

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:

J. NOBLE AND
D. NOBLE

) OTA Case No. 21067926
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OPINION

Representing the Parties:

For Appellants: J. Noble

For Respondent: Eric R. Brown, Tax Counsel III

S. HOSEY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, J. Noble and D. Noble (appellants) appeal an action by respondent Franchise Tax Board (FTB) proposing additional tax of \$1,026 for the 2015 taxable year.¹

Appellants waived the 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 for the 2015 taxable year.

FACTUAL FINDINGS

1. Appellants timely filed their 2015 California Nonresident or Part-Year Resident Income Tax Return (540NR) reporting an overpayment and requesting a refund. FTB refunded the requested amount to appellants.
2. FTB then audited appellants’ 2015 tax return and issued a Notice of Proposed Assessment (NPA). The NPA stated that appellants should have filed a California Form 540 (California Resident Income Tax Return) because they previously used a

¹ During this appeal appellants paid the proposed liability plus interest. FTB, therefore, converted the matter to a claim for refund.

California address. The NPA also included additional items that appellants reported on Schedule CA (540NR), which were not included as income on their California tax return. FTB proposed additional tax of \$1,916.²

3. Appellants protested the NPA, stating that appellant J. Noble was a resident of the state of Washington during the 2015 tax year and that they should not be taxed on that income.
4. After receiving documentation from appellants, FTB issued a Notice of Action (NOA) adjusting appellants' income to reflect appellant J. Noble's nonresident status and indicating that the tax should be calculated according to the "California Method" of taxing nonresidents.
5. Appellants filed this timely appeal.³

DISCUSSION

California residents are taxed upon their entire taxable income (regardless of source), while nonresidents are only taxed on income from California sources. (R&TC, §§ 17041(a), (b), & (i); 17951.)

The calculation of the tax rate on a nonresident, which is statutorily required by R&TC section 17041(b), is part of a multistep process known as the "California Method." Under the California Method, the rate of tax that is applied to the income of a nonresident 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 the out-of-state income into consideration in determining the tax rate that should apply to California-source income. (*Ibid.*) The purpose of the California Method is to apply the graduated tax rates to all persons, not just those who reside in California.

For the tax year at issue, California law requires the calculation of three ratios to be applied in determining: (1) a nonresident's prorated deductions, (2) the tax rate applicable to the taxpayer's California taxable income, and (3) allowable credits. A nonresident's prorated

² FTB concedes that computations in both the NPA and Notice of Action (NOA) were erroneous. FTB computes the correct additional amount of tax to be higher than the additional tax shown in the NOA but will adhere to the lower amount of \$1,026 as the amount on appeal.

³ Appellants remitted a check for payment in the amount of \$1,213.94 with their appeal letter (\$1,026 tax, plus \$187.94 interest), converting this matter from an appeal of a deficiency to an appeal of the denial of a claim for refund.

deductions ratio is calculated by dividing the California adjusted gross income (AGI) by the total AGI. (R&TC, § 17304.) The resulting ratio, not to exceed 1.00, is then applied to the itemized deductions or standard deduction to find the prorated allowable amount. (*Ibid.*) The tax rate ratio applicable to the taxpayer's California taxable income is calculated as if the taxpayer were a California resident, and then divided by the taxpayer's total taxable income. (R&TC, § 17041(b)(2).) The resulting ratio is then applied to the taxpayer's California taxable income to determine the California tax. (*Ibid.*) The allowable credits ratio is calculated by dividing the California taxable income by the total taxable income. (R&TC, § 17055(a).) The resulting ratio is then applied to the total exemption amount to find the prorated credits. (*Ibid.*)

FTB concedes that appellant J. Noble was a resident of the state of Washington for the entire year of 2015, while D. Noble was a resident of California. Therefore, it was appropriate to file using Form 540NR. However, appellants' tax is to be calculated according to the California Method of taxing nonresidents. Where one spouse is a resident of California and the other spouse is a nonresident of California, as in this case, the non-earning spouse's marital property interest in the income is taxable in California because the non-earning spouse is a resident of California who is taxed on all income regardless of source. (R&TC, § 17041(a); *Appeal of Cremel and Koeppl*, 2021-OTA-222P.) FTB correctly included appellants' income in total AGI from all sources for the purpose of computing appellants' California tax rate under the California Method of computing tax of a nonresident, as shown on FTB's corrected return, including appellant D. Noble's one-half community property interest in her spouse's earnings.

Appellants' California AGI is \$90,615, their California taxable income is \$74,652, and their California tax rate is .0377.⁴ Thus, appellants' total taxable income was used as the denominator to determine the graduated tax rate to be applied to their California taxable income. The \$2,814 tax (.0377 x \$74,562) minus the \$278 prorated exemption credits yielded \$2,536 total tax. Appellants' total payments were previously reported as \$1,066, which is subtracted from \$2,536 total tax. The result, \$1,470, is the additional tax appellants would be required to pay. However, FTB reduced the amount of additional tax owed to \$1,026, the amount stated in the original NOA. Because FTB has supported its computation with appellants' actual items of income, FTB has complied with the requirements of the California Method in the manner

⁴ This rate was calculated by dividing the \$3,309 tax by total taxable income of \$87,737 to arrive at the .0377 graduated tax rate to apply to appellants' \$74,562 California taxable income.

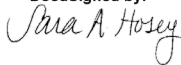
prescribed by R&TC section 17041(b). Furthermore, appellants have not produced any additional information or evidence to show error in either the proposed assessment or FTB’s application of the formula set forth in R&TC section 17041(b)(2).

HOLDING

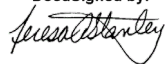
Appellants have not shown error in FTB’s proposed assessment of additional tax for the 2015 taxable year.

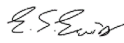
DISPOSITION

FTB’s action is sustained.

DocuSigned by:

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Sara A. Hosey
Administrative Law Judge

We concur:

DocuSigned by:

UCC6C6ACCC8A44D...
Teresa A. Stanley
Administrative Law Judge

DocuSigned by:

2D8DE82EB65E4A6...
Elliott Scott Ewing
Administrative Law Judge

Date Issued: 3/30/2022