BOARD OF EQUALIZATION

STATE OF CALIFORNIA

In the Matter of the Appeal of:	**SUMMARY DECISION**
	PERSONAL INCOME TAX APPEAL
RICHARD R. HUGHES	Case No. 507337
	Adopted: August 23, 2011

Representing the Parties:

For Appellant:	Babak Hashemi, Tax Appeals Assistance Program[1]
For Franchise Tax Board:	Claudia L. Cross, Legal Analyst
Counsel for the Board of Equalization:	Mohammed A. Lakhani, Legal Intern Charles E. Potter, Jr., Tax Counsel

This appeal is made pursuant to section 19045 of the Revenue and Taxation Code (R&TC) from the action of the Franchise Tax Board (FTB or respondent) on appellant's protest against a proposed assessment in the amount of $1,225 and applicable interest for 2006. The issues presented in this appeal are (1) whether appellant demonstrated error in the method used by respondent to compute appellant's California tax, and (2) whether interest can be abated.

FINDINGS AND DISCUSSION

Background

Appellant states that he relocated from California to Tennessee in 2002 and was no longer a California resident. Appellant continued his employment in California while commuting from

[1] Appellant filed his appeal letter. Subsequent representation and briefing was completed by the Tax Appeals Assistance Program (TAAP). Babak Hasheimi is the current TAAP representative as of the time of this summary decision.

Tennessee until he retired in Tennessee on June 2, 2006. Appellant timely filed a joint 2006 California Nonresident or Part-Year Resident Income Tax return.[2] On this return, appellant reported the following:

Total CA Wages	$42,400
IRA Distribution	$39,507
Pension Distribution	$18,838
Social Security Benefits	$10,398
Federal Adjusted Gross Income (AGI)	$111,143
CA Adjustments	
IRA Distribution	($39,507)
Pension Distribution	($18,838)
Social Security Benefits	($10,398)
Total CA Adjustments	($68,743)
CA AGI	$42,400
Total Standard Deduction	$6,820
Standard Deduction Rate	1.00
Allowable Standard Deduction	$6,820
CA Taxable Income	$35,580
Tax From Tax Table	$664
CA Tax Rate	0.0187
Total Exemption Credits	$182
CA Exemption Rate Percentage	1.00
Allowable exemption amount	$182
CA Tax	$482
Withholding	$1,322
Refund	$840

On February 26, 2007, respondent refunded $839 to appellant claiming appellant's total correct state tax was $483, not $482.[3] Respondent subsequently reviewed appellant's return and determined appellant incorrectly subtracted his IRA distribution of $39,507, and his pension distribution of $18,838 from his federal AGI. On December 10, 2008, respondent issued a Notice of Proposed Assessment (NPA) that added back these items. The NPA also allowed itemized deductions in the amount of $9,353, and added back appellant's standard deduction of $6,820, because appellant's revised

[2] Appellant filed the return with his spouse, but this appeal was filed in his name only.

[3] We note that $35,580 times 0.0187 is $665; however, the tax rate table for taxable income from $35,551 to $35,650 for married filing jointly is $664. (*See* 2006 California Tax Rate available online at http://www.ftb.ca.gov/forms/06_forms/06_540nrtt.pdf.) It appears in refunding $839, rather than $840, respondent was correcting for an alleged $1 error.

itemized deductions were greater than appellant's California standard deduction.

In comparing the NPA changes with appellant's original filing, respondent excluded the social security income from appellant's total AGI and increased his tax rate based on total AGI of $91,392 (as opposed to a tax rate based on $35,580). Respondent also started with an itemized deduction amount of $9,353, and multiplied this amount by a ratio of appellant's California income to total income (i.e., $42,400/$100,745) to arrive at an allowable itemized deduction amount of $3,937. This amount was then subtracted from appellant's California AGI of $42,400 to arrive at California taxable income of $38,463. Respondent then multiplied this amount by the 0.0464 tax rate to arrive at tax before credits of $1,785. Respondent then multiplied appellant's exemption credit of $182 by the California exemption credit rate (which is equal to California taxable income divided by total taxable income) to arrive at an allowable exemption credit of $77. When the $77 credit and appellant's earlier payment of $483[4] were subtracted from the tax of $1,785, the remaining assessment on the NPA was calculated as $1,225.

Appellant protested the NPA arguing that the inclusion of all of his income for 2006 (including his retirement income) constituted impermissible taxation of retirement income of a nonresident.

Respondent contacted appellant by telephone on August 12, 2009, explaining that California requires appellant to report AGI from both California and non-California sources. On August 19, 2009, respondent issued a Notice of Action (NOA), affirming the NPA. This timely appeal followed.

Contentions

Appellant disagrees with respondent's methodology "because it relies upon the pension income received during a period of nonresidency to calculate his tax burden. Appellant asserts that respondent's methodology violates section 114 of title 4 of the United States Code, which appellant contends should "eliminate the use of pension income in determining the amount of tax due from nonresidents." As a result, appellant contends that his pension distribution has been taxed twice.

[4] By giving appellant credit for paying $483 (rather than $482) with respect to the new assessment, respondent effectively canceled out any possible $1 error. (*See supra,* footnote 3.)

Appellant also argues respondent's methodology is unconstitutional under the Privileges and Immunities Clause, because it intentionally discriminates against nonresident taxpayers, by imposing a higher tax rate on nonresidents with California-source income than is imposed on residents with California-source income.

