OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18124073
Y. LIN AND H. GAO	)
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	)
	)
	)

OPINION

Representing the Parties:

For Appellants: Y. Lin

For Respondent: Marguerite Mosnier, Tax Counsel IV

J. MARGOLIS, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, Y. Lin and H. Gao (appellants) appeal an action by respondent Franchise Tax Board (FTB) proposing additional tax of $762 for appellants' 2013 taxable year.

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

ISSUE

Whether FTB erred in rejecting appellants' amended return based upon its determination that appellant-wife was not entitled to compute her 2013 California tax liability on a married filing separately basis under the "nonresident spouse exception" contained in R&TC section 18521(c).

FACTUAL FINDINGS

1. Appellant-wife (Ms. Lin) was neither a California domiciliary nor a California resident during 2013. She received $22,823 of wage income reported on a Form W-2 issued to her by the UC Irvine payroll office. The Form W-2 was addressed to Ms. Lin at her address in North Carolina. The Form W-2 treated the income as California source income and indicated that California income tax had been withheld from the amount paid.

2. Appellant-husband (Mr. Gao) also was neither a California domiciliary nor a resident during 2013. He earned $98,894 of non-California wages during 2013.
3. Although appellants were both *nonresidents* of California, they erroneously filed a joint California *resident* income tax return for 2013 (Form 540). On that return, they reported federal adjusted gross income (AGI) of $111,602, California adjustments of $94,894 (the subtraction of Mr. Gao's income), and zero tax liability.
4. FTB examined appellants' 2013 return and determined that appellants had erred in computing their California tax liability by: (1) failing to report on their California return the same AGI that they reported on their federal return; and (2) subtracting Mr. Gao's wages as a California adjustment. FTB also adjusted the educator expense deduction claimed on appellants' return.[1]
5. Based on these adjustments, FTB issued a Notice of Proposed Assessment (NPA), determining a $3,743 deficiency in appellants' 2013 tax liability. The NPA explained that FTB had "disallowed the deduction for those wages you subtracted on your Schedule CA (540) California Adjustments-Residents. As a California resident, all your wages are taxable, including those wages earned outside of California."
6. Appellants timely protested the NPA. Appellants attached to their protest an amended California return for 2013 and explained that they were changing their filing status from married filing jointly to single. The protest stated: "we file 540X in response to the above Notice of Proposed Assessment … since my husband … was a nonresident for the entire year and had no income from California sources during 2013." On the amended return, appellants again subtracted Mr. Gao's wages of $94,894 from their income, and checked the box indicating that their original California return for 2013 had been filed on a "married/RDP filing separately" basis, and the box indicating that their amended return was being filed on a "single" basis.[2]
7. Appellants remained married to each other throughout the 2013 tax year.

[1] Appellants do not contest FTB's adjustment to their educator expense deduction.

[2] It is undisputed that appellants remained married to each other throughout 2013. In their amended return, appellants appear to have equated filing as "single" as meaning married filing separately, and not as being unmarried. There is no suggestion in the record that FTB was at any time misled as to appellants' marital status or intended filing status.

8. In response to appellants' protest and amended 2013 tax return, FTB wrote a letter to appellants dated September 6, 2018, stating, in pertinent part, as follows:

> We are unable to accept your amended return in which you are changing your filing status from married filing joint to single.
>
> Married individuals will not qualify for the nonresident spouse exception if one of the spouses is earning California sourced income and is domiciled in California, which is a community property state.
>
> However, based on the information you provided, it appears you filed the 2013 540 California Resident Income Tax Return in error. Individuals who are nonresidents or part-year residents of California should file their taxes on the 540 Nonresident or Part-Year Resident Income Tax Return.

9. Based upon FTB's acceptance of the facts that Mr. Gao was not a California resident during 2013 and his income was not California source income, FTB's September 6, 2018 letter recalculated the proposed deficiency, reducing it to $762. FTB's letter explained that FTB still was refusing to recompute Ms. Lin's tax liability separately from Mr. Gao's because it found that appellants did not qualify for the "nonresident spouse exception" of R&TC section 18521(c)(2). In this letter, FTB took the position that the exception did not apply because one half of Ms. Lin's California source (wage) income must be treated as having been earned by Mr. Gao under California's community property laws.
10. On October 17, 2018, FTB issued a Notice of Action (NOA) to appellants. The NOA referred to the explanation provided in FTB's September 6, 2018 letter and reduced the proposed tax deficiency to $762.
11. Appellants timely appealed from the NOA. In their appeal letter, Ms. Lin explained that she did not live in California during 2013, and disputed FTB's position that appellants were not eligible for the nonresident spouse exception of R&TC section 18521(c)(2).
12. In its opening brief, FTB acknowledged that "[Mr.] Gao was a nonresident and had no California source income in 2013." However, FTB continued to maintain that Ms. Lin did not qualify for the nonresident spouse exception of R&TC section 18521(c)(2) because "married individuals do not qualify for the nonresident spouse exception if one spouse is earning California sourced income and is domiciled in California, a community property state."

13. In their reply to FTB's opening brief, appellants explained that, contrary to FTB's contention, they were *both* nonresidents of California during 2013. Therefore, appellants asserted that the FTB's position that they did not qualify for the nonresident spouse exception was in error.

14. FTB filed a reply brief in which it did not dispute that both appellants were nonresidents of California during 2013. However, it alleged that "Ms. Lin's status as a California resident or non-resident does not affect the amount of the proposed assessment." (Emphasis omitted.)

