OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 19034391
M. CRUCES AND	)
E. CRUCES	)
	)
	)

OPINION

Representing the Parties:

For Appellants: M. Cruces and E. Cruces

For Respondent: Rachel Abston, Senior Legal Analyst

For Office of Tax Appeals: James Scott Whitehouse, Analyst

D. BRAMHALL, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, M. Cruces and E. Cruces (also known as E. Cruces Roel) (appellants) appeal from the action of respondent Franchise Tax Board (FTB) proposing additional tax of $800 for the 2013 tax year, plus applicable interest.

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

ISSUE

Whether appellants have shown error in FTB's proposed assessment of additional tax of $800 for the 2013 tax year, plus applicable interest.

FACTUAL FINDINGS

1. Appellants filed a timely "married filing jointly" California Resident Income Tax Return, (Form 540) for the 2013 tax year. Appellants reported federal Adjusted Gross Income (AGI) of $104,718,[1] less California adjustments of $10,000 and the standard deduction of $7,812, for a taxable income of $86,906 and total tax liability of $1,203. Appellants

[1] Appellants' federal AGI consisted entirely of wages.

applied their withholding credit of $2,367 and claimed an overpayment of $1,164, which FTB refunded.

2. Subsequently, FTB examined appellants' return and determined that they incorrectly subtracted $5,000 described as wages and a Health Savings Account (HSA) distribution of $5,000 on Schedule CA (California Adjustments) of their Form 540.

3. Based on its review, FTB disallowed appellants' total California Adjustments of $10,000. FTB issued a Notice of Proposed Assessment (NPA), dated February 15, 2018, that proposed to assess additional taxes of $800, plus interest.[2]

4. Appellants protested the NPA.

5. FTB responded to appellants' protest by letter, explaining that the wage subtraction of $5,000 was not allowed on the Schedule CA because Schedule CA is only used to report adjustments to gross income when that income is taxed differently for state and federal purposes and that there is no difference between the state and federal tax law in the taxation of wages. FTB further explained that appellants' deduction for their HSA distribution of $5,000 was disallowed because appellants cannot deduct income that they did not include in their AGI on their federal return.

6. On January 16, 2019, FTB issued a Notice of Action affirming the NPA.

7. Appellants filed this timely appeal.

DISCUSSION

California residents are subject to tax on their entire taxable income. (R&TC, § 17041, subd. (a).) The federal AGI reported on the taxpayers' California income tax return must generally match the federal AGI reported on the taxpayers' federal return. (R&TC, § 17072; Int. Rev. Code (IRC), § 62.)

Internal Revenue Code section 213 allows taxpayers to claim a deduction for medical expenses incurred during the taxable year to the extent that the expenses exceed 10 percent of the taxpayer's AGI.[3] For California purposes, taxpayers are allowed to claim a deduction for

[2] The NPA reflected the interest charges, which included suspension of interest pursuant to R&TC section 19116. Appellants have asserted no arguments for separately abating interest as computed by FTB.

[3] Public Law 111-148, section 9013(a), amended IRC section 213(a) by substituting "10 percent" for "7.5 percent" effective for tax years beginning after December 31, 2012. For the 2013 tax year, California did not conform to the 10 percent limitation because California law conformed to the IRC as it was written on January 1, 2009.

medical expenses incurred during the taxable year to the extent that the expenses exceed 7.5 percent of the taxpayer's federal AGI. (R&TC, § 17201; IRC, § 213.)

FTB determined that appellants had properly omitted a $5,000 HSA distribution from federal AGI and accordingly from California AGI. Therefore, a further Schedule CA adjustment amounted to a double exclusion from California AGI and was not allowed. FTB also noted and determined that no differences exist between the federal and California definition of wages. Therefore, it disallowed the Schedule CA subtraction designated by appellants as a wage adjustment. No arguments have been advanced concerning the resulting additional tax amount, and from the record in this appeal we see no error in that computation.

FTB's determinations are presumed correct, and taxpayers bear the burden of proving error. (*Appeal of Brockett* (86-SBE-109) 1986 WL 22731; *Todd v. McColgan* (1949) 89 Cal.App.2d 509.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal Magidow* (82-SBE-274) 1982 WL 11930.)

Appellants, at various times, provided unsupported allegations concerning their grounds for the California Adjustments but on appeal now assert that they are entitled to a deduction of the entire $10,000 for medical expenses paid for their dependent.[4] Appellants argue that the deduction for medical expenses reported on their California tax return is inapplicable to their federal return because the standard federal deduction of $12,200 exceeded the $10,000 appellants deducted from their federal AGI. However, if appellants took the allowable deduction in California for medical expenses, that deduction would be limited to the amount in excess of 7.5 percent of their AGI. (R&TC, § 17201.) Their claimed medical expense deduction, if substantiated, would equal $2,146 (i.e., $104,718 x 7.5% = $7,853.85; $10,000 - $7,853.85 = $2,146.15).

It appears that appellants claimed a $10,000 deduction by subtracting that amount from their federal AGI: $5,000 in wages and $5,000 in HSA distributions. However, wages are included in the taxpayers' gross income for federal and California tax purposes in the same amount. (R&TC, § 17071; IRC, § 61(a)(1).) Therefore, appellants may not deduct $5,000 in wages from their federal AGI for California tax purposes.

[4] Earlier appellants contended the California Adjustments were appropriate because HSA distributions are not taxable and the wage adjustments reflected medical expenses and was entered as an adjustment because there was no line for medical expenses on Form 540.

As for the $5,000 in HSA distributions, appellants are correct that their HSA distribution is not subject to tax. California does not allow a deduction from gross income for contributions made to an HSA,[5] and, therefore, the distributions from an HSA are nontaxable for California purposes because they were already taxed when earned. However, to exclude HSA distributions from a taxpayer's AGI, it must first be included in federal AGI. In the instant case, appellants' HSA distribution was not subject to either federal or state tax, and appellants' $104,718 federal AGI for the 2013 tax year consisted entirely of wages. Since the HSA distributions were not included in appellants' federal AGI, it was erroneous to exclude that same distribution *again* from their California AGI.[6]

Accordingly, appellants have not shown that they are entitled to exclude $10,000 as California adjustments on their 2013 California return.

[5] Under federal law, eligible individuals may establish an HSA, which is a tax-exempt trust or custodial account used to pay or reimburse the qualified medical expenses of the account beneficiary and his or her spouse or dependents. (IRC, § 223(d)(1), (2)(a).) HSA *contributions* (which are not at issue here) made by eligible individuals and employers acting on their behalf are excludable from gross income. (IRC, §§ 223(a), 106(d).) However, in a departure from federal law, California requires that HSA contributions be included in gross income. (R&TC, §§ 17215.4, 17131.4.) In other words, contributions to an HSA are deductible for federal income tax purposes, but not for California tax purposes.

[6] Despite appellants' assertion to the contrary, FTB's proposed assessment did not result in their HSA distribution being subject to tax. The proposed assessment merely disallowed the subtraction of an item that had already been excluded from federal and California AGI.

HOLDING

Appellants have not shown error in FTB's proposed assessment of additional tax of $800 for the 2013 tax year, plus applicable interest.

DISPOSITION

FTB's action is sustained.

DocuSigned by:
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Douglas Bramhall
Administrative Law Judge

We concur:

DocuSigned by:
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Alberto T. Rosas
Administrative Law Judge

DocuSigned by:
5E9822FBB1BA41B...
Jeffrey I. Margolis
Administrative Law Judge

Date Issued: 2/18/2020