

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 19054773
R. McALLISTER)
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OPINION

Representing the Parties:

For Appellant: R. L. McAllister

For Respondent: Freddie C. Cauton, Legal Analyst

A. ROSAS, Administrative Law Judge: Under Revenue and Taxation Code (R&TC) section 19045, appellant R. McAllister appeals respondent Franchise Tax Board’s action proposing additional taxes of \$1,091, plus applicable interest, for tax year 2014. Appellant waived the right to an oral hearing, and therefore we decide this matter based on the written record.

ISSUE

Did appellant establish error in respondent’s proposed assessment for tax year 2014, which disallowed a qualified mortgage insurance deduction?

FACTUAL FINDINGS

1. Appellant filed a California Resident Income Tax Return for tax year 2014 and used the head of household filing status. Appellant reported federal adjusted gross income (AGI) of \$150,245, federal itemized deductions of \$54,622 minus a California adjustment of \$8,937 for total itemized deductions of \$45,685, total tax of \$5,814, and, after the withholding credit, reported an overpayment of \$2,547.
2. According to federal information that the Internal Revenue Service (IRS) provided to respondent, appellant reported total federal itemized deductions of \$41,720 (not \$54,622).

The reason for the discrepancy was because, on the California return, appellant claimed a mortgage insurance deduction of \$12,902, which appellant did not claim on the federal return. This mortgage insurance deduction was based on a Department of Veterans Affairs (VA) Funding Fee.

3. Respondent issued a Notice of Proposed Assessment (NPA) that, among other things, disallowed the mortgage insurance deduction and proposed additional tax of \$1,091.
4. Appellant protested the NPA and provided additional information to respondent, including a “Buyer(s) Estimated Closing Statement” that reflected that appellant paid a VA Funding Fee of \$12,899.70 in connection with the purchase of real property in Highland, California in 2014. Respondent issued a Notice of Action affirming the NPA.
5. Appellant filed this appeal.

DISCUSSION

Deductions are a matter of legislative grace, and the taxpayer bears the burden of proving entitlement to any deduction claimed. (*INDOPCO, Inc. v. Commissioner* (1992) 503 U.S. 79, 84; *New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435, 440.) Based on the preponderance of the evidence, a party must establish by documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (*Concrete Pipe and Products of California, Inc. v. Construction Laborers Pension Trust for Southern California* (1993) 508 U.S. 602, 622.) Taxpayers must identify an applicable statute allowing a deduction and provide credible evidence that their facts are within the terms of the legal authorities. (*Appeal of Telles* (86-SBE-061) 1986 WL 22792.)

On the 2014 federal return, appellant reported total itemized deductions of \$41,720, which the IRS allowed. On the 2014 California return, however, appellant reported federal itemized deductions of \$54,622. The additional deduction of \$12,902 (rounded up from \$12,899.70) was for a VA Funding Fee, which is a type of qualified mortgage insurance.¹

Qualified mortgage insurance means: (a) mortgage insurance provided by the VA, the Federal Housing Administration, or the Rural Housing Service; and (b) private mortgage insurance, as defined by section 2 of the Homeowners Protection Act of 1998 (12 U.S.C. § 4901), as in effect on December 20, 2006. (Int.Rev. Code (IRC), § 163(h)(4)(E); IRS Pub. 936

¹ See generally Title 38, U.S. Code Annotated, § 3710 [authorizing statute for VA loans for purchase or construction of homes].

(2014) at p. 8.) “Mortgage insurance provided by the Department of Veterans Affairs is commonly known as a funding fee.” (IRS Pub. 936 (2014) at p. 8.)

For federal tax purposes, these mortgage insurance premiums are generally treated as qualified residence interest. (IRC, § 163(h)(3)(E).) And subject to certain debt limitations and phase-out rules, qualified residence interest is generally deductible. (IRC, § 163(h)(3); see *Hume v. Commissioner* (2014) T.C. Memo. 2014-135.)

For California tax purposes, however, deductions for mortgage insurance premiums treated as qualified residence interest (including deductions based on VA Funding Fees) are not allowable deductions, because California does not conform to Internal Revenue Code section 163(h)(3)(E) regarding the deductibility of mortgage insurance premiums. (R&TC, § 17225.) Therefore, appellant’s claimed itemized deduction stemming from the VA Funding Fee of \$12,902 is not an allowable deduction for state tax purposes.

HOLDING

Appellant is unable to establish error in respondent’s proposed assessment for tax year 2014, which disallowed appellant’s qualified mortgage insurance deduction.

DISPOSITION

We sustain respondent’s action in full.

DocuSigned by:
Alberto T. Rosas
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Alberto T. Rosas
Administrative Law Judge

We concur:

DocuSigned by:
Michael F. Geary
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Michael F. Geary
Administrative Law Judge

DocuSigned by:
John O. Johnson
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John O. Johnson
Administrative Law Judge

Date Issued: 2/21/2020