

FACTUAL FINDINGS

1. During the 2017 tax year, appellant A. Kim owned 100 percent of the stock of AK 4 Best Translation, Inc. (AK4), an S Corporation.
2. Appellants filed their 2017 California income tax return (return) on June 22, 2018. Appellants' return subtracted California adjustments from their California AGI, including \$21,507, which was appellants' share of S corporation income.
3. Appellant T. Kim received a 2017 Form W-2 from Raytheon Company (Raytheon). The form included \$7,335 in box 12c, which was marked with code "W" signifying an employer contribution to the employee's HSA. Appellants did not include this employer HSA contribution in their California AGI.
4. Respondent issued a Notice of Proposed Assessment (NPA) to appellants, adding \$28,842¹ to appellants' California AGI, which resulted in additional tax due of \$2,682.
5. Appellants submitted a notice of protest asserting that they disagreed with respondent's NPA.
6. Subsequently, respondent issued a Notice of Action (NOA) affirming the NPA. This timely appeal followed.

DISCUSSION

Issue 1: Whether appellants properly excluded their share of S Corporation income from their California AGI.

California residents are taxed on their entire taxable income (regardless of source). (R&TC, §§ 17041(a); *Appeal of Mazer*, 2020-OTA-263P.) California conforms to Internal Revenue Code (IRC) section 1366 and imposes tax on a shareholder of an S corporation's share of S corporation income. (R&TC, § 17087.5; IRC, § 1366.) Respondent's determination of tax is presumed to be correct, and taxpayers have the burden of proving error. (*Appeal of GEF Operating, Inc*, 2020-OTA-057P.) For the 2017 tax year appellant A. Kim owned 100 percent of AK4's stock and it is undisputed that appellant A. Kim's share of AK4's 2017 ordinary income was \$21,554. Thus, this amount should have been included in appellants' California AGI.

¹ This amount consists of \$21,507 in S Corporation income and the \$7,335 employer's contribution to appellant T. Kim's HSA.

Appellants have not provided argument or evidence that they are entitled to exclude their share of S Corporation income from their California AGI.

Issue 2: Whether appellants properly excluded employer contributions made on their behalf to a HSA from their California AGI.

IRC section 106(d) provides that employer contributions to an employee's HSA is excluded from the employee's federal AGI. However, R&TC section 17131.4 provides that California does not conform to IRC section 106(d). (R&TC, § 17131.4.). Thus, Raytheon's contribution to appellant T. Kim's HSA is includible in appellants' California AGI. Appellants have not provided argument or evidence to show they are entitled to exclude employer contributions made on their behalf to an HSA from their California AGI.

HOLDINGS

1. Appellants are not entitled to exclude their share of S Corporation income from their California AGI.
2. Appellants are not entitled to exclude employer contributions made on their behalf to an HSA from their California AGI.

DISPOSITION

Respondent's actions are sustained.

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Natasha Ralston
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Natasha Ralston
Administrative Law Judge

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