

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 220911359
R. CALABRIA AND)
C. STEWART)
_____)

OPINION

Representing the Parties:

For Appellants: Kevin Lawrence, CPA
For Respondent: Peter Kwok, Attorney
Chris Davis, Attorney
For Office of Tax Appeals: Tom Hudson, Attorney

V. LONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, R. Calabria and C. Stewart (appellants) appeal an action by the Franchise Tax Board (FTB or respondent) in proposing to assess additional tax of \$13,737 for 2017, \$8,764 for 2018, \$7,936 for 2019, and \$13,224 for 2020, plus applicable interest.

Office of Tax Appeals Administrative Law Judges Veronica I. Long, John O. Johnson and Lauren Katagihara held a virtual hearing for this matter on April 25, 2024. At the conclusion of the hearing, the record was closed, and this matter was submitted for decision.

ISSUE

Whether appellants have shown that they are entitled to deductions for taxes paid to a foreign jurisdiction on their California tax returns.

FACTUAL FINDINGS

1. Appellants filed California resident income tax returns (Returns) for 2017 through 2020. On the Returns, appellants reported California Adjustments subtractions of \$147,712, \$94,233, \$85,329, and \$129,922 for 2017 through 2020, respectively. These amounts

- were reported on appellants' Schedule CA for each year as business expenses or taxes paid to a foreign jurisdiction.
2. On appellants' federal income tax returns for 2017 through 2020, appellants claimed foreign tax credits of \$147,712, \$152,143, \$140,316, and \$129,922 for 2017 through 2020, respectively.
 3. FTB disallowed appellants' adjustments and issued Notices of Proposed Assessment (NPAs) proposing to increase appellants' income by the amount of the adjustments. The NPAs proposed additional tax of \$13,737, \$8,764, \$7,936, and \$13,224, for 2017 through 2020, respectively.
 4. Appellants protested the NPAs, and FTB issued Notices of Action affirming the NPAs. This timely appeal followed.
 5. On appeal, appellants provide the testimony of their CPA, Mr. Lawrence, who prepared their 2017 through 2020 California and federal income tax returns. Mr. Lawrence testified that the taxes in dispute were gross receipts taxes.

DISCUSSION

Income tax deductions are a matter of legislative grace, and the taxpayer bears the burden of establishing entitlement to the deductions claimed. (*Appeal of Vardell*, 2020-OTA-190P.) To meet this burden, a taxpayer must point to an applicable statute authorizing the deduction and show by credible evidence that the deduction claimed falls within the scope of the statute. (*Appeal of Jindal*, 2019-OTA-372P; *Appeal of Dandridge*, 2019-OTA-458P.)

Internal Revenue Code (IRC) section 162, as incorporated into California law by R&TC section 17201(a), provides a deduction for ordinary and necessary expenses paid during the taxable year in carrying on a trade or business. R&TC section 17201(a) states that the IRC provisions regarding itemized deductions applies "except as otherwise provided."

California does not allow a deduction for foreign income taxes paid. R&TC section 17220 subdivision (a) states that "Section 164(a)(3) of the [IRC], relating to the deductibility of state, local, and foreign income, war profits, and excess profits taxes, shall not apply." Thus, while foreign income taxes may be deducted for federal income tax purposes, they are not deductible for California income tax purposes. (See *Beamer v. Franchise Tax Bd.* (1977) 19 Cal.3d 467; *Appeal of Barker* (83-SBE-027) 1983 WL 15414.) Accordingly, if the taxes were on, according to, or measured by gross income, they are not deductible; but if the taxes were on

gross receipts, which exclude the cost of goods sold, they may be deductible if they otherwise satisfy the requirements of IRC section 162. (See *Beamer v. Franchise Tax Board, supra.*)

During the years at issue, appellant R. Calabria performed work in Italy, during which time he paid tax to Italy and the city of Milan. Appellants assert that, for California purposes, these taxes were deductible business taxes and not foreign income taxes. As support for this contention, appellants provide the declaration of their Italian accountant, which states that the taxes paid by appellants were “professional employment tax payments.” On appeal, appellants provide testimony from their CPA, Mr. Lawrence, stating that the taxes were based on gross receipts, not gross income. To compute the deduction, appellants subtracted the foreign taxes paid from their federal adjusted gross income (AGI) to compute their California AGI. Appellants have not provided copies of the Italian tax forms or related materials showing the nature of the tax payments or how they were calculated.

Appellants have not substantiated that the foreign taxes paid were taxes on gross receipts and not taxes on income. Even if this assertion were accepted as true, the foreign taxes would still not be deductible by appellants because they did not report the taxes as a trade or business expense, but instead reported them as a reduction in computing appellants’ AGI.

In addition, appellants’ 2017 through 2020 federal returns were prepared by Mr. Lawrence who reported the taxes as foreign income taxes and claimed foreign tax credits for the taxes paid. While appellants acknowledge the discrepancy between their California and federal returns, appellants do not explain their position and have not provided evidence to substantiate that the taxes were deductible ordinary and necessary business expenses.

Appellants contend that California Code of Regulations, title 18, section 24345-7(b)(2) supports their position. However, this regulation pertains to deductions for corporations, not individuals, and further, only pertains to taxes that are not on, according to, or measured by income. (R&TC, § 24345.)

Based on the analysis of the law and facts above, appellants have failed to demonstrate entitlement to a deduction for their foreign taxes paid during the tax years at issue.

HOLDING

Appellants have not shown that they are entitled to deductions for taxes paid to a foreign jurisdiction on their California tax returns.

DISPOSITION

FTB’s proposed assessments are sustained.

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Veronica I. Long
Administrative Law Judge

We concur:

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John O Johnson
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John O. Johnson
Administrative Law Judge

DocuSigned by:
Lauren Katagihara
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Lauren Katagihara
Administrative Law Judge

Date Issued: 6/26/2024