

**OFFICE OF TAX APPEALS
STATE OF CALIFORNIA**

In the Matter of the Appeal of:) OTA Case No. 18083536
S. HORTON)
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OPINION

Representing the Parties:

For Appellant: S. Horton

For Respondent: Maria Brosterhous, Tax Counsel IV

For Office of Tax Appeals: Andrew Jacobson, Tax Counsel III

T. LEUNG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045,¹ S. Horton (appellant) appeals an action by respondent Franchise Tax Board (FTB) proposing an additional tax of \$1,495, plus applicable interest, for the 2012 taxable year.

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

ISSUE

Whether appellant has established that amounts he subtracted from his California income are not subject to California tax as undistributed capital gains received from a Regulated Investment Company (RIC).

FACTUAL FINDINGS

1. On his 2012 U.S. Individual Tax Return (Form 1040), appellant reported a capital gain of \$42,547.

¹ Unless otherwise provided, all section references are to laws operative for the 2012 taxable year.

2. On his 2012 Schedule CA (Form 540), appellant reported a federal capital gain of \$42,547 in Column A, line 13, which he subtracted in full in Column B, line 13. As a result, on his Form 540, appellant reported California adjustments (subtractions) of \$42,547, taxable income of zero, and a total tax of zero.
3. FTB received information from the Internal Revenue Service (IRS), showing that appellant had a capital gain in the amount of \$42,547, which is reflected in a Stars Data Sheet. FTB determined that appellant had erroneously subtracted this amount from his California income on the Schedule CA (Form 540).
4. FTB issued a Notice of Proposed Assessment (NPA), which increased appellant's reported 2012 income by the \$42,547 capital gain that he subtracted on his Schedule CA. As a result, the NPA computed a tax of \$1,599 and allowed a personal exemption of \$104, resulting in a proposed additional tax of \$1,495, plus applicable interest. The NPA stated that it adjusted appellant's California taxable income because appellant did not substantiate the income adjustments he had claimed on his 2012 Schedule CA (Form 540).
5. Appellant protested the NPA on the grounds that the \$42,547 was undistributed capital gains of a RIC (oftentimes referred to as a mutual fund) which were automatically reinvested and thus were not taxable as capital gains. Appellant asserted that he had held an Invesco Mutual Fund as a retirement account for more than 25 years and that his funds had been continuously and automatically reinvested at the end of every tax year under a reinvestment plan; he stated that he made no sale or redemption of his shares of Invesco.
6. Appellant conceded that, after examining his 2012 federal and California returns, he realized that he had understated his taxable income on line 19 of his California return and had overstated the amount subtracted in Column B, line 13 on his 2012 Schedule CA (Form 540). Appellant also asserted that the correct amount of subtracted capital gains from his taxable income is \$35,350, which he calculated on line 44 of an IRS Qualified Dividend and Capital Gain Tax Worksheet. Nevertheless, appellant asserted that he still owed no amount of tax. Appellant asserted that he would file an amended return if FTB wished.
7. Appellant submitted a copy of his 2012 return on which he wrote in and circled revised amounts next to several original amounts shown on the return. On the attached 2012

Schedule CA (Form 540), Column B, line 13, appellant replaced his claimed subtracted capital gain of \$42,571 with \$35,350. On a copy of his 2012 Form 540, appellant made handwritten revisions. He reduced the amount of California adjustments (subtractions) on line 14 from \$42,547 to \$35,350, along with other corresponding changes, but total tax and amount due remained zero. Appellant also attached copies of pages 23 and 24 of the 2012 IRS Form 1040 Instructions Booklet with handwritten notations. Finally, appellant attached copies of pages 33 and 41 of the 2012 IRS Form 1040 Instructions Booklet, a December 2012 Charles Schwab Statement Excerpt,² and his 2012 federal return (without attachments). There is no evidence that appellant ever filed an amended 2012 California return.

8. Appellant also produced the following supporting documents: (1) the 2012 NPA; (2) excerpts from the 2012 FTB Personal Income Tax Booklet, with handwritten markings; and (3) page 47 of Schedule CA (540) Instructions 2012 with handwritten markings.
9. After FTB issued a Notice of Action that affirmed the NPA, appellant provided a copy of a Charles Schwab Tax Year 2012 Form 1099 Composite (Form 1099 Composite), which reports capital gain distributions of \$42,547.18, among other amounts not at issue in this appeal.
10. Appellant's 2012 federal wage and income transcript reflects a Charles Schwab Form 1099-DIV that lists capital gains of \$42,547.

DISCUSSION

Internal Revenue Code (IRC) section 61, in defining gross income, includes income from gains derived from dealings in property. (IRC, § 61(a)(3).) California conforms to IRC section 61 at R&TC section 17071.

IRC section 852, to which California conforms under R&TC section 17088 (except as otherwise provided), grants special tax treatment for RICs and their shareholders for capital gains, dividends, losses on the sale of stock held for less than six months, and exempt interest

²This one-page excerpt (page 7 of 8) shows that on December 7, 2012, appellant had the following eight transactions for reinvested shares for a total amount of \$45,682.23: Invesco Divers Dividend, Invesco Technology FD, and, finally, Invesco Leisure FD INV, by far the most valuable group of investments listed, for which there was a transaction for a quantity of 1,184.4330 shares costing \$41,869.69, a transaction for a quantity of 67.2930 shares costing \$2,378.81 and a transaction for a quantity of 15.0530 shares costing \$532.14.

dividends. A RIC is defined as any domestic corporation, which at all times during the entire tax year is: (1) registered under the amended Investment Company Act of 1940 (15 U.S.C. §§ 80a-1 to 80b-2) as a management company or unit investment trust; (2) elects to be treated as a business development company; or (3) is a common trust fund or similar fund excluded by 15 U.S.C. section 80a-3(c) from the definition of “investment company” and is not included in the definition of “common trust fund” by IRC section 584(a). (IRC, § 851(a)(1).)

