

- 540NR. This adjustment increased appellants' taxable income and FTB proposed an additional tax of \$3,889.
3. Appellants protested the NPA, explaining the income should not have been considered California sourced-income because it included salary earned while they were residents of China and the dividends were from a Fidelity account.
 4. FTB did not dispute that appellants were nonresidents of California but maintained that the Schedule CA 540NR was completed incorrectly. FTB issued a Notice of Action (NOA) affirming the NPA.
 5. This timely appeal followed.

DISCUSSION

Because FTB accepted appellants' contention that they were both a nonresident or part-year resident of California during the 2015 tax year, the NOA did not include the \$195,529 for wages and \$1,836 for dividends in appellants' California AGI.¹ Instead, the NOA correctly included this additional income in appellants' AGI from all sources solely for the purpose of computing appellants' California tax rate under the "California Method" of computing tax of a nonresident or part-year resident. Under the California Method, the rate of tax that is applied to the income of a nonresident or part-year resident that is subject to California taxation is determined by taking into account the taxpayer's worldwide income for the entire tax year. (*Appeal of Million* (87-SBE-036) 1987 WL 59534.) This method does not tax out-of-state income received while a taxpayer is not a resident of California, but merely takes into account a taxpayer's "entire taxable income" for the year, including income from non-California sources, in determining the applicable tax rate. (R&TC, § 17041(b)(2).) The tax rate so determined is then applied only to the income the taxpayer earned while a California resident and to any other California source income the taxpayer might have earned. The purpose of the method is to apply the graduated tax rates to all persons (not just to those who reside in California).²

¹ California residents are taxed on their entire taxable income (regardless of source), while nonresidents are only taxed on income from California sources. (R&TC, §§ 17041(a), (b), & (i); 17954.) Part-year residents are taxed on their income (regardless of source) while they are residents of this state, as well as all income derived from California sources while they are nonresidents. (R&TC, § 17041(b) & (i).)

² The fundamental fairness and the constitutionality of using out-of-state income to calculate the rate of tax has been upheld. (*Brady v. New York* (1992) 80 N.Y.2d 596, cert. den. (1993) 509 U.S. 905 (*Brady*).) The court in *Brady* reasoned that similarly-situated taxpayers were those with the same total income. For example, a nonresident

While appellants state that they do not believe they owe the additional tax, as explained above, all of appellants’ 2015 income must be reported on the California return, since income from all sources is used to calculate the tax rate that applies to appellants’ California-sourced income. However, the income appellants earned while they were residents of China has not been subjected to California tax. Based on the above, appellants have not produced any additional information or evidence to show error in either the proposed assessment or FTB’s application of the formula set forth in R&TC section 17041(b)(2).

HOLDING

Appellants have not established error in FTB’s computation for the 2015 tax year.

DISPOSITION

FTB’s action is sustained.

DocuSigned by:
Sara A. Hosey
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Sara A. Hosey
Administrative Law Judge

We concur:

DocuSigned by:
Amanda Vassigh
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Amanda Vassigh
Administrative Law Judge

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

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earning \$20,000 in New York, but with \$100,000 of reported total income, should be taxed on the \$20,000 of New York-source income at the same tax rate as a New York resident with \$100,000 of total income (and not at the same tax rate as a New York resident with \$20,000 of total income).