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OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	)	OTA Case No. 18042732
	)	
	)	Date Issued: January 18, 2019
WILLIAM A. BORNHOEFT	)	
	)	
	)	

OPINION

Representing the Parties:

For Appellant: William A. Bornhoeft

For Respondent: Rachel Abston, Senior Legal Analyst

For Office of Tax Appeals: Tom Hudson, Tax Counsel III

K. GAST, Administrative Law Judge: Pursuant to California Revenue and Taxation Code section 19045,[1] William A. Bornhoeft (appellant) appeals an action by the Franchise Tax Board (FTB or respondent) in proposing additional tax of $126, plus interest, for the 2013 tax year.

Appellant waived his right to an oral hearing, and therefore this matter is being decided based on the written record.

ISSUE

Has appellant shown error in respondent's assessment, which is based on information received from the Internal Revenue Service (IRS)?

FACTUAL FINDINGS

1. During the 2013 tax year, appellant was a California nonresident, who timely filed a nonresident income tax return on Form 540NR. As relevant here, on this return,

[1] Unless otherwise indicated, all statutory "section" or "§" references are to sections of the California Revenue and Taxation Code for the tax year at issue.

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appellant reported California adjusted gross income (AGI) of $15,616 that consisted of W-2 wages derived from a California source.

2. Subsequently, respondent received information from the IRS indicating that, for the 2013 tax year, it had increased appellant's federal AGI by $10,411 related to unreported "other income."

3. Based on the IRS information, respondent issued a Notice of Proposed Assessment (NPA), treating the $10,411 as California source income. The NPA, thus, increased appellant's California AGI by $10,411 to match the IRS-adjusted increase to his federal AGI. This resulted in proposed additional tax due of $638, plus interest.

4. Appellant timely protested the NPA, contending he was California nonresident and the income in question of $10,411 was not derived from California sources. He asserted that, during the 2013 tax year, he was living in Ohio and paid all taxes due on the additional income.

5. Respondent affirmed its NPA with a Notice of Action (NOA), but revised the calculation of tax due by excluding the $10,411 from appellant's California AGI because it was derived from Ohio, not California, sources. Instead, respondent, as it did in its NPA, included the $10,411 in appellant's AGI from all sources for purposes of calculating a California tax rate of 5.4 percent that was used to determine his California nonresident tax. This resulted in a revised additional tax due of $126, plus interest, which was lower than that shown in the NPA. This timely appeal followed.

DISCUSSION

IRS Assessment

A taxpayer must report federal changes to income or deductions to respondent within six months of the date the federal changes become final. (§ 18622(a).) The taxpayer must concede the accuracy of the federal changes or prove that those changes are erroneous. (*Ibid.*) Respondent's deficiency assessment that is based on a federal audit report is presumed to be correct. (*Appeal of Aaron and Eloise Magidow*, 82-SBE-274, Nov. 17, 1982.)[2] Unsupported assertions are insufficient to satisfy a taxpayer's burden of proof. (*Ibid.*)

[2] Board of Equalization (BOE) opinions are generally available for viewing on its website: <http://www.boe.ca.gov/legal/legalopcont.htm#boeopinion>.

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On appeal, appellant contends the $10,411 of unreported income was never paid to him, but was instead paid "directly to the lawyers." He, therefore, appears to be arguing that the income should be taxed to the lawyers, who directly received and presumably earned it, and not him. However, we disagree with this contention. The record contains sufficient evidence to support that appellant did in fact earn the $10,411 of unreported income and, as such, he was subject to tax on it for federal purposes.

First, appellant's 2013 IRS Wage and Income Transcript indicates the $10,411 was paid to appellant as "other income" on Form 1099-MISC by the payer, "Michaels Stores, Inc. & Subs." Second, respondent received information from the IRS that shows the IRS increased appellant's federal AGI by the $10,411. Third, appellant's 2013 IRS Account Transcript shows the $10,411 was added to his self-reported federal AGI, which resulted in a federal tax assessment that he paid. Consequently, the federal assessment was not canceled or reduced, and there is no evidence to suggest appellant contested it before the IRS. Lastly, appellant admitted, in his protest of respondent's NPA, that he paid all taxes due on the income in question when he was living in Ohio, which appears to mean he paid taxes on this income for federal and Ohio personal income tax purposes. This admission is inconsistent with appellant's contention on appeal that he did not earn the income, and he has not otherwise explained this inconsistency.[3]

Based on the above, appellant has not shown error in the IRS assessment or in respondent's proposed assessment, which is based on the IRS audit report. Accordingly, respondent properly treated the $10,411 as appellant's income for the 2013 tax year. Because we conclude appellant earned this income, we next address whether respondent correctly calculated his California nonresident tax due based on this additional income.

