

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:)	OTA Case No. 20076357
M. PIRES AND)	
C. PIRES)	
)	
)	

OPINION

Representing the Parties:

For Appellants:	Scott B. Burkholder, Attorney
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For Respondent:	Eric A. Yadao, Attorney
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For Office of Tax Appeals:	Mai C. Tran, Attorney
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E. LAM, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, M. Pires and C. Pires (appellants) appeal an action by respondent Franchise Tax Board (FTB) proposing additional tax of \$58,332, \$53,526, \$46,879, and \$47,745, and applicable interest for the 2013, 2014, 2015, and 2016 tax years, respectively.

Appellants waived the right to an oral hearing; therefore, the matter was submitted to the Office of Tax Appeals (OTA) on the written record pursuant to California Code of Regulations, title 18, (Regulation) section 30209(a).¹

ISSUES

1. Whether appellants have shown that FTB erroneously reduced their other state tax credit (OSTC) for taxes paid to Connecticut on wages.
2. Whether appellants have shown that FTB erroneously reduced their OSTC for taxes paid to Connecticut on pass-through business income sourced to California and other non-Connecticut states.

¹ Appellants failed to complete the Response to Notice of Oral Hearing sent on June 13, 2024. Accordingly, OTA removed appellants from the oral hearing and the appeal is submitted for a decision on the basis of the written record. (Cal. Code Regs., tit. 18, § 30404(a).)

FACTUAL FINDINGS

1. Appellants filed California Resident Income Tax Returns, together with California Schedule S, claiming OSTC for the tax years 2013 through 2016. On those California Schedule S, appellants claimed an OSTC for taxes paid to Connecticut on the following Morse Watchmans, Inc. (MWI) business income, double taxed wages, and OSTC amounts:²
 - (a) For 2013, appellants reported total MWI business income of \$3,668,540. Appellants reported double taxed wages of \$476,308 and MWI business income of \$3,650,236. Appellants claimed an OSTC of \$275,948.
 - (b) For 2014, appellants reported total MWI business income of \$4,236,551. Appellants reported double taxed wages of \$483,973 and MWI business income of \$4,222,374. Appellants claimed an OSTC of \$317,172.
 - (c) For 2015, appellants reported total MWI business income of \$4,627,812. Appellants reported double taxed wages of \$440,803 and MWI business income of \$4,627,812. Appellants claimed an OSTC of \$355,697.
 - (d) For 2016, appellants reported total MWI business income of \$4,472,044. Appellants reported double taxed wages of \$406,608 and MWI business income of \$4,467,559. Appellants claimed an OSTC of \$341,898.
2. Appellant-husband earned wages from MWI of \$405,823; \$412,133; \$406,916; and \$406,608, for the tax years 2013, 2014, 2015, and 2016, respectively. Appellant-wife earned wages from MWI of \$70,485, \$71,840, and \$33,887, for the tax years 2013, 2014, and 2015, respectively. The combined MWI wages from appellants reflect their assertion that all MWI wages were double taxed by Connecticut, matching the amounts listed on the above corresponding Schedule S.
3. Appellant-husband, a shareholder and officer of MWI with a 0.5% ownership interest, received pass-through business income from MWI from 2013 to 2016. MWI issued California K-1s to appellant-husband reporting, in relevant parts, California source income amounts of: \$198,409, \$329,104, \$302,424, and \$311,747 for the tax years 2013, 2014, 2015, and 2016, respectively.

² For the tax years at issue, appellants also reported other income items on their Schedule S that are not at issue.

4. Appellants filed nonresident Connecticut tax returns and paid income tax to Connecticut for the wages earned from MWI, together with appellant-husband's share of the Connecticut-sourced business income from MWI.
5. For the 2013 tax year, appellants also reported tax paid to Georgia, Indiana, Ohio, and Virginia.
6. FTB audited appellants' returns.³ FTB determined that appellants provided services to MWI from California and therefore, their wages were California-sourced income. In addition, FTB determined that appellants' calculation of the OSTC for taxes paid to Connecticut incorrectly included California-sourced and non-Connecticut-sourced MWI business income. As a result, FTB reduced appellants' OSTC by the California-sourced wages and by the California-sourced and non-Connecticut sourced business income from MWI.
7. On March 22, 2019, FTB issued Notices of Proposed Assessment (NPAs) to appellants. For 2013, FTB reduced the OSTC to \$230,357. For 2014, FTB reduced the OSTC to \$263,646. For 2015, FTB reduced the OSTC to \$308,818. For 2016, FTB reduced the OSTC to \$294,153. FTB's reduction of the OSTC resulted in the proposed additional tax at issue in this appeal.
8. Appellants protested. FTB issued Notices of Action, affirming the NPAs.
9. Appellants then filed this timely appeal.
10. On appeal, appellants provided documentation of travel to Connecticut, where purportedly appellant-husband provided services to MWI in Connecticut for 47 days in 2013, 52 days in 2014, 57 days in 2015, and 51 days in 2016. Subsequently, in appellants' reply brief, they submitted credit card statements purporting to show that appellants worked from Connecticut for at least one week per month during each tax year at issue.

