OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **J. ACOSTA AND** **M. CASTRO**	) OTA Case No. 20116978)))))

OPINION

Representing the Parties:

For Appellants:	J. Acosta and M. Castro
For Respondent:	Eric R. Brown, Tax Counsel III Maria Brosterhous, Tax Counsel IV
For Office of Tax Appeals:	Linda Frenklak, Tax Counsel V

K. GAST, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, J. Acosta (appellant-husband) and M. Castro (appellant-wife) (collectively, appellants) appeal actions by respondent Franchise Tax Board (FTB) proposing additional tax of $19,191, $16,304, and $28,276, plus applicable interest, for the 2016, 2017, and 2018 tax years, respectively.

Office of Tax Appeals (OTA) Administrative Law Judges Kenneth Gast, Josh Lambert, and Cheryl L. Akin held an electronic oral hearing for this matter on February 23, 2022. At the conclusion of the hearing, the record was closed and this matter was submitted for a decision.

ISSUE[1]

Whether OTA has jurisdiction to decide whether 49 U.S.C. section 11502(a), a federal statute, preempts or otherwise prohibits California from taxing resident appellant-wife's community property share of nonresident appellant-husband's out-of-state railroad wages for the 2016, 2017, and 2018 tax years; and if OTA has jurisdiction, whether California is preempted.

[1] Appellants provide an issue statement that, in their view, properly frames the issue in this appeal. However, based upon the parties' briefing and oral argument, we find our phrasing more accurately reflects the dispute and is not materially different from the phrasing of appellants' proposed issue statement.

FACTUAL FINDINGS

1. During the tax years at issue, appellant-husband was a California nonresident who resided and was domiciled in Texas. He earned out-of-state wage income through his employment with the Burlington Northern Santa Fe Railway. During these same years, appellant-wife was a California resident.
2. Appellants filed joint California Nonresident or Part-Year Resident Income Tax Returns for the 2016, 2017, and 2018 tax years.[2] On these returns, they excluded from their California adjusted gross income the entirety of appellant-husband's out-of-state railroad wages, including appellant-wife's community property share (or one-half) of that income.
3. FTB examined these returns and determined: (1) appellant-wife has a one-half community property interest in appellant-husband's out-of-state railroad wages; and (2) because she was a California resident, she is taxable in full on this income regardless of source. FTB thus increased appellants' California adjusted gross income by this amount for the disputed tax years and issued Notices of Proposed Assessment (NPAs) reflecting this determination.[3]
4. Following protest proceedings, FTB issued Notices of Action, affirming the NPAs. This timely appeal followed.

DISCUSSION

Appellants argue California is preempted or otherwise prohibited by 49 U.S.C. section 11502, a federal statute, from taxing one-half of appellant-husband's out-of-state railroad wages. They assert this federal statute prohibits California from attributing that income to appellant-wife as her community property share and taxing it, even though she is a California resident who is taxed all on her income regardless of source. However, as discussed below, we

[2] Since appellant-husband was a California nonresident, and appellants filed joint federal income tax returns for the years at issue, they properly filed joint California nonresident tax returns for these same years, even though appellant-wife was a California resident. (See R&TC, § 18521(a)(3).)

[3] Specifically, FTB increased appellants' California adjusted gross income by $237,141 for 2016, $209,622 for 2017, and $318,365.50 for 2018. These amounts reflect appellant-wife's community property share (or one-half) of appellant-husband's out-of-state railroad wages. We note there is no dispute that appellants properly excluded from their California adjusted gross income *appellant-husband's* community property share (i.e., the other half) of his out-of-state railroad wages, presumably because he was a California nonresident and those wages were not derived from sources within this state (see Cal. Code Regs., tit. 18, § 17951-5), or if they were, R&TC section 17951(b)(2), discussed below, excluded them from being taxed in California.

lack jurisdiction to rule on this issue. Instead, based on California's income tax statutes and authorities that we can consider, we find appellants have not carried their burden of proving error in FTB's proposed assessments. (See *Appeal of Stabile*, 2020-OTA-198P [FTB's determination is presumed to be correct, and a taxpayer has the burden of proving error].)

