

- subtractions of \$14,465, for California AGI of \$51,178.¹ Appellants reported total tax of \$359. Appellants requested a refund of overpaid tax.
2. FTB accepted the return as filed and issued appellants a refund.²
 3. Subsequently, FTB received information from the IRS showing that appellants reported federal AGI of \$89,643 on their federal income tax return. FTB issued a Notice of Proposed Assessment (NPA) proposing to increase appellants' AGI to reflect their federal AGI of \$89,643, to disallow the claimed California subtraction of \$14,465, and to disallow a claimed nonrefundable renter's credit. FTB proposed additional tax of \$1,993, plus applicable interest.³
 4. Appellants protested the NPA and informed FTB that they had moved out of California in 2018, after paying rent in California for more than eight months.
 5. Appellants' federal Wage and Income Transcripts reflect New York wages of \$19,753.⁴
 6. FTB accepted appellants' assertion that they were part-year residents during the 2018 taxable year, recalculated appellants' proposed tax rate based on total federal AGI of \$89,643⁵ and California wages of \$70,122,⁶ and prorated appellants' standard deduction and exemption credits. FTB computed revised tax of \$1,839, and after subtracting previously reported tax of \$359, proposed additional tax of \$1,480.
 7. FTB issued a Notice of Action reducing the proposed additional tax to \$1,480, plus applicable interest.

¹ Appellants did not include a Schedule CA, California Adjustments, with their Form 540 to explain the California subtractions.

² California income tax withholdings of \$2,870 - reported tax of \$359 = \$2,511, which FTB refunded to appellants.

³ FTB's proposed assessment assumed that appellants were residents of California because they filed Form 540, which is used by residents to report income.

⁴ Appellant's New York wages includes \$16,251 from Giuro, LLC and \$3,502 from Regine Restaurants, LLC.

⁵ Appellants' federal AGI, which was carried over to FTB's Notice of Action excluded \$232 in California wages (although the \$232 was included in appellants' California taxable income). The difference in the calculation of tax using the California method when including this income results in a nominal increase of \$1 in tax. OTA, therefore, accepts FTB's calculation.

⁶ Income earned by appellants from California sources (\$8,561 from International School of Pizza + \$25,153 from S2 HR Solutions 1D, LLC + \$232 from Pool V International School of Pizza + \$36,176 from Fagiolo Nero, Inc.) totals \$70,122.

8. This timely appeal followed.

DISCUSSION

Issue 1: Have appellants established error in FTB's proposed assessment for the 2018 taxable year?

FTB's determinations of fact are presumed correct, and a taxpayer has the burden of proving error. (*Appeal of Head and Feliciano*, 2020-OTA-127P.) Generally, the burden of proof requires proof by a preponderance of the evidence, that is, the taxpayer must establish that the taxpayer's assertions are more likely than not to be correct. (Cal. Code Regs., tit. 18, § 30219(c); *Appeal of Gillespie*, 2018-OTA-052P.) In the absence of credible, competent, and relevant evidence showing FTB's determination is incorrect, it must be upheld. (*Appeal of Valenti*, 2021-OTA-093P.)

While California residents are taxed on their entire taxable income regardless of source, part-year residents are taxed on all income earned while residing in California and income from California sources. (R&TC, §§ 17041(a), (b), (i), 17951.) For a nonresident or part-year resident taxpayer, the California tax rate is calculated using the taxpayer's entire taxable income as if the nonresident or part-year resident were a resident of California for the entire year. (R&TC, § 17041(b)(2).)

