BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
CEDA SCHELLER, AS EXECUTRIX OF)
THE LAST WILL AND TESTAMENT OF)
V. A. SCHELLER)

Appearances:

For Appellant: Conrad T. Hubner, Attorney at Law

For Respondent: W. M. Walsh, Assistant Franchise Tax Commissioner; James J. Arditto, Franchise Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 19 of the Personal Income Tax Act (Chapter 329, Statutes of 1935, as amended) from the action of the Franchise Tax Commissioner in overruling the protest of Ceda Scheller, as Executrix of the Last Will and Testament of V. A. Scheller, to a proposed assessment of additional tax in the amount of $110.55 for the taxable year ended December 31, 1936.

During the period 1930 to 1936, the decedent, V. A. Scheller served as the attorney for the executors of the Estate of Viola K. Dunne. As the Estate contained extensive properties and involved considerable litigation, Mr. Scheller abandoned his other law practice to devote his entire time to it. Upon the final settlement of the Estate in 1936, he was allowed and received a fee of $20,000 for extraordinary services in addition to the regular statutory fee of $14,530. Although he reported on a cash receipts and disbursements basis, he included in his return of income for 1936 only portions of the two fees on the theory that only such portions as were allocable to services performed after December 31, 1934, were subject to tax under Section 36 of the Act and Article 36-1 of the Commissioner's Regulations relating thereto. The Commissioner allowed the proration of the ordinary statutory fee but regarded the entire $20,000 fee for extraordinary services as 1936 income on the basis that such fee did not accrue as income until settled and allowed by the Court. The propriety of his action with respect to this $20,000 fee is the only question involved herein.

In arguing in support of their respective positions both parties assumed that the portion of Article 36-1 of the Regulations providing that "income accrued prior to January 1, 1935, is not taxable and need not be reported, even though the income is received on or after that date and even though the taxpayer reports on the cash receipts and disbursements basis" was valid.

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The only point considered was whether some portion of the $20,000 fee accrued prior to 1935. Subsequently, the Appellant was afforded an opportunity to file a supplemental memorandum discussing any possible p plication the case of Dillman v. McColgan, 63 C.A. 2d 405 (hearing in California Supreme Court denied May 18, 1944) might have on the question at issue, but such a memorandum was not filed.

The Dillman case must, we believe, be regarded as controlling this matter and as requiring that the position of the Commissioner be sustained. It was there held that a taxpayer reporting on a cash receipts and disbursements basis was entitled to deduct in 1935 as a loss sustained in that year the amount of a national bank stockholders' liability assessment paid in 1935 even though the liability may have accrued prior to that year. In reaching this conclusion the Court found that the portion of Article 36-1, providing that a taxpayer reporting on a cash basis could not deduct in 1935 an amount paid in that year if liability therefor was incurred prior to to 1935 was not a proper interpretation of the Act. Section 16 of the Act was regarded as determinative, the Court quoting subsections (a), (d) and (e) thereof. The first of these subsections provides, so far as material herein, that net income shall be computed in accordance with the method of accounting regularly employed in keeping the books of the taxpayer; the second that all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless pursuant to subsection (a) any such amounts are to be properly accounted for as of a different period; and the third that deductions and credits shall be taken for the taxable year in which paid or accrued or paid or incurred depending upon the method of accounting employed in computing net income. Just as subsections (a) and (e) were there held to require the conclusion that a taxpayer on a cash basis could deduct an amount paid in 1935 even though the liability accrued prior to that year, So in our opinion, do subsections (a) and (d) require the conclusion that an item of gross income received in 1936 is includible in its entirety in gross income for that year even though it may have accrued in part prior to 1935. Only if the amount received by Appellant in 1936 as compensation for his services in prior years is included in his gross income for 1936 will his net income for that year have been computed in accordance with the method of accounting regularly employed in the keeping of his books, as required by subsection (a) and will there have been compliance with the specific mandate of subsection (d). In fact, in the course of its opinion in the Dillman case the Court stated

> "...Our attention is not directed to any language in the statute that authorized the commissioner to make the exception set forth in art. 36-1, that income accrued prior to January 1, 1935, was not taxable and need not be reported though received after that date and even though the taxpayer reported on the cash receipts and disbursements basis...'!

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O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the action of Chas. J. McColgan, Franchise Tax Commissioner, in overruling the protest of Ceda Scheller, as Executrix of the Last Will and Testament of V. A. Scheller, to a proposed assessment of additional tax in the amount of $110.55 for the taxable year ended December 31, 1936, pursuant to Chapter 329, Statutes of 1935, as amended, be and the same is hereby sustained.

Done at Sacramento, California, this 9th day of May, 1945, by the State Board of Equalization.

R. E. Collins, Chairman
Wm. G. Bonelli, Member
Geo. R. Reilly, Member
J. H. Quinn, Member

ATTEST: Dixwell L. Pierce, Secretary