Before we address appellants' preemption argument, we begin with the relevant California income tax statutes and authorities. In general, California residents, such as appellant-wife, are taxed on their entire taxable income regardless of source, while California nonresidents, such as appellant-husband, are taxed only on income from California sources. (R&TC, §§ 17041(a), (b), & (i), 17951.) At issue here is whether California can tax, on a residency basis, appellant-wife's community property share of nonresident appellant-husband's out-of-state railroad wages. "In situations such as this, where one spouse is a resident of California [here, appellant-wife] and the other spouse is a nonresident of California [here, appellant-husband], the determination of whether an item of income is taxable in California to the nonearning spouse [here, appellant-wife] can be broken down into a two-step analysis ....." (*Appeals of Cremel and Koeppel*, 2021-OTA-222P, at p. *5 (*Cremel*).)

The first step requires a determination of the nonearning spouse's (i.e., appellant-wife's) marital property interest in the earning spouse's (i.e., appellant-husband's) income. (*Cremel*, *supra*, at p. *5.) An individual's marital property interest in personal property is determined by the laws of the earning or acquiring spouse's domicile. (*Ibid*. [citing California Supreme Court opinions in *Schecter v. Superior Court* (1957) 49 Cal.2d 3, 10, and *Rozan v. Rozan* (1957) 49 Cal.2d 322, 326].) Since appellant-husband was a Texas domiciliary when he earned the railroad wages, and Texas is a community property state (see Tex. Fam. Code, § 3.003(a)), that income is characterized as community property and one-half is attributed to appellant-wife. (*Cremel*, *supra*, at p. *6 [citing U.S. Supreme Court opinions in *United States v. Mitchell* (1971) 403 U.S. 190, *U.S. v. Malcom* (1931) 282 U.S. 792, and *Poe v. Seaborn* (1930) 282 U.S. 101].)

Since appellant-wife has a marital property interest in appellant-husband's out-of-state railroad wages, we proceed to the second step to determine whether appellant-wife's interest in such income is taxable in California. (*Cremel*, *supra*, at p. *6.) We conclude that it is. Because appellant-wife was a California resident during each of the tax years at issue, all her income, including her one-half community property interest in appellant-husband's out-of-state railroad wages, is subject to California income tax regardless of source. (See R&TC, § 17041(a); see

also *Appeal of Misskelley* (84-SBE-077) 1984 WL 16156 [California resident spouse liable for California income tax on share of out-of-state earnings of nonresident spouse domiciled in a non-California community property state].) Accordingly, based on these controlling authorities, we find no error in FTB's proposed assessments.

Appellants disagree, arguing that 49 U.S.C. section 11502(a), a federal statute, preempts or otherwise prohibits California from taxing appellant-wife's one-half community property interest in appellant-husband's out-of-state railroad wages. 49 U.S.C. section 11502(a) provides in full:

> No part of the compensation paid by a rail carrier providing transportation subject to the jurisdiction of [the Surface Transportation Board] under this part to an employee who performs regularly assigned duties as such an employee on a railroad in more than one State shall be subject to the income tax laws of any State or subdivision of that State, other than the State or subdivision thereof of the employee's residence.[4]

Based on this language, appellants assert that "[n]o part" of the compensation earned by appellant-husband from his railroad employment—including the portion attributed to appellant-wife through Texas's community property laws—can be subjected to an income tax in any state, including California, that is not the employee's (i.e., appellant-husband's) state of residence. At its core, appellants' argument is essentially that under the supremacy clause of the U.S. Constitution, 49 U.S.C. section 11502(a) controls over R&TC section 17041(a)—the California statute that permits taxation of all a resident's income—and therefore R&TC section 17041(a) is preempted and cannot be followed when the two statutes conflict.

[4] Appellants incorrectly refer to 49 U.S.C. section 11502 as part of the "Amtrak Act." Although 49 U.S.C. section 11502's predecessor provision, 49 U.S.C. section 11504, was enacted as part of the Amtrak Reauthorization and Improvement Act of 1990 (Pub. L. 101-322, § 7, July 6, 1990), 49 U.S. C. section 11504 was later reenacted in its present iteration, without substantial change, under 49 U.S.C. section 11502 as part of the ICC Termination Act of 1995 (Pub. L. 104-88, Title I, § 102(a), Dec. 29, 1995). Thus, during the tax years at issue, the ICC Termination Act of 1995 was controlling, although this fact has no bearing on our conclusion here.