For federal tax purposes, undistributed capital gains from a RIC shall be subject to tax in the year earned pursuant to IRC section 852(b)(3)(D). A RIC shall provide notice to its shareholders of any funds that constitute undistributed capital gains within 60 days after close of its tax year. (IRC, § 852(b)(3)(D)(i).) The undistributed amounts shall be treated as if they had been distributed as capital gain dividends by the company to the holders of such shares at the close of its taxable year. (*Ibid.*) The shareholder of the undistributed capital gain shall be deemed to have paid tax on those shares when computing long-term capital gains for that year; and shall be allowed a credit or a refund for the tax so deemed to have been paid. (IRC, § 852(b)(3)(D)(ii).) The shareholder shall then increase his adjusted basis by the difference between the amount of includible gains and the tax deemed paid by the shareholder. (IRC, § 852(b)(3)(D)(iii).) For California tax purposes, however, R&TC section 17088(c)(1) provides that the provisions of IRC section 852(b)(3)(D) “relating to treatment by shareholders of undistributed capital gains, shall not apply.”

Income tax deductions and credits are a matter of legislative grace, and a taxpayer who claims a deduction or credit has the burden of proving by competent evidence that he or she is entitled to that deduction or credit. (*New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435, 440.) To sustain his or her burden of proof, a taxpayer must be able to point to an applicable deduction or credit statute and show that he or she came within its terms. (*Appeal of Briglia* (86-SBE-153) 1986 WL 22833.) Unsupported assertions cannot satisfy a taxpayer's burden of proof. (*Appeal of Magidow* (82-SBE-274) 1982 WL 11930.) 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 have been unfavorable to the taxpayer's case. (*Appeal of Cookston* (83-SBE-048) 1983 WL 15434.)

While appellant makes numerous arguments regarding undistributed capital gains, the record shows that the \$42,547 was indeed distributed; both the Charles Schwab composite 1099

and appellant's wage and income transcript bear this out. Appellant even asserted that he received a statement at the end of the year showing the reinvestment of his capital gains, which is evidence that he exercised dominion and control over the \$42,547 and, as such, subjected him to tax on those amounts (see *Lucas v. Earl* (1930) 281 U.S. 111); put another way, if the \$42,547 was undistributed, appellant would not have been able to direct its reinvestment. While appellant argues that FTB referred him to the Volunteer Income Tax Assistance (VITA) program for help, even if VITA representatives provided ambiguous advice that seemed to support his position, the documents presented demonstrate that appellant received a distribution of \$42,547 in 2012 which must be recognized as income. (See IRC, § 61(a)(3).)

Finally, when FTB requested a copy of appellant's federal Form 2439 at protest and on appeal, appellant failed to provide a copy of the document, even though it must be distributed by RICs to shareholders whose investments have undistributed capital gains. (IRC, § 852(b)(3)(D)(i).) This leads us to conclude that such a document was never actually issued to appellant.³ (*Appeal of Cookston, supra.*) Based on this evidence, we find that the capital gain of \$42,547 was distributed by Invesco to appellant, either as part of the amounts shown on the Charles Schwab Statement Excerpt or else on another page that appellant has not provided.

Appellant argues that FTB's 2012 Personal Income Booklet (California Forms 540 and 540A) and FTB's website do not prevent him from reporting his California taxable income in the same way as his federal taxable income. Appellant is apparently referring to the instructions for the 2012 IRS Form 1040 and the 2012 FTB Personal Income Tax Bulletin as support for his argument. We find no language in either document that states that federal and California tax laws are the same in their respective treatment of undistributed capital gains of RICs. The Charles Schwab Statement Excerpt and the IRS Wage and Income Transcript show that capital gains were distributed to appellant during 2012. Furthermore, and as discussed above, California does not conform to federal tax law on undistributed capital gains from a RIC. (R&TC, § 17088(c)(1).) Thus, appellant improperly subtracted the \$42,547 on his 2012 California tax return.

³ Appellant asserts that he did not need to provide a federal Form 2439, because the IRS Schedule D instructions state that he only needed to provide a Form 2439 if he also needed to file a Schedule D. The IRS instructions to which appellant cites state that a taxpayer is not required to file a Form 8949, *Sales and Other Dispositions of Capital Assets*, or a Schedule D if certain conditions are met. There is no mention of not having to file a Form 2439 when reporting capital gains received from a RIC.

Therefore, we find that appellant has failed to show that the proposed assessment is in error.

HOLDING

Appellant did not prove that his \$42,547 California adjustment was based on an undistributed capital gain from a RIC, and R&TC section 17088(c)(1) did not allow him to subtract the \$42,547 from his 2012 California income tax return.

DISPOSITION

FTB’s action is sustained.

DocuSigned by:
Tommy Leung

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Tommy Leung
Administrative Law Judge

We concur:

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John O Johnson

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John O. Johnson
Administrative Law Judge

DocuSigned by:
Sara A Hosey

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Sara A. Hosey
Administrative Law Judge

Date Issued: 6/24/2020