

**OFFICE OF TAX APPEALS
STATE OF CALIFORNIA**

In the Matter of the Appeal of:) OTA Case No. 18011740
)
ARTHUR ENGELEN AND) Date Issued: June 26, 2018
)
TERESA SMITH-ENGELEN)
_____)

OPINION

Representing the Parties:

For Appellants: Arthur Engelen and Teresa Smith-Engelen
For Respondent: Rachel Abston, Senior Legal Analyst

J. ANGEJA, Administrative Law Judge: Pursuant to Revenue and Taxation Code section 19045,¹ Arthur Engelen and Teresa Smith-Engelen (appellants) appeal an action by the Franchise Tax Board (FTB or respondent) in proposing additional tax of \$3,837 for the 2012 tax year.

Appellants waived their right to an oral hearing and therefore the matter is being decided based on the written record.

ISSUE

- 1. Whether appellants’ 2012 pension income is subject to tax.
- 2. Whether FTB correctly adjusted appellants’ reported income tax withholdings for 2012.

FACTUAL FINDINGS

- 1. Appellants filed a timely joint 2012 California income tax return, reporting federal adjusted gross income (AGI) of \$186,347, less California subtractions of \$51,459 and itemized deductions of \$9,753, for taxable income of \$125,135 and tax of \$6,844.

¹ Unless otherwise indicated, all “Section” references are to sections of the California Revenue and Taxation Code. Section 19045 states that taxpayers have 30 days to appeal FTB’s action upon taxpayer’s protest to the board (Board of Equalization). Effective July 1, 2017, Section 20(b) was amended to read, “Unless the context requires otherwise, as used in this code or any other code, ‘board’ with respect to an appeal, means the Office of Tax Appeals.”

- Appellants' California subtractions included \$39,714 of pension income shown on Form 1099-R from Lockheed Martin Salaried Savings Plan. After subtracting exemption credits of \$208, appellants reported a total tax liability of \$6,636. Appellants applied their claimed withholding credit of \$9,000, and reported an overpayment of \$2,364.
2. Although appellants claimed state tax withholdings of \$9,000, appellants' Lockheed Form W-2 shows state withholdings of \$6,640.87; appellants' Lockheed Martin Salaried Savings Plan shows state tax withholdings of \$794.29; and appellants' Lockheed Martin Capital Accumulation Plan shows state tax withholdings of \$608.85, for total state tax withholdings of \$8,044.01. The difference between this amount and the \$9,000 amount claimed is \$956 (rounded). Appellants' Lockheed W-2 shows California State Disability Insurance (SDI) withholding of \$955.85.
 3. FTB examined appellants' return and determined that their claimed \$9,000.00 withholding credit erroneously included the SDI withholdings of \$955.85. When FTB processed appellants' return, it reduced appellants' withholding credit to \$8,044, rounded ($\$9,000.00 - \$955.85 = \$8,044.15$), and issued a \$1,408 refund (rounded) on May 23, 2013.
 4. Subsequently, FTB examined appellants' return and determined that, in relevant part, appellants erroneously subtracted pension income of \$39,714 from their California AGI. (FTB also disallowed two additional deductions for gambling losses of \$773 each, which appellants concede and are not at issue herein.) Accordingly, on February 5, 2016, FTB issued a Notice of Proposed Assessment (NPA) that proposed to assess additional tax of \$3,837.
 5. By letter dated April 1, 2016, appellants protested the NPA. In their letter, appellants assert that "[t]he pension and annuities adjustment entry is per the instructions for Column B line 16. The first paragraph in the instructions states that 'or partially taxable distributions from a pension plan' is allowed as an adjustment." (Emphasis in original). Appellants assert that they received a \$70,156 pension distribution, of which \$30,442 was a total distribution and \$39,714 was a partial distribution, and therefore the entry of \$39,714 in Column B, line 16 is correct. Appellants also assert that FTB reduced appellants' initially claimed refund amount of \$2,364, and then assessed additional tax after issuing the reduced refund, without adequate explanation.

6. On May 30, 2017, FTB issued a Notice of Action affirming the NPA. This timely appeal followed.

DISCUSSION

1. Pension Income

Unless an exemption applies, pensions are includible in the gross income of all California residents who receive them. (See Rev. & Tax. Code, §§ 17071, 17504; Int. Rev. Code, §§ 61, 402(a).) It is well settled that pension income received by a resident of California is taxable by California, even though the taxpayer may have been a resident of another state when engaged in the employment from which the pension income was derived. (See *Appeal of Daks*, 94-SBE-001, Jan. 5, 1994; *Appeal of Simmons*, 83-SBE-216, Sept. 15, 1983.)

Here, there is no dispute that appellants received the disputed pension income of \$39,714, and we are aware of no tax exemption or exclusion that applies to that pension income. Appellants rely on their interpretation of the Schedule CA instructions for Column B, line 16, for the proposition that the pension income is exempt; however, appellants appear to have misinterpreted those instructions. Specifically, the instructions for Column B, Line 16 provide:

“Generally, no adjustments are made on this line. However, if you received Tier 2 railroad retirement benefits or partially taxable distributions from a pension plan, you may need to make the following adjustments.”

The instructions proceed to identify the situations in which an adjustment *may* need to be made. None of those situations include the situation here. Appellants’ misinterpretation of the instructions does not support their claimed income exclusion. The pension income they received is subject to California tax.

2. Withholding Adjustment

Appellants claimed \$9,000 in California withholding credits, but the aggregate amount of their withholdings was only \$8,044.01, reflecting a difference of approximately \$956. That is also the approximate amount by which FTB reduced appellants’ initially claimed refund, from \$2,364 to \$1,408 ($\$2,364 - \$1,408 = \$956$). Because appellants’ Lockheed Martin W-2 shows California SDI withholding of \$955.85, it appears that appellants mistakenly treated the

disability insurance withholding as part of their income tax withholdings. Regardless, because appellants' W-2 statements only establish a total withholding amount of \$8,044, rather than \$9,000, FTB properly reduced appellants' refund.

HOLDING

Appellants' 2012 pension income is subject to tax, and appellants' claimed withholdings were properly reduced.

DISPOSITION

Respondent's action in is sustained.

DocuSigned by:
Jeff Angeja
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Jeffrey G. Angeja
Administrative Law Judge

We concur:

DocuSigned by:
Teresa A. Stanley
0EC6C6ACCC6A44D...
Teresa A. Stanley
Administrative Law Judge

DocuSigned by:
Grant S. Thompson
FC572D5881AE41B...
Grant S. Thompson
Administrative Law Judge