However, we lack jurisdiction to rule on the merits of this argument. A California administrative agency, such as OTA, has limited jurisdiction. Article III, section 3.5, of the California Constitution provides in relevant part:

> An administrative agency . . . has no power:
>
> . . .
>
> (c) To declare a statute unenforceable, or to refuse to enforce a statute on the basis that federal law or federal regulations prohibit the enforcement of such statute unless an appellate court has made a determination that the enforcement of such statute is prohibited by federal law or federal regulations.

California Code of Regulations, title 18, (Regulation) section 30104(a) also specifically provides that OTA does not have jurisdiction to determine "[w]hether a California statute is invalid or unenforceable under the United States or California Constitutions, unless a federal or California appellate court has already made such a determination." In addition, our predecessor, the Board of Equalization, had a long-established policy of abstaining from deciding constitutional issues. (*Appeal of Aimor Corp*. (83-SBE-221) 1983 WL 15592.) "This policy is based upon the absence of any specific statutory authority which would allow [FTB] to obtain judicial review of a decision in such cases and upon our belief that judicial review should be available for questions of constitutional importance." (*Ibid*.) Appellants do not direct us to, nor are we aware of, any appellate court that has determined whether 49 U.S.C. section 11502 preempts R&TC section 17041(a).[5] Accordingly, we are prohibited from ruling on this issue.

Appellants nonetheless make two primary arguments to avoid this result. They first clarify they are only asking OTA to find a California regulation, not a statute, is preempted-here, Regulation section 18501(d). Regulation section 18501(d) essentially provides guidance to "married couple[s] who are nonresidents of" California on how they should report the other spouse's income if they file separate California returns. It reiterates the well-established legal proposition that reporting "depends upon the [earning] spouse's domicile . . . ." (Cal. Code Regs., tit. 18, § 18501(d).)

[5] Appellants also do not direct us to, nor are we aware of, any appellate court that has determined whether 49 U.S.C. section 11502 preempts state community property laws. Although appellants cite to the U.S. Supreme Court's opinion in *Hisquierdo v. Hisquierdo* (1979) 439 U.S. 572, in which the Court found the federal Railroad Retirement Act of 1974 preempted California community property law, that case did not involve 49 U.S.C. section 11502 and is therefore inapplicable here.

However, Regulation section 18501(d) is not the source of the legal proposition it states; rather, that source comes from controlling California Supreme Court and U.S. Supreme Court opinions cited above. Regulation section 18501(d) also only addresses whether a nonearning spouse has a marital interest in the earning spouse's income, not whether California can tax that income once it is determined the nonearning spouse has such an interest. As discussed, the answer to that latter issue is found in R&TC section 17041 and other income tax statutes, which provide that California residents are taxable on all their income regardless of source and California nonresidents are taxable only on income derived from sources in this state. Here, R&TC section 17041(a) provides the statutory authority for California to tax resident appellant-wife's community property interest in nonresident appellant-husband's out-of-state railroad wages. Thus, appellants are indeed asking us to find a statute—here, R&TC section 17041(a)—is preempted, which we cannot do.[6]

Appellants also contend that by enacting R&TC section 17951(b)(2), the California Legislature specifically recognized that 49 U.S.C. section 11502(a) preempts California from taxing not only nonresident appellant-husband's out-of-state railroad wages, but also resident appellant-wife's community property share of those wages. We disagree.

