

**OFFICE OF TAX APPEALS
STATE OF CALIFORNIA**

In the Matter of the Appeal of:)
J. DUNN AND)
B. DUNN)
)
)
)
)

OTA Case No. 230713761

OPINION

Representing the Parties:

For Appellants: Allison R. Cordova, Representative

For Respondent: Teresa Kayatta, Attorney

K. LONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, J. Dunn and B. Dunn (appellants) appeal an action by respondent Franchise Tax Board (FTB) denying appellants' claim for refund of \$109,705 for the 2021 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 established entitlement to a refund based on a claimed ordinary flow-through business loss deduction arising from their participation in Corona Energy Partners 20, LLC (Corona) for the 2021 tax year.

FACTUAL FINDINGS

1. On April 13, 2022, appellants timely filed their original 2021 California Resident Income Tax Return (Form 540). The return indicates that appellants were calendar year taxpayers.
2. Two months later, on June 13, 2022, appellant B. Dunn executed a Member Capital Contribution Agreement with Corona. According to the agreement, appellant B. Dunn agreed to make a capital contribution of \$537,690 in exchange for a member interest in Corona. Additionally, Corona would consider appellant B. Dunn a general partner for federal income tax purposes. The agreement appears to anticipate that appellant

- B. Dunn's capital contribution would be paid from federal and state tax refunds for the 2020 and 2021 tax years.
3. Two days later, on June 15, 2022, appellants filed an amended California tax return for the 2021 tax year, in which they claimed an ordinary flow-through business loss of \$1,111,703 from Corona. After application of the ordinary business loss, appellants reduced their reported tax liability to zero and claimed a refund of \$61,174. The ordinary business loss from Corona was reported on a Schedule K-1, which listed Corona as having a fiscal tax year from September 1, 2021, to August 31, 2022. FTB treated appellants' amended return as a claim for refund.
 4. By letter dated January 9, 2023, FTB stated that it would disallow appellants' claimed loss of \$1,111,703, because appellants did not have any basis in Corona. FTB provided appellants with time to provide support to show entitlement to the claimed loss. Subsequently, appellants provided FTB with a second Schedule K-1 from Corona showing Corona's fiscal tax year as July 1, 2021, to June 30, 2022.¹
 5. In a letter dated September 29, 2022, appellants asserted that their only activity in Corona was financial involvement. Appellants asserted that Corona had not filed final Schedules K-1 and were unable to calculate appellants' ownership percentage. Appellants also stated that as of September 29, 2022, their capital contribution to the partnership had not become due.²
 6. On May 9, 2023, FTB issued a Claim for Refund Denial.

¹ In addition to the inconsistent fiscal year dates, the Office of Tax Appeals notes other important differences between the two Schedules K-1 submitted by appellants. The first Schedule that appellants filed with their amended return appears to be incomplete. It does not indicate any capital contribution. It also does not provide any information with respect to appellant B. Dunn's share of profits, losses, or capital. The second Schedule K-1 indicates that appellants contributed \$537,690 and received a net loss of \$1,111,703. The second Schedule K-1 also indicates that appellant B. Dunn's ending share of the profit, loss, and capital was 9.237 percent. In addition, appellants' correspondence to FTB, which is dated after they submitted the second Schedule K-1, indicates that their capital contribution was not yet paid. Thus, it is unclear when, or if, appellants actually made a capital contribution to Corona. However, this Opinion does not further address this issue because the appeal is decided on different grounds.

² Additionally, on appeal appellants provided a document titled "Corona Energy IRS Rules Regarding The Transfer of Tax Benefits," which provides the following:

Q: As a general partner what is my expected involvement with the holding company LLC?

A: General Partners are kept apprised of the operations of the LLC by email, and may be asked for their input on certain management decisions quarterly. They can also be assessed additional capital contributions for administrative costs not to exceed \$100 in a given tax year. In addition to this, all general partners will be provided with the necessary IRS forms for the preparation of a correct tax return.

7. This timely appeal followed.

DISCUSSION

Taxpayers have the burden of proof in an action for refund. (*Appeal of Li*, 2020-OTA-095P.) To determine a partner's income tax, each partner shall take into account separately the partner's distributive share of the partnership's items of income, gain, loss, deduction, or credits. (Internal Revenue Code (IRC), § 702(a)(7); R&TC, § 17851.) In computing the taxable income of a partner for a taxable year, the inclusions required by IRC section 702 with respect to a partnership shall be based on the income, gain, loss, deduction, or credit of the partnership for any taxable year of the partnership ending within or with the taxable year of the partner. (IRC, § 706(a); Treas. Reg. § 1.706-1(a)(1), (2).) A partner's distributive share of partnership loss (including capital loss) shall be allowed only to the extent of the adjusted basis of such partner's interest in the partnership at the end of the partnership year in which such loss occurred. (IRC, § 704(d)(1); *Appeal of Davis*, 2020-OTA-182P.)

Here, appellants were calendar year taxpayers. The two Schedules K-1 from Corona show that Corona's taxable year ended on either June 30, 2022, or August 31, 2022. Therefore, appellants are treated as having received the claimed flow-through ordinary business loss of \$1,111,703 from Corona for the 2022 tax year, not the 2021 tax year at issue, because under IRC section 706(a), Corona's 2022 tax year, from which the claimed loss arose, ends within appellants' 2022 tax year. In addition, if appellants report a net operating loss (NOL) on their tax return for the 2022 tax year based on the claimed ordinary business loss from Corona, then appellants may not carryback the NOL from the 2022 tax year to the 2021 tax year at issue because NOLs attributable to taxable years beginning after December 31, 2018 (such as the 2021 tax year here) cannot be carried back. (R&TC, § 17276(c)(1).)

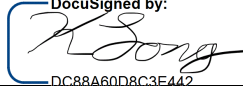
Therefore, appellants' claimed ordinary flow-through business loss from Corona cannot be deducted in the 2021 tax year.

HOLDING

Appellants have not established entitlement to a refund based on a claimed ordinary flow-through business loss deduction arising from their participation in Corona for the 2021 tax year.

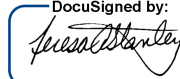
DISPOSITION

FTB's action denying appellants' refund claim is sustained in full.

DocuSigned by:

DC88A60D8C3E442

Keith T. Long
Administrative Law Judge

We concur:

DocuSigned by:

8CC6C6AC6C6A44D...

Teresa A. Stanley
Administrative Law Judge

DocuSigned by:

3AE5C32BB93B456

Kenneth Gast
Administrative Law Judge

Date Issued: 12/2/2024