OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **S. GUHA AND** **B. MURPHY**	) OTA Case No. 20127027)))))

OPINION

Representing the Parties:

For Appellants: Jane Allen, CPA

For Respondent: Melisa Recendez, Legal Analyst

For Office of Tax Appeals: Oliver Pfost, Tax Counsel

T. STANLEY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, S. Guha and B. Murphy (appellants) appeal an action by respondent Franchise Tax Board (FTB) proposing additional tax of $5,132 plus applicable interest for the 2015 taxable year.

Appellants waived the right to an oral hearing; therefore, we decide the matter based on the written record.

ISSUE

Have appellants established that they are entitled to a tax credit for tax paid to another state (other state tax credit) of $6,770 for income taxes paid to Connecticut in the 2015 taxable year?

FACTUAL FINDINGS

1. Appellants were part-year California residents in 2015, and timely filed a joint 2015 California Nonresident or Part-Year Resident Income Tax Return (original tax return). Appellants reported earning income from California, Connecticut, and Texas sources.
2. During the audit of appellants' original tax return FTB determined appellants incorrectly excluded the Connecticut and Texas source income from the calculation of appellants'

applicable California tax rate. FTB issued appellants a Notice of Proposed Assessment (NPA) proposing additional tax of $5,132 plus applicable interest for the 2015 taxable year. FTB later issued a Notice of Action (NOA) affirming the NPA in its entirety.

3. Appellants submitted an amended 2015 California personal income tax return (amended tax return) and provided a copy of their 2015 Connecticut Nonresident and Part-Year Resident Income Tax Return (Connecticut return).
4. On the amended tax return, appellants included their California, Connecticut, and Texas source income in the calculation of the applicable California tax rate.
5. Appellants reported California tax (before credits) of $8,090 on their amended tax return, which was $15 more than the tax proposed in the NPA.
6. Appellants attached to their original tax return a 2015 Form W-2 issued by Unitrends reporting that one of the appellants received wages from this employer. On both the original and amended tax returns appellants reported the Unitrends income as either income received as a California resident or received from a California source as a nonresident.
7. Appellants also attached to their original tax return a 2015 Form W-2 issued by Pitney Bowes reporting income from a Texas source and income from a Connecticut source. On both the original and amended tax returns, appellants reported the Pitney Bowes income as neither income received as a California resident nor received from California sources.
8. On their amended tax return, appellants claimed a $6,770 other state tax credit for income taxes paid to Connecticut.
9. On appellants' Connecticut return, appellants reported $6,770 in Connecticut tax. The tax was based solely on the Connecticut income reported on the Pitney Bowes Form W-2. The return did not include appellants' California income received from Unitrends or their Texas income received from Pitney Bowes.
10. Appellants timely appealed FTB's NOA to the Office of Tax Appeals.

DISCUSSION

California Taxation of Part-Year Residents and the California Method

Part-year California residents, such as appellants, are taxed on their entire taxable income for the period of their residency, and only on income from California sources for the period of

their non-residency. (R&TC, §§ 17041(b) & (i), 17951; *Appeal of Bracamonte*, 2021-OTA-156P.) California nevertheless determines the applicable California tax rate of a part-year resident based on the part-year resident's income from all sources during the taxable year, using a formula commonly referred to as the "California Method." (R&TC, § 17041(b); see *Appeal of Million*, (87-SBE-036) 1987 WL 59534.) The California Method is a multistep process in which the part-year resident's total income is used to compute the appropriate California tax rate and to prorate the part-year resident's California standard or itemized deduction(s) and exemption credits. R&TC section 17041(b) requires that a part-year resident's California tax liability be computed by dividing California adjusted gross income by total adjusted gross income and then applying the resulting apportionment ratio against the total tax appellants would have incurred if the taxpayer were a California resident. After similarly apportioning deductions and credits relative to the amount of California source or residency income, the tax rate is applied to only the California source and residency income. (R&TC, § 17041(b)(1)-(2).) The use of the California Method preserves the progressive nature of California's personal income tax system, so taxpayers with higher incomes are taxed at a higher rate than taxpayers with lower incomes.[1]

On appeal, appellants do not contest the use of the California Method or the inclusion of their Connecticut and Texas source income in the calculation of their applicable California tax rate. Rather, appellants provide evidence indicating the Connecticut and Texas source income is includible in that California Method calculation. Appellants reported on both their original and amended tax returns having earned income from California, Connecticut, and Texas sources in the 2015 taxable year. During the audit, FTB determined appellants' original tax return excluded the Connecticut and Texas source income from the calculation of appellants' applicable California tax rate, and FTB adjusted appellants' California tax (before credits) from $2,943 to $8,075.[2] In other words, FTB determined appellants did not calculate their California tax rate or

[1] The fundamental fairness and constitutionality of using out-of-state income to calculate the rate of tax has been upheld by New York's highest court, and the United States Supreme Court refused to hear an appeal from the New York decision. (*Brady v. New York* (1992) 80 N.Y.2d 596, cert. den. (1993) 509 U.S. 905.) The Brady court reasoned that similarly situated taxpayers were those with the same total income. For example, a nonresident earning $20,000 in New York, but with $100,000 reported total income, should be taxed on the $20,000 New York-source income at the same rate as a New York resident with $100,000 total income (and not at the same rate as a New York resident with $20,000 total income).