R&TC section 17951(a) provides that a nonresident's California taxable income only includes gross income derived from California sources. As relevant to this appeal, R&TC section 17951(b)(2) then provides an exception to this general rule: "[T]he gross income of a *nonresident* taxpayer does not include income not subject to the [California] Personal Income Tax Law" by operation of "Section 11502 of Title 49, United States Code, relating to compensation of an employee of a rail carrier." (Italics added.) We find the language of R&TC section 17951(b)(2) to be clear and unambiguous because by its terms, it only applies to nonresidents, and it never uses the term "resident." (See *Lungren v. Deukmejian* (1988) 45 Cal.3d 727, 735 [there is no need for statutory construction or to resort to legislative history

[6] Appellants submit a Workers' Compensation Appeals Board (WCAB) opinion entitled *Enriquez (Deceased) v. Couto Dairy and Zenith Insurance Company* (2013) 78 Cal.Comp.Cases 323, in which the WCAB interpreted Article III, section 3.5, of the California Constitution as only preventing an administrative agency from declaring a *statute* unenforceable and therefore found it had jurisdiction to decide whether a federal statute preempted a California *regulation*. However, the WCAB's opinion, which is not binding on OTA, is distinguishable. As discussed, we find appellants are asking us to find R&TC section 17041(a), a California statute, is preempted by 49 U.S.C. section 11502(a), a federal statute. And although the WCAB noted it is not precluded by our state Constitution from determining a state law is unconstitutional if that determination is based on an extensive body of federal or state case law, we lack here any such case law authority addressing the issue in this appeal.

when the statute's language is clear and unambiguous].) Therefore, we decline to read into the statute an exemption for residents, specifically resident spouses who are attributed one-half of their nonresident spouse's out-of-state income under community property laws.[7]

Indeed, we emphasize that FTB is not attributing any portion of appellant-husband's non-California source railroad wages to a nonresident taxpayer or characterizing any portion of that income as derived from a California source. Instead, FTB is attributing one-half of appellant-husband's railroad wages to appellant-wife as her community property interest under Texas's community property laws. As a California resident, appellant-wife is taxed on her entire taxable income regardless of whether it has a source in California and this income includes her share of appellant-husband's railroad wages. (R&TC, § 17041(a).)

Accordingly, we lack jurisdiction to find FTB's proposed assessments are invalid based on appellants' federal preemption claim. The rightful process for appellants to seek such a remedy is to pay the proposed assessments, request refunds, and pursue their constitutional arguments in the courts. (See *Hyatt v. Yee* (9th Cir. 2017) 871 F.3d 1067, 1074.)[8]

[7] Although we need not discuss appellants' reliance on R&TC section 17951's legislative history, we note it does not support their position. In 2004, Senate Bill 1172 amended R&TC section 17951 by adding, as relevant here, subdivision (b)(2). (Stats. 2004, Ch. 62, § 1.) The Legislative Counsel's Digest provides that "[e]xisting federal laws limit or preempt California's ability to tax the California source income of certain nonresidents and part-year residents. This bill, in specified conformity with those federal laws, would clarify existing law by expressly providing that California may not tax the *California source income* of certain *nonresidents* and part-year residents." (Legis. Counsel's Dig., SB 1172 (2003-2004 Reg. Sess.), italics added.) The legislative committee analyses contain similar explanations. (See, e.g., Sen. Com. on Rev. & Tax., Analysis of Sen. Bill No. 1172 (2003-2004 Reg. Sess.) as introduced March 26, 2004.) Since the legislative history does not indicate R&TC section 17951(b)(2) also applies to residents, we find it actually supports FTB's position. (Cf. R&TC, § 17140.5(c)(3) [providing that California may not use the military compensation of a servicemember who is not domiciled in California to increase the California tax liability imposed on other income of that servicemember or that servicemember's spouse].)

[8] To the extent appellants raise arguments that we have not addressed, we have considered and found them to be without merit.

HOLDING

OTA does not have jurisdiction to decide whether 49 U.S.C. section 11502(a), a federal statute, preempts or otherwise prohibits California from taxing resident appellant-wife's community property share of nonresident appellant-husband's out-of-state railroad wages.

DISPOSITION

FTB's actions are sustained.

DocuSigned by:
Kenneth Gast
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Kenneth Gast
Administrative Law Judge

We concur:

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Josh Lambert
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Josh Lambert
Administrative Law Judge

DocuSigned by:
Cheryl L. Akin
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Cheryl L. Akin
Administrative Law Judge

Date Issued: 3/30/2022