Finally, appellant also urges this Board to take note of his financial hardship and deteriorating health in making its decision and to waive the penalty and interest on the alleged amounts to prevent further economic hardship and mental anguish to appellant.

Respondent contends it used the proper method specified by law, (i.e., the California method) to calculate appellant's tax liability. Respondent contends the California method does not tax non-California-source income, but considers all income to arrive at the applicable tax rate (0.0464) to apply against a nonresident's California-source income ($38,463). With respect to appellant's health and financial problems, respondent states it is sympathetic with appellant's situation and provided a copy of an Installment Agreement Request Form and an Offer in Compromise (OIC) Form. However, respondent states that a formal payment arrangement or an OIC is a collection matter that cannot be entered into until the close of this appeal and any tax due has become final.

Discussion

The California Method

R&TC section 17041, subdivision (b)(1), imposes a tax upon the California-source income of part-year residents. R&TC section 17041, subdivision (b)(2), provides that the tax imposed under subdivision (b)(1) shall be calculated by multiplying the "taxable income of a nonresident or part-year resident," as defined in subdivision (i) (i.e., $38,463) by a rate equal to the tax computed under subdivision (a) on the entire taxable income of the nonresident or part-year resident as if he were a resident of California for the taxable year, divided by the amount of that income. In other words, appellant's applicable tax rate to be applied against his California taxable income was 0.0464 (i.e., $4,243 divided by $91,392). Finally, in determining how much of the total California exemption credit of $182 is allowed against the net tax, the credit must be multiplied by a ratio of California taxable income ($38,463) to total taxable income ($91,392). (Rev. & Tax. Code, § 17055.) Thus, appellant's allowable exemption credit was $77. R&TC section 17041, subdivision (b), imposes a tax upon the

California-source income of part-year residents for periods when he or she is a nonresident and upon his or her income from all sources for periods when he or she is a California resident. The rate of tax on part-year residents is determined by taking into account the taxpayer's worldwide income. (See *Appeal of Louis N. Million*, 87-SBE-036, May 7, 1987.) The method does not tax out-of-state income that is 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 income. (*Id*.) The purpose of the method is to apply the graduated tax rates to all persons (not just those who live in California for the full year).[5]

In reviewing respondent's calculations, we conclude they are consistent with the law as described above and respondent's use of appellant's IRA and pension distribution to determine the applicable tax rate to be applied against appellant's California taxable income was proper. Consequently, respondent's use of appellant's income from all sources, including appellant's IRA and pension distributions to calculate appellant's applicable tax rate did not result in taxation of appellant's retirement income. (See *Appeal of Louis N. Million, supra.*)

In this regard, we reject appellant's claim that the California method violates section 114 of title 4 of the United States Code (section 114) which provides that, "No State may impose an income tax on any retirement income of an individual who is not a resident or domiciliary of such State." As noted above, under the California method, tax is not imposed on appellant's retirement income but rather the income subjected to tax was appellant's California-source income (i.e., California wages) minus allowable deductions (i.e., $38,463). Section 114 does not prohibit the consideration of appellant's total income to determine the applicable tax rate.

With respect to appellant's claim that the California method violates the privileges and immunities clause by discriminating against citizens of other states, this Board does not have jurisdiction

[5] The fundamental fairness and constitutionality of using out-of-state income to calculate the rate of tax has been upheld by New York's highest court, and the United States Supreme Court refused to hear an appeal from the New York decision. (*Brady v. New York* (1992) 80 N.Y.2d 596, cert. den. (1993) 509 U.S. 905.) The *Brady* court reasoned that similarly situated taxpayers were those with the same total income. For example, a nonresident earning $20,000 in New York, but with $100,000 reported total income, should be taxed on the $20,000 New York-source income at the same rate as a New York resident with $100,000 total income (and not at the same rate as a New York resident with $20,000 total income).

to consider whether a California statute is constitutionally invalid, unless a federal or California appellate court has already made such a determination. (Cal. Code Regs., tit. 18, § 5412, subd. (b)(1).) Moreover, section 3.5 of article III of the California Constitution prevents this Board from determining that statutory provisions are unconstitutional or unenforceable. (*Appeal of Aimor Corporation*, 83-SBE-221, Oct. 26, 1983.)

Interest and Penalty Abatement

With regard to interest on the unpaid tax, interest is mandatory and respondent is not allowed to abate interest except where authorized by law. (*Appeal of Amy M. Yamachi*, 77-SBE-095, June 28, 1977.) The imposition of interest is not a penalty, but is merely intended to compensate California for appellant's use of money that should have been turned over earlier to California. (*Appeal of Audrey C. Jaegle*, 76-SBE-070, June 22, 1976.) Under R&TC section 19104, respondent is authorized to abate interest if there has been an unreasonable error or delay in the performance of a ministerial or managerial act by an employee of respondent. Such abatement can only occur if no significant aspect of the error or delay can be attributed to the taxpayer and after respondent first contacted the taxpayer in writing. (Rev. & Tax. Code, § 19104, subd. (b)(1).) Appellant has not demonstrated any error or delay on the part of respondent that led to additional interest in this case. In addition, appellant's grounds for interest abatement based on financial and/or current medical reasons are not grounds upon which this Board has authority to abate interest.[6]

At the conclusion of this appeal, appellant may wish to review the OIC information and installment agreement information provided by the FTB and to contact the FTB to determine whether either arrangement would apply.

CONCLUSION

For the foregoing reasons, respondent's action is sustained.

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[6] Appellant's request to abate penalties in this case is moot, since no penalties were assessed by respondent.