³ Appellants signed a statute of limitations waiver for the 2013 tax year.

DISCUSSIONIssue 1: Whether appellants have shown that FTB erroneously reduced their OSTC for taxes paid to Connecticut on wages.Burden of Proof

Tax credits are a matter of legislative grace, and taxpayers bear the burden of proving they are entitled to claimed tax credits. (*Appeals of Swat-Fame, Inc., et al.*, 2020-OTA-046P.) Statutes granting tax credits are to be construed strictly against the taxpayer with any doubts resolved in FTB's favor. (*Ibid.*) FTB's determinations are presumed correct, and the taxpayer bears the burden of proving that the determinations are erroneous. (*Appeal of Morosky*, 2019-OTA-312P.) Unsupported assertions cannot satisfy the taxpayer's burden of proof. (*Ibid.*) Tax returns are not proof of the statements made therein. (*Bruno v. Commissioner*, T.C. Memo. 1990-109.) The failure to produce evidence that is within the taxpayer's control gives rise to a presumption that such evidence is unfavorable to the taxpayer's case. (*Appeal of Kwon, et. al.*, 2021-OTA-296P.)

California's Personal Income Tax Law and the OSTC

In accordance with R&TC section 17041(a), the entire income of California residents is subject to taxation by California, regardless of the source. (*Appeal of Morosky, supra.*) If California residents also earn income in states where they are nonresidents, those nonresident states can (and often do) tax California residents on income sourced to those states under those states' tax laws. Therefore, to avoid double taxation, R&TC section 18001 provides some relief in the form of a credit against the California's resident tax for income taxes imposed by and paid to the nonresident state, provided that certain conditions are met. (*Appeal of Buehler*, 2023-OTA-215P; see *Christman v. Franchise Tax Bd.* (1976) 64 Cal.App.3d 751, 758.)

R&TC section 18001(a)(1) provides that the OSTC shall be allowed only for net income taxes paid to the other state on "income derived from sources within that state." For purposes of that section, "income derived from sources within that state" shall be determined by applying California's nonresident sourcing rules for determining income from sources within California, commencing with R&TC section 17951 et seq., as well as the regulations thereunder. (R&TC, § 18001(c).) Stated differently, in order for a California resident taxpayer to be entitled to the OSTC, income taxes paid to the nonresident state (here, Connecticut) must be based on income sourced to that nonresident state using *California's* nonresident sourcing rules. (R&TC, § 18001(a)(1), (c).) As relevant here, California's nonresident sourcing rules for wages,

salaries, and other compensation for personal services require appellants to substantiate what portion of their total compensation is reasonably attributable to personal services performed in Connecticut compared to personal services performed in California.

(Cal. Code Regs., tit. 18, § 17951-5.)

The parties agree that appellants paid tax to Connecticut and that the Connecticut tax is a net income tax. However, the parties dispute whether the wages earned by both appellants are properly sourced to Connecticut or California, under Regulation section 17951-5.

FTB determined that appellants' wages were sourced to California, not Connecticut. Appellants contend that all services were performed in Connecticut and, therefore, all wages should be sourced to Connecticut. Appellants assert that neither appellant-husband nor appellant-wife provided services for MWI while they were in California. Appellants assert that they were busy establishing another winery business in California and were no longer responsible for the day-to-day operations of MWI. When MWI business required appellants' attention, appellants assert that they would travel and perform services exclusively in Connecticut. Appellant-husband is an officer and shareholder of MWI.

Here, appellants initially contend that appellant-husband provided services for MWI in Connecticut for 47 days in 2013, 52 days in 2014, 57 days in 2015, and 51 days in 2016. Appellants assert that appellant-husband travelled to Connecticut in particular weeks to perform specific tasks, such as approving invoices. Subsequently, in appellants' reply brief, they submitted credit card statements purporting to show that appellant-husband worked from Connecticut for at least one week per month in each tax year at issue.