Calculating the tax for a nonresident or part-year resident taxpayer requires a multi-step process known as the "California method." (*Appeal of Williams*, 2023-OTA-041P.) The California method applies formulas to: (1) prorate deductions to determine the amount deductible from California income; (2) calculate the tax rate applicable to the taxpayer's California taxable income; and (3) prorate credits to determine the amount to offset against the taxpayer's California tax. (*Ibid.*) To calculate the percentage of itemized deductions or the prorated standard deduction allowable, the taxpayer must divide California AGI by total AGI from all sources, then apply the resulting ratio to the itemized deductions or standard deduction to find the prorated allowable amount. (R&TC, § 17304; *Appeal of Williams, supra.*) To calculate the tax rate for California, the taxpayer must divide the tax on the total taxable income (calculated as if the taxpayer were a California resident for the entire year) by the taxpayer's total taxable income; the resulting rate is then applied to the taxpayer's California taxable income. (R&TC, § 17041(b)(2); *Appeal of Williams, supra.*) To calculate the percentage of credits

allowed on the taxpayer's California return, the taxpayer must divide the California taxable income by the total taxable income; the resulting ratio is then applied to the total exemption credit amount. (R&TC, § 17055; *Appeal of Williams, supra.*)

Appellants contend that FTB is attempting to double tax them on income earned while appellants were nonresidents of California. In support of their position, appellants submit a revised Form 540 reporting California AGI of \$69,890 (\$89,643 federal AGI - \$19,753 New York wages). Appellants argue that they were unable to submit a California Non-Resident or Part-Year Resident Income Tax Return (Form 540NR) as directed by FTB because the form is “difficult” and does not “compute properly.”⁷

FTB contends that as part-year residents, appellants' tax should have been reported on Form 540NR. FTB prepared a Form 540NR to show appellants how their tax should have been reported using the California method. FTB asserts that it is using appellants' federal AGI of \$89,643 to determine appellants' California *tax rate* and the prorated deductions and credits to apply to appellants' California wages only. FTB contends that it was proper to deny appellants' nonrefundable renter's credit because their total federal AGI exceeded the amount allowed for 2018.⁸

Appellants' manner of calculating their tax by subtracting their New York wages from their federal AGI is incorrect under California law, as explained above. Part-year residents' income tax must be calculated using the California method. The California method uses a taxpayer's total income from all sources (\$89,643 from both California and New York wages) only to determine the *tax rate* to apply to the California wages (\$70,122). The calculations to determine appellants' tax are as follows:

Step One

To calculate appellants' percentage of the 2018 California standard deduction to apply to their California taxable income, FTB first divided appellants' California AGI of \$70,122 by total

⁷ Appellants also assert an inability to pay the tax liability. When this appeal becomes final, appellants may apply to FTB directly if they wish to request either an offer in compromise or installment payment plan. (See <https://www.ftb.ca.gov/pay/if-you-cant-pay>.)

⁸ Taxpayers with total AGI in excess of \$50,000 (adjusted annually for inflation) do not qualify for the nonrefundable renter's credit. (R&TC, § 17053.5(a)(1)(A), (j).) The limit for joint filers was \$83,282 in taxable year 2018. (See <https://www.ftb.ca.gov/forms/2018/18-540-booklet.html#Nonrefundable-Renter's-Credit-Qualification-Record>.)

AGI from both California and New York wages of \$89,643, resulting in a ratio of 78.22 percent ($\$70,122 \div \$89,643$). This ratio (78.22 percent) was then applied to the California standard deduction for 2018 of \$8,802⁹ to calculate appellants' prorated standard deduction of \$6,885 (78.22 percent x \$8,802). FTB then subtracted the \$6,885 from appellants' California AGI to compute California taxable income of \$63,237 ($\$70,122 - \$6,885$).

Step Two

To establish the tax rate to apply to appellants' California taxable wages, FTB first subtracted the standard deduction of \$8,802 from appellants' federal AGI of \$89,643, resulting in total taxable income of \$80,841. Based on appellants' total taxable income, FTB determined that the tax on appellants' total taxable income would be \$2,588 if it were all taxable by California. FTB then divided that tax by appellants' total taxable income to compute a California tax rate of 3.2 percent ($\$2,588 \div \$80,841$). FTB then calculated tax of \$2,024 by multiplying the 3.2 percent tax rate by appellants' California taxable income of \$63,237.¹⁰

Step Three

After determining appellants' California tax before exemption credits, FTB calculated the percentage of exemption credits that appellants could apply, by dividing California taxable income of \$63,237 by total taxable income of \$80,841 to determine the portion of the exemption credits of \$236 to subtract from appellants' California tax. FTB calculated that 78.22 percent ($\$63,237 \div \$80,841$) of the exemption credits, or \$185, should be used to reduce appellants' California tax. Total California tax of \$2,024 less prorated exemption credits of \$185 results in total California tax of \$1,839. This total California tax minus the \$359 tax originally reported on appellants' return results in the proposed additional tax of \$1,480 as calculated by FTB.

