

**OFFICE OF TAX APPEALS**  
**STATE OF CALIFORNIA**

In the Matter of the Appeal of:                     ) OTA Case No. 18053118  
  )     )  
**TRACY L. AND RICHARD C. ROUVIERE**         ) Date Issued: June 12, 2019  
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**OPINION**

Representing the Parties:

For Appellants:   Tracy L. Rouviere, Taxpayer  
  Richard C. Rouviere, Taxpayer

For Respondent:   Rachel Abston, Senior Legal Analyst

For Office of Tax Appeals:                             Andrea Long, Tax Counsel

A. KWEE, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, Tracy L. and Richard C. Rouviere (appellants) appeal an action by respondent Franchise Tax Board (FTB) proposing additional tax of \$646 plus applicable interest for the 2013 tax year. This matter is being decided based on the written record because appellants waived the right to an oral hearing.

**ISSUE**

Whether appellants established error in FTB’s proposed assessment for the 2013 tax year, which is based on a final federal determination.

**FACTUAL FINDINGS**

1. Appellants, a married couple, jointly filed a 2013 California Nonresident or Part-Year Resident Income Tax Return (Form 540NR). Both spouses signed the return, which was dated April 14, 2014. On the return, appellants reported that for 2013, appellant-husband was domiciled in California, spent 365 days in California during the tax year, and that both appellants owned a home or property in California. Appellants reported federal adjusted gross income (AGI) of \$162,054, and California taxable income of \$112,030, for

a total state tax of \$5,566. After applying withholdings of \$7,087, appellants reported an overpayment of \$1,521, which FTB refunded to appellants.

2. Based on the IRS's review of income tax forms furnished to the IRS and to appellants, the IRS determined that appellants failed to report all of their gross income on their 2013 federal income tax return. The IRS made a \$11,547 adjustment to appellants' income for unreported wages of \$1,815, pension income of \$100 reportedly paid to appellants by JP Morgan, and rental income of \$9,632 reportedly paid to appellants by Marceau Real Estate. The IRS also reduced the itemized deduction for medical expenses by \$1,155 (i.e., 10 percent of the adjustment to income, because medical expenses are allowable to the extent they exceed 10 percent of AGI). On April 25, 2016, the IRS assessed taxes, interest, and penalties based on these federal adjustments. The IRS also reported to FTB that it had made these adjustments to appellants' 2013 federal tax return.
3. FTB issued a Notice of Proposed Assessment (NPA) on April 25, 2017, making the same adjustments that the IRS made at the federal level. The NPA proposes additional tax of \$1,062, plus interest.
4. On June 8, 2017, appellant-wife protested the NPA on behalf of appellants, on the basis that she is an Arizona resident, she filed an Arizona tax return, and she did not owe any tax to California. Appellant-wife also contends that her husband files his return separately in California.
5. On October 23, 2017, FTB notified appellants that it was reducing the amount due, based on an adjustment made by the IRS to reduce rental income of \$9,632 by rental expenses of \$4,613, reported on Schedule E. As relevant, on July 18, 2016, the IRS had reduced the prior assessed taxes to account for these adjustments. As revised, the IRS made a \$6,934 adjustment to appellants' income, for unreported wages of \$1,815, pension income of \$100, and rental income of \$5,019. The IRS also reduced the itemized deduction for medical expenses by \$694 (i.e., 10 percent of the adjustment to income). The final federal income adjustment was \$7,628.

6. Based on the changes as reflected in the final federal determination, FTB issued a Notice of Action dated December 26, 2017, which erroneously recomputed additional tax due in the amount of \$646, plus interest.<sup>1</sup>
7. This timely appeal followed. By letter dated November 7, 2018, appellant-wife requested that the appeal be dismissed on the basis that she has no obligation to pay tax to California. By letter dated December 12, 2018, OTA requested that appellants choose one of two options: dismiss the appeal in favor of FTB or continue to pursue the appeal. Appellant-wife responded by choosing both options (requesting the appeal be dismissed, and that OTA decide her appeal on the basis of the written record). Separately, appellant-wife asked OTA to stop sending her any further letters.