While the travel documents and invoices suggest that appellant-husband may have worked in Connecticut for a few weeks each year, appellants have not provided any evidence that would corroborate their assertion that appellant-husband or appellant-wife exclusively performed personal services in Connecticut for MWI, such as a work contract, work correspondence, affidavits from co-workers, or other similar evidence. Here, appellants have not provided details about the scope of appellant-husband's services for MWI that are performed exclusively in Connecticut, nor explained the nature of his services would necessitate that they be carried out only in Connecticut. In addition, appellants have not provided any evidence of appellant-wife providing services for MWI in Connecticut.⁴ If appellants, in fact, worked exclusively in Connecticut, such evidence would be available, and presumably appellants would have provided it. To reiterate, a taxpayer's failure to produce evidence that is

⁴ Appellants have not provided any travel documents for appellant-wife.

within the taxpayer's control gives rise to a presumption that such evidence is unfavorable to the taxpayer's case. (*Appeal of Kwon, et. al., supra.*) The absence of such evidence weighs against appellants' position. Furthermore, statutes granting tax credits are strictly construed against the taxpayers. (*Appeals of Swat-Fame, Inc., et al., supra.*) As such, appellants have not demonstrated that their entire wages are Connecticut-sourced income eligible for the OSTC.⁵

Issue 2: Whether appellants have shown that FTB erroneously reduced their OSTC for taxes paid to Connecticut on pass-through business income sourced to California and other non-Connecticut states.

As previously discussed, R&TC section 18001(a)(1) provides that the OSTC is only allowed for taxes paid to the other state on income sourced to that state, using *California's* nonresident sourcing rules. Generally, income from sources within California includes income from a business, trade, or profession carried on within California. (Cal. Code Regs., tit. 18, § 17951-4.)

In this case, FTB calculated the eligible income to be sourced to Connecticut by taking appellants' reported MWI's business income and subtracting the portions sourced to California and other states. However, on Schedule S, appellants reported a Connecticut sourced amount of MWI business income that was higher than the eligible amount calculated by FTB.⁶ Additionally, for the 2013 tax year, appellants did not exclude from Connecticut sourced MWI business income that was sourced to Georgia, Indiana, Ohio, and Virginia. Therefore, FTB determined that appellants' calculation of the OSTC for taxes paid to Connecticut incorrectly included California-sourced and non-Connecticut-sourced MWI business income. As a result,

⁵ After appellants submitted credit card statements purporting to show that they worked from Connecticut for at least one week per month during each relevant tax years, appellants argue that granting the OSTC credit "as reported" on their tax returns is "in the interest of justice," claiming all wage income being generated were performed only in Connecticut. Although working-day calculations are standard for prorating income of nonresidents and part-year residents, appellants did not request that OTA allocate services or wages between California and Connecticut by working-day. (*Appeal of Stabile*, 2020-OTA-198P.) Accordingly, OTA will not address the allocation of wages in this Opinion.

⁶ For illustration, in the 2016 tax year, appellants reported \$4,472,044 in MWI business income. Of the 4,472,044 in MWI business income, \$311,747 was identified as California source income from the 2016 California K-1 issued to appellant by MWI, leaving \$4,160,297 eligible to be sourced to Connecticut (\$4,472,044 - \$311,747 = \$4,160,297). However, for OSTC calculation purposes, appellants reported \$4,467,559 (more than \$4,160,297) of MWI business income sourced to Connecticut, resulting in a higher OSTC for taxes paid to Connecticut. This illustration's approach is consistent across all tax years at issue.

FTB reduced appellants' OSTC by the California-sourced wages and by the California-sourced and non-Connecticut sourced business income from MWI.

To reiterate, the taxpayer bears the burden of proving that the determinations are erroneous. (*Appeal of Morosky, supra.*) Appellants have provided no arguments, nor does the record contain evidence challenging FTB's computation. Consequently, appellants have not demonstrated that FTB's calculation of business income sourced to Connecticut is erroneous.

HOLDINGS

1. Appellants have not shown that FTB erroneously reduced their OSTC for taxes paid to Connecticut on wages.
2. Appellants have not shown that FTB erroneously reduced their OSTC for taxes paid to Connecticut on pass-through income sourced to California and other non-Connecticut states.

DISPOSITION

FTB's action is sustained.

DocuSigned by:

Eddy Y. H. Lam

Eddy Y.H. Lam

Administrative Law Judge

We concur:

Signed by:

Josh Lambert

Josh Lambert

Administrative Law Judge

Signed by:

Natasha Ralston

Natasha Ralston

Administrative Law Judge

Date Issued: 12/13/2024