The California Method

Appellant also contends that by taxing him on the $10,411 of unreported income, respondent is taxing both him and the lawyers on the same income. He further contends that

[3] Appellant has not explained the circumstances that led to his contention that the payment was made to the lawyers, but we note that the assignment of income doctrine might be applicable to his situation. Under that doctrine, it is common for payments to third parties (here, the lawyers) to be taxable to the party (here, appellant) who controlled the money or benefitted from the payment. The guiding principle in assignment of income cases is that income is taxed to the person or entity (here, appellant) who in fact controls the earning of the income rather than the person or entity (here, the lawyers) who ultimately receives the income. (See, e.g., *Vnuk v. Commissioner* (8th Cir. 1980) 621 F.2d 1318, 1320.) Thus, even if appellant did not receive the $10,411 payment directly and instead assigned it to his lawyers, he is still liable for the tax on it.

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since the money was not paid to a California resident or derived from California sources, no tax is due.

Appellant's contentions are misplaced. Respondent is not taxing appellant's additional income of $10,411, which respondent treated as Ohio, not California, source income. Rather, respondent is merely using the $10,411 for purposes of computing, among other things, the appropriate California *tax rate* to apply to appellant's income that has a California source. The calculation of this tax rate, which is statutorily required by section 17041(b), is part of a multistep process of taxing nonresidents, known as the "California Method."[4]

Here, and as shown more fully in its NOA, respondent calculated a hypothetical California resident tax (i.e., $3,375) on appellant's recomputed total taxable income derived from all sources (i.e., $62,466, which is $55,961 of federal AGI as filed, plus $10,411 of unreported income, less a California standard deduction of $3,906). Respondent divided the $3,375 by $62,466, to derived a California tax rate of 5.4 percent. This 5.4 percent was then multiplied by appellant's California AGI (i.e., California source income) of $14,697, which consisted solely of as filed California wages and therefore *excluded* the $10,411,[5] to compute a tax due of $794. After reducing this tax by a prorated exemption credit[6] and the tax appellant reported as paid on his California return as filed, respondent computed additional tax due of $126, plus interest. Indeed, the reason appellant's additional principal tax due was reduced from $638 (as shown in the NPA) to $126 (as shown in the NOA) was respondent excluded the $10,411 from appellant's California AGI, or California source income.

[4] The BOE, our predecessor agency, has consistently held that this method does not result in an assessment of tax on income from out-of-state sources. (See *Appeal of Louis N. Million*, 87-SBE-036, May 7, 1987 & *Appeal of Dennis L. Boone*, 93-SBE-015, Oct. 28, 1993). The purpose of the California Method is to preserve the progressive nature of the income tax system, so that taxpayers with higher incomes are taxed at a higher rate than taxpayers with lower incomes.

[5] Appellant's California source income of $14,697 was computed by subtracting a prorated standard deduction of $919 from his as filed California source wages of $15,616, which, again, does not include the $10,411 of unreported income. The prorated standard deduction was computed using a similar, but different percentage from that computed for the California tax rate (i.e., the $10,411 was included in the denominator of prorated standard deduction percentage, but it was not included in the numerator).

[6] The prorated exemption credit was also computed using a similar, but different percentage from that computed for the prorated standard deduction and California tax rate (i.e., the $10,411 was included in the denominator of prorated exemption credit percentage, but it was not included in the numerator).

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Accordingly, respondent properly applied the California Method when computing appellant's California nonresident tax, and therefore did not tax the $10,411 of income in question.

HOLDING

Appellant has not shown error in respondent's assessment, which is based on information received from the IRS.

DISPOSITION

Respondent's action is sustained.

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Kenneth Gast
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Kenneth Gast
Administrative Law Judge

We concur:

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

DocuSigned by:
Jeff Angeja
0D390BC3CCB14A9...
Jeffrey G. Angeja
Administrative Law Judge