FTB properly followed the steps using the California method to calculate appellants' revised California tax liability for 2018. (See R&TC, §§ 17041(b), 17304, 17055.) The California method does not result in California taxing appellants' \$19,753 of income earned in New York. Appellants' total income, including the \$19,753 earned in New York is only used for the purpose of computing the tax rate that applies to appellants' California wages. The resulting

⁹ The standard deduction for married filing jointly status for 2018 was \$8,802, which appellants claimed on their California tax return.

¹⁰ California wage income of \$70,122 minus the prorated standard deduction of \$6,885.

tax rate of 3.2 percent is then applied *only* to appellants' California taxable wages. Additionally, FTB properly denied appellants' claimed nonrefundable renter's credit because their AGI of \$89,643 exceeds the AGI qualification limit for 2018 of \$83,282.¹¹ Based on the foregoing, appellants have not established error in FTB's proposed assessment of additional tax for 2018.

Issue 2: Have appellants established that interest should be waived or abated?

Interest must be assessed from the date a tax payment is due through the date that it is paid. (R&TC, § 19101.) The imposition of interest is mandatory and accrues regardless of the reason for the deficiency. (R&TC, § 19101(a); *Appeal of Balch*, 2018-OTA-159P.) The imposition of interest is not a penalty but is compensation for a taxpayer's use of money after it should have been paid to the state. (*Appeal of Moy*, 2019-OTA-057P.) There is no reasonable cause exception to the imposition of interest. (*Ibid.*) Thus, in order to obtain interest relief, a taxpayer must qualify under the waiver provisions of R&TC sections 19104, 19112, or 21012. (*Ibid.*) FTB may abate interest to the extent the interest is attributable in whole or in part to an unreasonable error or delay in the performance of a ministerial or managerial act by an employee of FTB. (R&TC, § 19104.) FTB may waive interest if a person's failure to make a timely return or payment was due to the person's reasonable reliance on written advice of FTB. (R&TC, § 21012.) FTB may waive interest for any period of time for which it determines that an individual demonstrates inability to pay interest solely because of extreme financial hardship caused by significant disability or other catastrophic circumstance. (R&TC, § 19112.)

Here, appellants argue that FTB's Form 540NR is "difficult and does not compute properly," and as such, FTB should not impose any additional interest. Additionally, appellants argue that they are unemployed and unable to pay any interest.

The relief of interest under R&TC sections 19104 and 21012 are not relevant here as appellants have not alleged, and OTA's record does not reflect, an unreasonable error or delay by an FTB employee or that appellants relied on written advice from FTB. OTA does not have jurisdiction to review FTB's denial of a waiver of interest based on extreme financial hardship. (*Appeal of Moy, supra.*) Accordingly, there is no basis to abate or waive interest.


¹¹ For part-year residents such as appellants, the nonrefundable renter's credit is not prorated using the California method; instead, R&TC section 17053.5(e) provides that the credit is prorated based on the number of full months qualified taxpayers paid rent in California during the taxable year. However, that provision does not apply to appellants as their AGI exceeds the limit set forth in R&TC section 17053.5(a)(1)(A).

HOLDINGS

1. Appellants have not established error in FTB’s proposed assessment of additional tax for the 2018 taxable year.
2. Appellants have not established a basis to waive or abate interest.


DISPOSITION

FTB’s action is sustained.


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 Teresa A. Stanley
 Administrative Law Judge

We concur:

DocuSigned by:

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 Andrew Wong
 Administrative Law Judge

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 Josh Aldrich
 Administrative Law Judge

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