

**OFFICE OF TAX APPEALS
STATE OF CALIFORNIA**

In the Matter of the Appeal of:) OTA Case No. 21108893
D. DUARTE JR. AND)
D. DUARTE)
_____)

OPINION

Representing the Parties:

For Appellants: D. Duarte Jr.
D. Duarte

For Respondent: David Muradyan, Attorney

V. LONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, D. Duarte Jr. and D. Duarte (appellants) appeal an action by respondent Franchise Tax Board (FTB) proposing additional tax of \$13,528 and applicable interest for the 2017 tax year.

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 2017 tax year.

FACTUAL FINDINGS

1. Appellants timely filed their 2017 California Resident Income Tax Return (Form 540) reporting federal adjusted gross income (AGI) of \$1,213,417, a California adjustment subtracting \$184,788 from their California AGI, resulting in a reported California AGI of \$1,028,629.
2. FTB examined appellants’ 2017 tax return and issued a Notice of Proposed Assessment (NPA). On examination, FTB determined that D. Duarte Jr. was a part-year resident of

California. FTB informed appellants that they should have filed a California Nonresident or Part-Year Resident Income Tax Return (Form 540NR), and recomputed appellants' California income using a Form 540NR under the "California method." The NPA proposed additional tax of \$13,528.

3. Appellants protested the NPA, stating that appellant D. Duarte Jr. earned the wages in Arizona, not California, and that appellants should not be taxed on that income by California.
4. FTB issued a Notice of Action affirming the NPA.
5. Appellants filed this timely appeal. On appeal, FTB provides a pro forma return demonstrating its computation.

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 Williams*, 2023-OTA-041P.) 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. (*Appeal of Williams, supra.*) A nonresident's prorated deductions ratio is calculated by dividing the California 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.*)

Where one spouse is a resident of California and the other spouse is a part-year resident of California, as in this case, the non-earning spouse's marital property interest in the income is taxable in California because the nonearning spouse is a resident of California who is taxed on all income regardless of source. (R&TC, § 17041(a); *Appeal of Cremel and Koeppel*, 2021-OTA-222P.) An individual's marital property interest in personal property is determined by the laws of the earning or acquiring spouse's domicile. (*Appeal of Cremel and Koeppel, supra.*) 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 pro forma return, including appellant D. Duarte's one-half community property interest in her spouse's earnings.

Based on the evidence provided, appellants' taxable income is \$1,119,012 and their California tax is \$119,030, resulting in a California tax rate of 0.0993. Multiplying this tax rate by appellants' California taxable income of \$1,108,886 results in a tax of \$1,110,112. The tax plus a Mental Health Service Tax of \$1,089 yielded \$111,201 total tax. Appellants' total payments were previously reported as \$97,673, which is subtracted from the total tax. The result, \$13,528, is the additional tax appellants are required to pay. 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 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 2017 taxable year.

DISPOSITION

FTB’s action is sustained.

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Veronica I. Long
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Veronica I. Long
Administrative Law Judge

We concur:

DocuSigned by:
Sara A. Hosey
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Sara A. Hosey
Administrative Law Judge

DocuSigned by:
Andrew Wong
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Andrew Wong
Administrative Law Judge

Date Issued: 12/8/2023