consideration in determining the tax rate that should apply to California-source income.[13] (*Id.*)

---

[13] The fundamental fairness and constitutionality of this method of taxing the California-source income of part-year residents has been upheld by New York's highest court, and the United States Supreme Court refused to hear an 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 of reported total income, should be taxed on the $20,000 of New York-source income at the same rate as a New York resident with $100,000 of total income (and not at the same rate as a New York resident with $20,000 of total income).

California-Source Income

R&TC section 17041, subdivision (b), provides that California imposes a tax upon the California-source income of part-year residents and nonresidents for periods when they are nonresidents and upon their income from all sources for periods when they are California residents. For purposes of computing California taxable income, R&TC section 17951, and California Code of Regulations section (Regulation) 17951-1, subdivision (a), provide that the gross income of nonresidents includes only their gross income from sources within California.

Income received from personal services performed in California is income from a California source and is taxable by this state. (*Appeal of Edwin O. and Wanda L. Stevens, supra*, citing *Appeal of Janice Rule*, 76-SBE-099, Oct. 6, 1976.) Further, benefits, such as sick leave, vacation pay, bonuses and severance pay, earned by a nonresident for services performed in California are considered California source income. (*Appeal of Edwin O. and Wanda L. Stevens, supra*.) The factor which determines the source of income from personal services is the place where the services were actually performed and not the residence of the taxpayer or the place of payment. (*Id*.)

STAFF COMMENTS

Appellants dispute respondent's proposed assessment based on appellant-husband's severance pay and appellant-wife's sick pay disability payments. Appellants contend that, as they were not California residents in 2009, they are not subject to California income tax on these amounts. With regard to the severance pay, it is undisputed that this income arose from appellant-husband's former employment in California. As such, appellant-husband's severance pay is California-source income and is subject to California income tax regardless of appellants' residency in 2009. (*Appeal of Edwin O. and Wanda L. Stevens, supra*.)

As to the sick pay disability payments, appellants contend that these payments arose from appellant-wife's former employment in Texas. The parties should be prepared to discuss whether these payments from Unum are related to appellant-wife's former employment with Kaneka. Respondent relies on the 2009 Form W-2 issued by Unum to appellant-wife which lists California as the state of taxation and the EDD letter dated January 21, 2015 in support of its determination that this income is subject to California income tax. Appellants provided a Form W-2 from Kaneka for 2001

and the Kaneka employment verification letter dated August 26, 2015, establishing that appellant-wife was employed by Kaneka in 2001. Appellants also provide a January 19, 2004 letter from Unum addressing the sick pay disability payments for 2003. The Unum letter does not indicate whether the disability claim or sick pay was related to appellant-wife's employment at Kaneka. Appellants also provided a October 12, 2001 letter from GreenTree Administrators discussing appellant-wife's Cobra election, but the letter does not make any reference to sick pay or a disability claim under a Unum policy. The parties should be prepared to discuss whether these documents support a finding that appellant-wife's payments from Unum were related to her former employment. If the Board determines that the Unum payments are related to appellant-wife's former employment in Texas, then the payments are not California source income.

However, if the Board determines that appellants were part-year residents in California in 2009, then the California method pursuant to R&TC section 17041 will apply to tax a portion of that sick pay disability income in California. The parties should be prepared to discuss when appellants moved to Texas. In their protest letter, appellants originally indicated that they both moved from California to Texas on April 1, 2009. Subsequently, appellants contend that they both moved out of California in late 2008 and early 2009. The parties should also be prepared to discuss whether the documentation provided by appellants supports a finding that they moved to Texas in January or February of 2009.

As to the federal adjustments, appellants should be prepared to address whether they dispute the adjustments and provide supporting evidence to demonstrate that respondent's proposed assessment based on the federal adjustments is in error.

If either party has any additional evidence to present, that party should provide their evidence to the Board Proceedings Division at least 14 days prior to the oral hearing pursuant to California Code of Regulations, title 18, section 5523.6.[14]

[14] 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.