

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:
OWEN SEGERSTROM AND
HANNAH CURCIO

) OTA Case No. 18042694
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) Date Issued: September 17, 2019
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OPINION

Representing the Parties:

For Appellant: Owen Segerstrom and Hannah Curcio

For Respondent: Rachel Abston, Senior Legal Analyst

For Office of Tax Appeals (OTA): Sarah Fassett, Tax Counsel

N. ROBINSON, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC) section 19045,¹ Owen Segerstrom and Hannah Curcio (appellants) appeal an action by respondent Franchise Tax Board (FTB) proposing \$1,342 of additional tax, plus applicable interest, for the 2013 tax year.

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

ISSUE

Whether appellants have established error in FTB’s computation of their tax liability pursuant to the method prescribed by section 17041(b).

FACTUAL FINDINGS

1. Appellants timely filed a 2013 joint California Nonresident or Part-Year Resident Income Tax Return (Form 540NR). On that return, appellants reported federal adjusted gross income (AGI) of \$76,535, less the standard deduction of \$7,812, for total taxable income of \$68,723. Appellants also reported California AGI and California taxable income in

¹ Unless otherwise indicated, all statutory references are to sections of the Revenue and Taxation Code, effective for the tax year at issue.

the same amounts as above. Appellants reported tax of \$2,116, less \$538 in exemption credits, for a total tax liability of \$1,579. Appellants reported withholding credit of \$2,907 and claimed an overpayment of \$1,329. During the processing of appellants' return, FTB adjusted appellants' return and issued a refund in the amount of \$1,328.²

2. FTB received information from the Internal Revenue Service (IRS) and determined that appellants did not report \$35,646 of income on their 2013 Form 540NR. The \$35,646 of income includes: \$11 of interest; \$3,840 of non-employee compensation; \$31,116 from the sale of securities; and \$679 of taxable dividends. The federal information also showed an allowed self-employment tax deduction of \$272.
3. Based on the information obtained from the IRS, FTB issued a Notice of Proposed Assessment (NPA) on February 9, 2017. The NPA increased appellants' taxable income by \$35,374 (i.e., \$35,646 - \$272), and proposed additional tax of \$2,692, plus interest.
4. Appellants protested the NPA, stating that they disagreed with the proposed assessment because they became Nevada residents as of May 9, 2013, the unreported income was earned after that date, and they were not liable for California tax on that income.
5. On September 29, 2017, FTB sent appellants a position letter, which explained that based on the information appellants provided, FTB excluded the unreported income as California source income (i.e., removed it from California AGI) and only included it for purposes of re-computing appellants' California income tax liability. FTB attached to its position letter a California Nonresident or Part-Year Resident Net Tax Liability Computation Worksheet to demonstrate the calculations for appellants' 2013 tax year. The letter indicated that based on the part-year residency calculations, FTB would reduce the proposed additional tax from \$2,692 to \$1,342, plus interest.
6. FTB issued a Notice of Action (NOA) affirming the revised proposed assessment of \$1,342, plus interest. This timely appeal followed.

DISCUSSION

Once FTB shows that its assessment was reasonable and rational, its determination is presumed correct and a taxpayer has the burden of proving error. (*Todd v. McColgan* (1949) 89

² During processing of appellants' return, respondent increased appellants' self-reported tax liability from \$1,578 to \$1,579, which decreased the claimed overpayment from \$1,329 to \$1,328.

Cal.App.2d 509.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Aaron and Eloise Magidow* (82- SBE-274) 1982 WL 11930.)

R&TC section 18622(a) provides that a taxpayer shall either concede the accuracy of a federal determination or state wherein it is erroneous. The taxpayer bears the burden of proving that the determination is erroneous. (*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. (R&TC, §§ 17041(a)(b) and (i), 17951(a).) Part-year residents are taxed on their income earned while residents of this state, as well as all income derived from California sources. The rate of tax on part-year residents is determined by taking into account the taxpayer's total income. (*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, but merely takes the out-of-state income into consideration in determining the tax rate that should apply to the California-source income. (*Ibid.*) The purpose of the method is to apply the graduated tax rates to all persons (not just those who reside in California).³

For the year at issue, 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 find the prorated allowable amount. (R&TC, § 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. (R&TC, § 17041(b)(2).)

³ The fundamental fairness and the constitutionality of using out-of-state income to calculate the rate of tax has been upheld. (*Brady v. New York* (1992) 80 N.Y.2d 596, cert. den. (1993) 509 U.S. 905.) The court in *Brady* 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).

3. Prorated Credits. To calculate the percentage of credits allowed on a taxpayer's California return, the California taxable income is divided by the total taxable income. The resulting rate is then applied to the exemption amount and other credits to determine the prorated credits. (R&TC, § 17055.)

In reviewing FTB's calculations on the Form 540NR it prepared for this matter, we conclude the calculations are consistent with the law described above. The corrected Form 540NR shows appellants' federal AGI (as well as their AGI from all sources) of \$111,909, less the standard deduction of \$7,812, for a revised total taxable income of \$104,097 and tax of \$4,806. Appellants' California AGI is \$76,535, their California taxable income is \$71,192 (\$76,535 minus prorated standard deduction of \$5,343 (i.e., \$7,812 x 0.6839)⁴), and their California tax rate is 0.0462.⁵ Appellants' California tax rate is applied to their California taxable income of \$71,192. Thus, appellants' revised total taxable income of \$104,097 was only used as the denominator to determine the applicable tax rate, which was then used to determine their California tax liability. The \$3,289 tax liability (i.e., \$71,192 x 0.0462), less the \$368 prorated exemption credit (i.e., \$538 x 0.6839),⁶ arrives at a corrected tax liability of \$2,921. After applying \$1,579 of tax that appellants remitted with their original Form 540NR, the revised tax due is \$1,342, which is the amount reflected in the NOA.

Appellants assert that they disagree with the proposed assessment since they received the income while residents of Nevada. However, as explained above, all of appellants' 2013 income must be reported on their California return, since their income from all sources is used to calculate the tax rate that applies to appellants' California-sourced income. However, the income appellants earned while they were residents of Nevada has not been subjected to California tax. Appellants have not produced any additional information or evidence to show error in either the proposed assessment or FTB's application of the formula set forth in section 17041(b).

⁴ The percentage of standard deduction allowed was calculated by dividing appellants' California AGI of \$76,535 by appellants' total AGI of \$111,909.

⁵ This rate is calculated by dividing the \$4,806 tax liability on the total taxable income by the total taxable income of \$104,097.

⁶ The percentage of credits allowed was calculated by dividing appellants' California taxable income of \$71,192 by appellants' total taxable income of \$104,097.

HOLDING

Appellants have not established error in FTB’s computation of their tax liability pursuant to the California Method as prescribed by section 17041(b).

DISPOSITION

FTB’s action is sustained.

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Neil Robinson
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Neil Robinson
Administrative Law Judge

We concur:

DocuSigned by:
Amanda Vassigh
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Amanda Vassigh
Administrative Law Judge

DocuSigned by:
Sara A. Hosey
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Sara A. Hosey
Administrative Law Judge