

**OFFICE OF TAX APPEALS  
STATE OF CALIFORNIA**

In the Matter of the Appeal of:  <b>JAMES K. PADGETT AND SHANE PADGETT</b> <hr style="width: 100%;"/>	) ) ) ) ) )	OTA Case No. 18011215  Date Issued: November 1, 2018
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**OPINION**

Representing the Parties:

For Appellants:	James K. Padgett Shane Padgett
For Respondent:	David Kowalczyk, Tax Counsel Craig Scott, Assistant Chief Counsel

S. HOSEY, Administrative Law Judge: Pursuant to Revenue and Taxation Code section 19047,<sup>1</sup> James K. and Shane Padgett (Appellants) appeal an action by the Franchise Tax Board (FTB or respondent) proposing \$1,614 of additional tax and applicable interest for the 2013 tax year.

Office of Tax Appeals (OTA) Administrative Law Judges Sara A. Hosey, Alberto T. Rosas, and Andrew J. Kwee held an oral hearing for this matter in Sacramento, California, on August 28, 2018. At the conclusion of the hearing, the record was closed and this matter was submitted for decision.

**ISSUE**

Have appellants shown that FTB improperly proposed additional tax for the 2013 tax year?

**FACTUAL FINDINGS**

1. Appellants moved to California from New Mexico in June 2013.

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<sup>1</sup> Unless otherwise indicated, all statutory (“section” or “§”) references are to sections of the Revenue and Taxation Code.

2. Appellants filed a joint 2013 California Nonresident or Part-Year Resident Income Tax Return (Form 540NR) reporting federal adjusted gross income (AGI) of \$67,533, and California adjustments of \$29,729, for a California AGI of \$37,803.
3. FTB received information that showed the Internal Revenue Service (IRS) adjusted Appellants' federal return for unreported wages of \$80 and pension income of \$40,279.
4. FTB issued a Notice of Proposed Assessment (NPA) that proposed increasing Appellants' taxable income by \$40,359 and assessing additional tax of \$2,647.<sup>2</sup>
5. Appellants protested the NPA, arguing the pension income was received while living in New Mexico and should not be taxed by California.
6. FTB issued a Notice of Action (NOA) that revised the NPA by using the California Nonresident or Part-Year Resident method of taxation in section 17041(b) and reducing the proposed additional tax to \$1,614, plus interest.
7. Appellants filed this timely appeal.

#### DISCUSSION

A proposed deficiency assessment based on federal adjustments to income is presumed to be correct, and the burden is on the taxpayer to prove it is erroneous. (*Appeal of Lew*, 78-SBE-073, Aug. 15, 1978.)<sup>3</sup> Section 18622 requires a taxpayer to concede the accuracy of the federal changes or to state wherein the changes are erroneous. In taxing nonresidents or part-year residents, California law takes into account a taxpayer's "entire taxable income" for the year, including income from non-California sources, in determining the applicable tax rate. (§ 17041(b)(2).) Generally speaking, the tax rate is applied to "all items of gross income and all deductions, regardless of source" for any part of the year during which the taxpayer was a California resident, and to the "gross income and deductions derived from sources within this state" for any part of the year during which the taxpayer was not a California resident. (§ 17041(i)(1).) California's method of computing tax liability for part year-residents does not impose a tax on the part-year resident's income from non-California source income. (*Appeal of Boone*, 93-SBE-015, Oct. 28, 1993.)

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<sup>2</sup> The NPA also included a 2.5 percent premature distribution tax of \$819. FTB conceded the premature distribution tax of \$819 and agreed to reduce the tax proposed on the NOA from \$1,614 to \$1,303, plus interest.

<sup>3</sup> Published decisions of the Board of Equalization, designated by "SBE" in the citation, are available on that Board's website at: <<http://www.boe.ca.gov/legal/legalopcont.htm>>.

In this case, section 17041(b)(2) requires appellants' non-California source income, the income received while residents in New Mexico, to be part of a formula for computing appellants' California income tax liability. The New Mexico pension income and wages must be included in the total AGI from all sources to determine the correct tax rate that applies to the California source income. Appellants' revised AGI from all sources of \$107,892, less the standard deduction of \$7,812, totals taxable income of \$100,080 and tax due of \$4,432. The California tax rate is determined by dividing the total tax of \$4,432 by the total taxable income of \$100,080 to arrive at 4.43 percent tax rate.

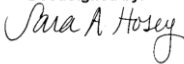
California's method of computing a part-year resident's tax is not the same as taxing non-California source income, but rather uses the taxpayer's total income from all sources to determine the rate of tax. While appellants argued at the hearing that the pension income was received while living in New Mexico and should not be taxed by California, FTB did not in fact tax the pension income. The pension income from New Mexico only was used to determine the tax rate that applies in taxing appellants' California-source income. Appellants have not shown error in FTB's proposed deficiency assessment based on federal adjustments.

#### HOLDING

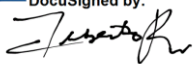
Appellants have failed to demonstrate that FTB's imposition of additional tax was improper, except for the FTB concession mentioned above.


DISPOSITION

FTB's NOA tax deficiency determination is reduced to \$1,303 (plus interest), consistent with FTB's concession described above. In all other respects, FTB's determination is sustained.

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Sara A. Hosey  
Administrative Law Judge

We concur:

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Alberto T. Rosas  
Administrative Law Judge

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Andrew J. Kwee  
Administrative Law Judge