DISCUSSION

The general rule is that California taxpayers must use the same filing status on their California return that they use on their federal return. (R&TC, § 18521(a)(1).) This appeal involves an exception to this general rule, one contained in R&TC section 18521(c)(2), which FTB refers to as the "nonresident spouse exception." Under its provisions, an individual who has filed jointly for federal income tax purposes may file separately for California tax purposes if either spouse was, during the taxable year, "[a] nonresident for the entire taxable year who had no income from a California source." (R&TC, § 18521(c)(2).)

FTB originally contended (in its response to appellants' protest) that appellants did not qualify for this exception because Ms. Lin resided in California and, pursuant to California's community property laws, one half of her income is treated as his income. (See generally, Fam. Code, § 760.) According to FTB, inasmuch as Ms. Lin does not dispute that her wage income was California source income, that income would retain its character as California source income even if it were taxable to Mr. Gao, a nonresident of California, under California's community property laws. We find, however, that FTB's errs in assuming that Ms. Lin's income was subject to California's community property laws since neither Ms. Lin nor Mr. Gao was a California domiciliary during 2013. (See Fam. Code, § 760 ["property … acquired by a married person "*while domiciled in this state*" is community property"] (italics added).)

After appellants presented evidence establishing that *both* Mr. Gao and Ms. Lin were neither residents nor domiciliaries of California during 2013, FTB took the position that this fact makes no difference in the computation of appellants' tax liability for 2013. But it does. Since both Mr. Gao and Ms. Lin were not California domiciliaries during 2013, California's

community property laws do not apply to their income.[3] Therefore, Mr. Gao had no California source income, and Ms. Lin was entitled to file her amended return utilizing the nonresident spouse exception of R&TC section 18521(c)(2). And although the amount of Ms. Lin's California taxable income is the same regardless of whether she files as married filing separately or married filing jointly, *her California tax liability would be different*. This is because, if Ms. Lin is entitled to file using the married filing separately status, then Mr. Gao's income would not be included in determining the tax rate applicable to her California source income, whereas his income would be taken into account in determining the applicable tax rate if she is required to file on the basis of married filing jointly. (R&TC, § 17041(b) & (i).)[4]

We note that appellants inadvertently checked the wrong boxes on their amended California return regarding their filing status. On that return, they checked the box indicating that they originally had filed as married filing separately whereas they originally had filed on a joint basis (although that return claimed a subtraction for Mr. Gao's income). They also erroneously checked the box indicating that their amended return was filed on a single basis, whereas the return and cover letter both indicated that Ms. Lin remained married to Mr. Gao during 2013, which precluded them from filing as single.[5] It was (or should have been) clear to the FTB protest hearing officer who received appellants' protest and amended return that appellants were seeking to change their California filing status from married filing jointly to married filing separately. Indeed, when FTB responded to the protest, FTB rejected appellants' amended return based on its claim that the nonresident spouse exception of R&TC section 18521(c) did not apply because appellants were married during 2013.[6] This further shows that FTB was aware of the filing status appellants were attempting to claim on their amended return.

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[3] During 2013, Ms. Lin was a resident of North Carolina and New York, both of which are not community property states. The record does not indicate where Mr. Gao resided, although it is undisputed that he did not reside in California.

[4] The allowance of credits and itemized deductions also may be affected by whether appellants file using a status of married filing jointly or married filing separately. (See generally, R&TC, §§ 17304, 17055; see also FTB Publication 1100 (accessible at <https://www.ftb.ca.gov/forms/misc/1100.html> [accessed Jan. 4, 2020].)

[5] As noted earlier, appellants appear to have confused filing on a single basis with filing on a married filing separately basis. However, it was clear from the correspondence between appellants and FTB that appellants intended for their amended return to be a separate return for Ms. Lin, a married woman. FTB was not confused about appellants' intention.

[6] FTB also made this argument in its opening brief in this appeal.

The case law reveals that one may take into account the "intent of the parties" in ascertaining the filing status claimed by the taxpayer. (See generally *Okorogu v. Commissioner*, T.C. Memo. 2017-53; see also *Camara v. Commissioner* (2017) 149 T.C. 317.) Appellants' checking of the wrong boxes on their amended return did not mislead the FTB as to the fact that appellants' intent was to change their filing status from married filing jointly to married filing separately. Their amended return was a valid separate return for Ms. Lin on a married filing separately basis. Ms. Lin was permitted to claim that status on her amended return pursuant to R&TC section 18521(c)(2). Accordingly, we direct FTB to recompute her tax liability for 2013 on that basis, without treating either of appellants' incomes as being subject to California's community property laws.

HOLDING

Both appellants were nondomiciliaries and nonresidents of California and their incomes were not subject to California's community property law. Only Ms. Lin had California source income in 2013. Thus, Ms. Lin was entitled to (and did) claim the filing status of married filing separately for 2013, under the nonresident spouse exception of R&TC section 18521(c)(2).

DISPOSITION

Appellants' tax liability for 2013 shall be recomputed treating only Ms. Lin's wage income from U.C. Irvine as California source income, and none of that income is taxable to Mr. Gao as community property income. Furthermore, Ms. Lin was entitled to (and did) claim the filing status of married filing separately for 2013, under nonresident spouse exception of R&TC section 18521(c)(2). Hence, her tax liability for 2013 shall be recomputed on a married filing separately basis.

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Jeffrey I. Margolis
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Jeffrey I. Margolis
Administrative Law Judge

We concur:

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

DocuSigned by:
Douglas Bramhall
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