

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 18073514
)
MARK J. MOROSKY) Date Issued: October 18, 2019
AND LYNNETTE A. MOROSKY)
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)

OPINION

Representing the Parties:

For Appellants: Jason Cardinet, CPA

For Respondent: Veronica Long, Tax Counsel

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

P. KUSIAK, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, appellants Mark J. Morosky and Lynnette A. Morosky appeal the action of the Franchise Tax Board (FTB) proposing additional tax of \$37,896 for the 2013 tax year, plus applicable interest.

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

ISSUE

Whether appellants have shown that they are entitled to the Other State Tax Credit for taxes paid to Virginia.

FACTUAL FINDINGS

1. Appellants were California residents during 2013. Appellant-husband wholly owns Marcraft Systems, LLC (Marcraft), which is taxable as an S Corporation. During 2013, this company received only Virginia-source income.
2. On or about June 9, 2014, Marcraft filed a 2013 Virginia Form 502, Pass-Through Entity Return of Income and Return of Nonresident Withholding Tax. On that return, Marcraft

reported having one owner and owing \$34,413 of withholding tax on behalf of that owner.

3. Appellants jointly filed a Virginia Nonresident Individual Income Tax Return (Virginia Form 763) for 2013 reporting tax liability of \$37,896 to Virginia. This tax return indicates that appellants applied against their Virginia income tax liability \$34,413 of tax withholdings Marcrafft made on behalf of appellant-husband, leaving a balance due to Virginia of \$3,483. The Virginia return did not claim a credit for taxes paid to California.
4. On September 15, 2014, appellants filed a joint California resident income tax return (Form 540) for 2013. Appellants reported taxable income of \$1,683,358, resulting in tax of \$180,821. Appellants claimed the Other State Tax Credit of \$37,896 for income taxes paid to Virginia. As a result, appellants reported an overpayment of \$37,896, which was refunded by FTB on September 18, 2014.
5. On November 6, 2017, FTB issued a Notice of Proposed Assessment disallowing the Other State Tax Credit of \$37,896 and proposing additional tax in that amount. On June 18, 2018, FTB issued a Notice of Action that affirmed the proposed assessment. This timely appeal followed.

DISCUSSION

FTB's determination is presumed correct and the taxpayer has the burden of proving error. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Michael E. Myers* (2001-SBE-001) 2001 WL 37126924.) 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.) In the absence of credible, competent, and relevant evidence showing error in FTB's determination, FTB's determination must be upheld. (*Appeal of Oscar D. and Agatha E. Seltzer* (80-SBE-154) 1980 WL 5068.) A taxpayer's failure to produce evidence that is within his or her control gives rise to a presumption that such evidence, if provided, would be unfavorable to the taxpayer's case. (*Appeal of Don S. Cookston* (83-SBE-048) 1983 WL 15434.)

In accordance with R&TC section 17041(a), the entire income of California residents is subject to taxation by the State of California, regardless of the source. Appellants acknowledge that they were California residents during 2013. Appellants filed a California resident return for the 2013 tax year, and assert that they were California residents. Therefore, even though the income from Marcrafft was Virginia-source income, that income is subject to California taxation.

R&TC section 18001(a)(1) provides a tax credit to California-resident taxpayers for taxes paid to another state on income derived from sources within that other state. This credit is extended to members of partnerships and S corporation shareholders for the pro rata share of taxes paid to another state by California residents. (R&TC, § 18001(b).) However, subdivision (a)(2) of R&TC section 18001 provides that this credit will not be allowed if the other state allows residents of California a credit against the taxes imposed by that state for taxes paid or payable in California. States that allow such a credit for California residents are referred to as “reverse credit states.” This subdivision prevents tax credits from being applied to both states at the same time. Virginia allows credits for nonresidents based on the taxes paid in the resident’s state, so long as that state allows a reciprocal credit for Virginia residents. (Va. Code Ann., § 58.1-332(B).) California has a reciprocal credit that satisfies the Virginia requirement. (R&TC, § 18002.) Thus, because Virginia allows nonresident taxpayers a credit in Virginia for California taxes paid, the Other State Tax Credit is generally unavailable to California residents who paid taxes to Virginia. Even if a taxpayer failed to apply for the credit from a reverse credit state, the Other State Tax Credit is still unavailable. (*Appeal of Mrs. Thomas E. Curtin* (43-SBE-015) 1943 WL 282.)

Appellants assert that Virginia does not allow a credit for taxes paid to California on a group nonresident tax return (also known as a “composite return”). Citing FTB Technical Advice Memorandum (TAM) 2017-01¹ and the filing instructions for Form 540, Schedule S, appellants argue that the Other State Tax Credit is available to them because Marcraft filed a composite return in Virginia, a Virginia Unified Nonresident Individual Income Tax Return (Virginia Form 765). However, Marcraft’s originally filed Virginia return for 2013 was not a composite return (Virginia Form 765); it was a Pass-Through Entity Return of Income and Return of Nonresident Withholding Tax (Virginia Form 502). Although appellants submitted a copy of composite return (Virginia Form 765) for Marcraft signed by appellant-husband, dated January 4, 2018—approximately four years after the due date for the return—this return was not accepted for filing by the Virginia tax authorities. In this regard, we note that the Marcraft’s late-filed Virginia Form 765 also may have been rejected because Marcraft had only one owner

¹ TAM 2017-01 states, in pertinent part, that the Other State Tax Credit “will be allowed for taxes paid to a reverse credit state by a California resident that is included in a group return filed in the reverse credit state when the reverse credit state does not allow a credit for taxes paid to California on the group return.” TAM: 2017-04 withdrew and superseded TAM: 2017-01, but reached the same conclusion.

and, according to the Virginia Department of Taxation’s website, composite returns may only be filed by business pass-through entities that have two or more qualified nonresident owners. (<<https://www.tax.virginia.gov/pass-through-entities>> [as of September 20, 2019].) In any event, FTB submitted official correspondence from the Virginia Department of Taxation dated October 11, 2018, indicating there was no record of a Virginia Form 765 filed by Marcrafft on behalf of appellant-husband.

FTB concedes that it would allow the credit in the circumstances described in TAM 2017-01. But since appellants have not established that they were listed as a participant in a composite return filed on behalf of Marcrafft, FTB takes the position that appellants are subject to the normal rule that applies to California residents that paid taxes to in reverse credit states; namely, they must clam their Other State Tax Credit in reverse credit state, not in California. We agree.


We find that appellants have not established that a group return was filed on their behalf in Virginia. Consequently, they are not entitled to a credit for taxes paid to Virginia for 2013. There is no legal basis to overturn FTB’s determination.

HOLDING


Appellants have not shown that they are entitled to the Other State Tax Credit for taxes paid to Virginia.


DISPOSITION

FTB’s action is sustained.

DocuSigned by:

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Patrick J. Kusiak
Administrative Law Judge

We concur:

DocuSigned by:

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Richard Tay
Administrative Law Judge

DocuSigned by:

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Suzanne B. Brown
Administrative Law Judge