[2] Appellants' original tax return reported a California tax rate of .0376 percent after excluding the Connecticut and Texas income from taxable income. FTB subsequently adjusted the California tax rate to .0757 percent after including appellants' total income from all sources. FTB also prorated appellants' itemized deductions and exemption credits with respect to California income relative to income from all sources. The adjustment to the

prorate their California itemized deductions and exemption credits using the California Method. Appellants' amended tax return applies the California Method and reports California tax (before credits) of $8,090, a difference of $15 from FTB's determination. Since appellants' amended tax return properly applied the California Method, and because appellants do not argue otherwise, we find appellants no longer dispute the proposed computational adjustments in FTB's NPA. Instead, appellants seek to offset the additional tax resulting from the upward adjustment by claiming an other state tax credit of $6,770 for income taxes paid to Connecticut.

California's Other State Tax Credit Provisions

To alleviate the possibility of double taxation, California provides a tax credit for net income taxes paid to another state, such as Connecticut, but only on income having a source within that state that is taxed by both California and the other state. (R&TC, §§ 18001, 18002.) Tax credits are a matter of legislative grace, and appellants bear the burden of proving, by a preponderance of the evidence, they are entitled to a claimed tax credit. (*Appeals of Swat-Fame, Inc., et al*., 2020-OTA-046P, at p. *8; Cal. Code Regs., tit. 18, § 30219(c).) Statutes granting tax credits are strictly construed against taxpayers, and any doubts are resolved in FTB's favor. (*Appeals of Swat-Fame, Inc., et al., supra*, citing *Dicon Fiberoptics, Inc. v. Franchise Tax Bd.* (2012) 53 Cal.4th 1227, 1235.)

Appellants reported on their original and amended tax returns, receiving income from California, Connecticut, and Texas sources. Attached to the original tax return is a 2015 Form W-2 issued by Unitrends reporting that one of the appellants received California wages from this employer. On both the original and amended tax returns, appellants reported the Unitrends income as either income received as a California resident or received from a California source as a nonresident. Also attached to the original tax return is a 2015 Form W-2 issued by Pitney Bowes reporting that one of the appellants received wages that were sourced to Connecticut and to Texas. Appellants did not report the Pitney Bowes income as either income received as a California resident or received from California sources as a nonresident.

Comparing appellants' California and Connecticut tax returns, it is clear that the two states are not taxing the same income. Rather, the Connecticut return shows that Connecticut is only taxing appellants' Connecticut source income (i.e., the income that is reported as

tax rate and the proration of appellants' deductions and credits resulted in an upwards adjustment to appellants' proposed 2015 tax liability.

Connecticut income on the 2015 Form W-2 issued by Pitney Bowes).[3] California, on the other hand, taxed only appellants' Unitrends wage income, and excluded appellants' Connecticut and Texas income from Pitney Bowes, using that income only to determine appellants' California tax rate. Since California is not taxing appellants' Connecticut source income, and Connecticut did not tax appellants' California source income, there is no double taxed income (i.e., income that is taxed in both California and Connecticut), and appellants are not entitled to an other state tax credit of $6,770 for income taxes paid to Connecticut in the 2015 taxable year.

HOLDING

Appellants have not established they are entitled to an other state tax credit of $6,770 for income taxes paid to Connecticut in the 2015 taxable year.

DISPOSITION

We sustain FTB's action in full.

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Teresa A. Stanley
Administrative Law Judge

We concur:

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Administrative Law Judge

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Cheryl L. Akin
Administrative Law Judge

Date Issued: 12/22/2021

[3] Like California, during the taxable year at issue Connecticut imposed an income tax on Connecticut nonresidents on income derived from or connected with sources within the state. (Connecticut General Statutes § 12-700(b).) This statute is reflected in the Connecticut return. On a 2015 Form CT-1040NR/PY (the return appellants completed) taxpayers report Connecticut adjusted gross income and income from Connecticut sources. The taxpayer divides the Connecticut source income by the Connecticut adjusted gross income. The resulting amount is then multiplied by the tax shown on a corresponding income tax table—thus showing Connecticut is only taxing the Connecticut source income.