

- NPA reflected that appellant-husband was a domiciliary of California, a community property state, while appellant-wife was a domiciliary and resident of California.
3. Appellants protested and submitted an amended Form 540 California Nonresident or Part-Year Resident return (Form 540NR) for the 2017 tax year stating that appellant-husband was a domiciliary and resident of Nevada. FTB did not accept the amended return due to errors. FTB issued a Notice of Action affirming the NPA. In a letter dated November 17, 2021, FTB agreed that appellant-husband was domiciled in Nevada, but that it did not change the determination because Nevada is a community property state.
 4. This timely appeal follows. On appeal, FTB revises the additional tax due from \$3,154 to \$3,108, plus applicable interest.

DISCUSSION

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), 17951.) It is undisputed that appellant-wife was a domiciliary and resident of California for the 2017 tax year. Appellants assert on their amended Form 540NR, and FTB does not dispute, that appellant-husband was a domiciliary and resident of Nevada for the 2017 tax year. For the 2017 tax year, appellant-wife is taxed on all of her income, regardless of the source of that income, because she was a California resident. Because appellant-husband was a nonresident for the 2017 tax year, he will only be taxed on California source income earned during the 2017 tax year.

Two-Step Analysis

In situations such as this, where one spouse is a resident of California and the other spouse is a nonresident of California, the determination of whether an item of income is taxable in California to the nonearning spouse can be broken down into a two-step analysis. (*Appeals of Cremel and Koeppel*, 2021-OTA-222P.) The first step requires a determination of the nonearning spouse's marital property interest in the earning spouse's income. (*Ibid.*) If the nonearning spouse has a marital property interest in the earning spouse's income, the second step requires a determination of whether the nonearning spouse's interest in such income is taxable in California. (*Ibid.*) The nonearning spouse's marital property interest in the income is taxable in California if the earning spouse is domiciled in a community property state and the nonearning

spouse is a resident of California who is taxed on all income regardless of source. (R&TC, § 17041(a); *Appeals of Cremel and Koepfel, supra*; see also, *Appeal of Li*, 2020-OTA-095P.)

Step 1: Determination of Appellant-wife’s Marital Property Interest in Appellant-husband’s Income.

An individual’s marital property interest in personal property is determined by the laws of the earning spouse’s domicile. (*Appeal of Li, supra*.) Here, the issue is whether appellant-wife has a marital property interest in appellant-husband’s Nevada wage income. Nevada Revised Statutes section 123.220 provides, with certain exceptions not relevant here, that all property acquired after marriage by either spouse or both spouses is community property. Because appellant-husband was domiciled in Nevada when the income was earned, and because Nevada is a community property state, the income in question is community property. (*Ibid.*)

Where the income in question is community property, one-half of the income is attributable to each spouse and each spouse must report and pay tax on his or her respective one-half community property interest in the income. (See *Appeals of Cremel and Koepfel, supra*.) Thus, one-half of the community property income is attributable to appellant-wife for tax purposes.

Step 2: Determination of Whether Appellant-wife’s Community Property Interest in Appellant-husband’s Income is California Taxable Income.

After establishing that appellant-wife was a resident of California, and that one-half of appellant-husband’s income is attributable to appellant-wife, the next step is the question of whether California can tax the income. 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), 17951.) Because appellant-wife was a California resident for the 2017 tax year, appellant-wife is taxed on all of her income, regardless of the source of that income. (See *Appeals of Cremel and Koepfel, supra*.) Thus, appellants’ California taxable income includes appellant-wife’s one-half community property interest in appellant-husband’s Nevada wages for the 2017 tax year.

Appellants contend they should not be subject to California tax on any portion of appellant-husband’s Nevada wage income, and that in the alternative if some portion of that income is subject to tax in California, no more than half of appellants’ joint income should be

subject to tax in California. As stated above, under California law, all of appellant-wife’s income is taxable by California because she is a California resident. Additionally, because appellant-wife has a community property interest in one-half of appellant-husband’s Nevada wage income, that portion is also subject to tax in California. California law does allow a credit, called the Other State Tax Credit,² against the tax in certain cases to prevent double taxation, but that credit is unavailable to appellants in this case because Nevada does not have an income tax. Accordingly, appellants have not demonstrated error in FTB’s proposed assessment.

HOLDING

Appellants have not established that appellant-wife’s community property share of appellant-husband’s Nevada wage income earned during the 2017 tax year is not California taxable income.

DISPOSITION

FTB’s action is modified as conceded on appeal to revise the proposed assessment of tax to \$3,108, plus interest, and is otherwise sustained.

DocuSigned by:
Veronica I. Long
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Veronica I. Long
Administrative Law Judge

We concur:
DocuSigned by:
Teresa A. Stanley
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Teresa A. Stanley
Administrative Law Judge

DocuSigned by:
Tommy Leung
0C90542BE88D4E7...

Tommy Leung
Administrative Law Judge

Date Issued: 5/24/2023

² R&TC, § 18002.