### DISCUSSION

Gross income means all income from whatever source derived, unless specifically excluded. (Rev. & Tax Code, § 17071; Int.Rev. Code, § 61(a).) The taxpayer bears the burden of establishing entitlement to any deductions claimed. (*Appeal of Gilbert W. Janke* (80-SBE-059) 1980 WL 4988; *Appeal of J. Walshe and M. Walshe* (75-SBE-073) 1975 WL 3557.) If the IRS makes a change or correction to any item of gross income or deduction, the taxpayer must report the federal change to the FTB within six months after the date it becomes final. (Rev. & Tax Code, § 18622, subd. (a).) The date of each final federal determination is the date the IRS assesses the tax within the meaning of IRC section 6203 (which provides that the IRS shall record the liability of the taxpayer pursuant to the applicable rules and regulations). (R&TC, § 18622, subd. (d).) An NPA issued by FTB based on a final federal determination is presumed correct, and the taxpayer bears the burden of proving error. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Sheldon I. and Helen E. Brockett* (86-SBE-109) 1986 WL 22731.)

California residents are taxed upon their entire taxable income (regardless of source), while nonresidents are only taxed on income from California sources. (Rev. & Tax. Code, §§ 17041, subds. (a), (b), and (i), 17951.) Part-year residents are taxed on income earned while residents of this state, as well as all income derived from California sources. (Rev. & Tax. Code, § 17041, subds. (b) & (i).)

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<sup>1</sup> These adjustments would result in additional tax of \$948. FTB concedes that although it made a computational error in appellants' favor, the amount at issue in this appeal is limited to the \$646 in tax proposed in the NOA.

A California resident's taxable income includes income earned by a nonresident spouse under certain instances. "Marital property interests in personal property are determined under the laws of the acquiring spouse's domicile." (*Appeal of Roy L. and Patricia A. Misskelley* (84-SBE-077) 1984 WL 16156 [citing *Schechter v. Superior Court* (1957) 49 Cal.2d 3, 10]; see *Rozan v. Rozan* (1957) 49 Cal.2d 322, 326.) Both California and Arizona adhere to community property laws. (Fam. Code, § 760; Ariz. Rev. Stat., § 25-211.) For a California resident married to a person who resides in a community property state (other than California), the California resident's taxable income includes a one-half community interest in the nonresident spouse's earnings. (*Appeal of Roy L. and Patricia A. Misskelley, supra*, 1984 WL 16156.)

Here, appellants reported on their tax return that appellant-husband was a California resident during all of 2013. Therefore, all of his income is subject to tax in California. (Rev. & Tax. Code, § 17041, subd. (a).) Furthermore, appellant-husband's income subject to California tax also includes his one-half share of appellant-wife's income of \$28,655,<sup>2</sup> which amounts to \$14,328.<sup>3</sup>

Although appellant-wife is a non-resident or part-year resident, the rate of tax is determined by taking into account appellants' worldwide income. (See *Appeal of Louis N. Million* (87-SBE-036) 1987 WL 59534.) This method, known as the "California Method," does not tax out-of-state income received while a taxpayer is not a resident of California (here, appellant-wife's one-half community property share of her Arizona income). Instead, this method merely takes the out-of-state income into consideration in determining the tax rate that should apply to California-source income. (*Ibid.*) The purpose of the California Method is to apply graduated tax rates to all persons, not just those who reside in California.<sup>4</sup>

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<sup>2</sup>The federal information does not indicate whether the income was earned by appellant-husband or appellant-wife. With regard to the federal adjustments to income, FTB attributed the pension and wage income to appellant-wife, and the rental income to appellant-husband. Appellants have not disputed this allocation or provided any evidence or argument to support a different allocation.

<sup>3</sup>This amount consists of one-half of the following items: additional \$1,815 in wages, the pension income of \$100, and the business income of \$26,740.

