

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

In the Matter of the Appeal of: ) OTA Case No. 19044712  
**ALAN E. TROTTER** )  
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**OPINION**

Representing the Parties:

For Appellant: Alan E. Trotter

For Respondent: Donna L. Webb, Staff Operations Specialist

K. GAST, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC) section 19045, Alan E. Trotter (appellant) appeals an action by respondent Franchise Tax Board (FTB) in proposing additional tax of \$1,619, plus interest, for the 2015 tax year. Appellant waived the right to an oral hearing and therefore the matter is being decided on the written record.

**ISSUE**

Whether appellant has shown error in FTB’s proposed assessment.

**FACTUAL FINDINGS**

1. Appellant filed a 2015 California nonresident or part-year resident income tax return on Form 540NR. On this return, appellant reported federal and California adjusted gross income (AGI) of \$43,551, which consisted of California W-2 wages of \$38,277 and gambling winnings of \$5,274.
2. Subsequently, FTB received information from the Internal Revenue Service (IRS) indicating it had increased appellant’s federal AGI by \$64,841 for unreported wage income.

3. Based on the IRS information, FTB issued a Notice of Proposed Assessment (NPA), increasing appellant's California AGI, and thus California source income, by the \$64,841. This resulted in proposed additional tax due, plus interest.
4. Appellant protested the NPA, contending he earned the unreported wages of \$64,841, as well as the originally reported gambling winnings of \$5,274, while a resident of Texas. He asserted he moved to California in August 2015, after he earned that income.
5. FTB affirmed its NPA with a Notice of Action (NOA), but revised the tax due by excluding the \$64,841 from appellant's California AGI because it was not derived from a California source. Instead, FTB, as it did in its NPA, included the \$64,841 in appellant's AGI from all sources for purposes of calculating a California tax rate of 6.88 percent that was used to determine his California tax. Based on a California AGI of \$43,551, the NOA computed additional tax due of \$1,619, plus interest, which was lower than that shown in the NPA. This timely appeal followed.
6. In his appeal letter, appellant disputes that his California AGI is \$43,551. He contends only \$38,042 of that amount consists of California W-2 wages that is properly taxable in this state, but the remaining \$5,509 is not taxable here because it is from gambling winnings earned while he resided in Texas.
7. In its opening brief, FTB agreed to remove the gambling winnings of \$5,274 from appellant's California AGI of \$43,551. This adjustment reduced his California AGI to \$38,277, which now consists solely of California W-2 wages.<sup>1</sup> Consequently, the additional tax due in the NOA decreased from \$1,619 to \$1,275, plus interest. FTB prepared a corrected 2015 Form 540NR that shows these computations, which was submitted as an exhibit to its opening brief.

### DISCUSSION

A taxpayer must report federal changes to income or deductions to FTB within six months of the date the federal changes become final. (R&TC, § 18622(a).) The taxpayer must concede the accuracy of the federal changes or prove that those changes are erroneous. (*Ibid.*)

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<sup>1</sup> FTB did not use appellant's uncorroborated amounts of \$38,042 for California W-2 wages and \$5,509 for gambling winnings. Rather, it used \$38,277 for California wages reported on IRS Form W-2 and \$5,274 for gambling winnings reported on IRS Form W-2G. These amounts also match what was reported on appellant's IRS Wage and Income Transcript (although the wages FTB used are higher by a \$1). We agree with FTB that it used the correct amounts.

On appeal, appellant contends FTB cannot tax his gambling winnings that were earned while he was a California nonresident. However, in its opening brief, FTB conceded those winnings should not be taxed in California. FTB therefore removed it from appellant's California AGI and recomputed the tax due, as reflected on the corrected 2015 Form 540NR.

Appellant also submits figures he believes accurately reflect his revised total and California AGI.<sup>2</sup> But since appellant did not further compute tax on those figures, it is unclear whether he is also contending that California's method of taxing nonresidents or part-year residents is somehow incorrect. We find no error in FTB's corrected 2015 Form 540NR and explain our reasoning below.

FTB is not taxing appellant's unreported wage income of \$64,841 or his gambling winnings of \$5,274. Rather, FTB is merely using that out-of-state income 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 R&TC section 17041(b), is part of a multistep process of taxing nonresidents and part-year residents, known as the "California Method."<sup>3</sup>

Here, and as shown more fully in the corrected 2015 Form 540NR, FTB calculated a California resident tax (i.e., \$7,181) on appellant's recomputed total taxable income derived from all sources (i.e., \$104,348, which is federal AGI of \$108,392, less a California standard deduction of \$4,044). FTB divided the \$7,181 by \$104,348, to derive a California tax rate of 6.88 percent. The 6.88 percent was then multiplied by appellant's California taxable income of \$36,849, which consists solely of California W-2 wage income,<sup>4</sup> to compute a tax due of \$2,535. After reducing this tax by a prorated exemption credit and the tax appellant reported as paid on his as filed California return, FTB computed additional tax due of \$1,275, plus interest.

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<sup>2</sup> These figures show a revised "total" AGI of \$108,392, and a revised California AGI of \$38,042. Based on the record, we agree the former figure is properly stated and consistent with appellant's IRS Account Transcript. But we believe \$38,277—not \$38,042—accurately reflects appellant's California AGI since, as stated above, that amount matches what was reported on his IRS Form W-2 and IRS Wage and Income Transcript.

<sup>3</sup> The Board of Equalization, 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 Million* (87-SBE-036) 1987 WL 59534; *Appeal of Boone* (93-SBE-015) 1993 WL 460748.) 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.

<sup>4</sup> Appellant's California taxable income was computed by subtracting a prorated standard deduction of \$1,428 from his California source wages of \$38,277, which does not include the unreported wages of \$64,841 or the gambling winnings of \$5,274 earned while he was a California nonresident.

Accordingly, FTB properly applied the California Method when computing appellant’s California nonresident tax.

HOLDING

Appellant has not shown error in FTB’s proposed assessment.

DISPOSITION

FTB’s action is sustained, subject to its concession that the tax liability should be reduced from \$1,619 to \$1,275, plus interest.

DocuSigned by:  
*Kenneth Gast*  
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Kenneth Gast  
Administrative Law Judge

We concur:

DocuSigned by:  
*Linda C. Cheng*  
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Linda C. Cheng  
Administrative Law Judge

DocuSigned by:  
*Sara A. Hosey*  
8D3FE4A0CA514E7...  
Sara A. Hosey  
Administrative Law Judge

Date Issued: 1/22/2020