<sup>4</sup>The fundamental fairness and the constitutionality of using out-of-state income to calculate the rate of tax has been upheld by New York's highest court. (*Brady v. New York* (1992) 80 N.Y.2d 596.) 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 law requires the calculation of three ratios to be applied in determining (1) a part-year resident's prorated deductions, (2) tax rate applicable to the taxpayer's California taxable income, and (3) allowable credits, as follows:

1. Prorated Deductions. To calculate the percentage of itemized deductions or prorated standard deduction allowable, a taxpayer must divide California AGI by total AGI. The resulting ratio is then applied to the itemized deductions or standard deduction to determine the prorated allowable amount. (Rev. & Tax. Code, § 17304.)
2. Tax Rate. To calculate the tax rate for California, the tax on the total taxable income is calculated as if the taxpayer was a California resident, and then divided by the taxpayer's total taxable income. The resulting rate is then applied to the taxpayer's California taxable income to determine the California tax. (Rev. & Tax. Code, § 17041, subd. (b)(2).)
3. Prorated Credits. To calculate the percentage of credits allowed on a part-year resident's California return, the California taxable income is divided by the total taxable income. The resulting rate is then applied to the total exemption amount to determine the prorated credits. (Rev. & Tax. Code, § 17055.)

We find that FTB's calculation of the additional tax is consistent with the laws described above. Appellants' California AGI is \$155,011, their California taxable income is \$129,603 (\$155,011 minus prorated itemized deductions of \$25,408 (i.e., \$27,444 x 0.9258)<sup>5</sup>), and their California tax rate is 0.0582. This rate is then applied to appellants' California taxable income of \$129,603. Appellants' total taxable income was used only as the denominator to determine the graduated tax rate to be applied to their California taxable income. The tax of \$6,743 (i.e., \$129,603 x 0.0582) less the prorated exemption credit of \$800 (i.e., \$864 x 0.9258)<sup>6</sup> and the Other State Tax Credit (OSTC) of \$229 arrives at a corrected tax of \$6,514. After applying total payments of \$5,566, the additional tax due is \$948, but FTB only seeks to collect \$646 plus interest (see footnote 1, *supra*).

To eliminate double taxation, R&TC section 18001, subdivision (a), generally allows a California resident to claim a credit against the "net tax" (as defined in R&TC section 17039) for net income taxes imposed by and paid to another state on income subject to California income

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<sup>5</sup> The percentage of deductions allowed was calculated by dividing the appellants' California AGI by their total AGI.

<sup>6</sup> The percentage of credits allowed was calculated by dividing the appellants' California taxable income by their total taxable income.

tax. An OSTC is not allowed for taxes paid to a state that allows nonresidents a credit against the taxes imposed by such state for taxes paid or payable to the state of residence. (Cal. Code Regs., tit. 18, § 18001-2, subd. (b).) Here, appellant-wife contends that she already paid tax to Arizona, and FTB does not dispute the payment or amount of the Arizona tax payment. As such, FTB allowed an OSTC as provided above, which reduced appellants' tax liability by \$229 to account for the tax paid to Arizona. Therefore, appellants' income was not subject to double taxation.

Appellant-wife separately disputes the liability on the basis that she cannot be held liable for any taxes owed to California. California law provides that “[w]henver a joint return is filed by spouses, the liability for the tax on the aggregate income is joint and several.” (Rev. & Tax Code, § 19006, subd. (b).) Here, appellants used the status “married filing jointly” on their California tax return, and appellant-wife signed this return under penalty of perjury. Therefore, we find that she is jointly and severally liable for the tax.

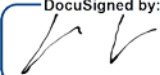
Appellants did not provide any evidence or argument that there was an error in the final federal determination. To the contrary, the evidence demonstrates that the adjustments to income resulted from appellants failing to report income to the state or to the IRS, and the payors of such income reported to the IRS that they did in fact pay this income to appellants. Therefore, appellants did not meet their burden of proving that FTB's proposed assessment, which is based on the federal adjustments, is erroneous.

HOLDING


Appellants did not establish error in FTB’s proposed assessment, which is based on a federal determination.

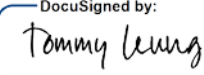
DISPOSITION

FTB’s action is sustained.

DocuSigned by:  
  
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Andrew J. Kwee  
Administrative Law Judge

We concur:

DocuSigned by:  
  
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Tommy Leung  
Administrative Law Judge

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Sara A. Hosey  
Administrative Law Judge