



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
THE FIRST NATIONAL BANK OF CHICAGO,)
TRUSTEE FOR CHARLES ERRETT CORD TRUST,)
ET AL.)

Appearances:

For Appellant: Edward D. Neuhoff, Attorney at Law

For Respondent: Burl D. Lack, Chief Counsel

O P I N I O N

This appeal is made pursuant to Section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of The First National Bank of Chicago, as Trustee, to proposed assessments of additional personal income tax against the following trusts in the amounts and for the years indicated:

<u>Trust</u>	<u>Year</u>	<u>Amount</u>
Charles Errett Cord-Trust	1949	\$ 35.42
	1950	224.46
	1951	3,687.51
Billy James Cord Trust	1951	39.86
	Susan Errett Cord Trust	412.53
Sally Kirk Cord Trust	1949	412.53
	1950	503.58
	1951	4,607.01
Nancy Virginia Cord Trust	1949	1,369.10
	1950	2,328.38
	1951	7,183.15
Virginia Kirk Cord Trust	1949	1,370.18
	1950	2,328.34
	1951	7,131.51
Virginia Kirk Cord Trust	1949	35.59
	1950	224.45
	1951	3,667.01

The trusts involved in this appeal were created by E. L. Cord for the benefit of his wife, Virginia Kirk Cord, and children. The instrument creating the trusts for Virginia Kirk Cord, Charles Errett Cord, Nancy Virginia Cord and Sally Kirk Cord was executed on August 21, 1935. The trust for Billy James Cord was executed on December 28, 1935, and the trust for Susan Errett Cord on May 1, 1945. During the years on appeal the Appellant trustee was a corporation having its sole place of business in Chicago, Illinois.

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The trust instruments provided that the trustee, during the minority of any beneficiary, could accumulate the income and add it to the principal or, in the discretion of the trustee, distribute the income to the beneficiary for support and education. When the income beneficiary reached the age of 21 years, all of the income was to be distributed in quarterly installments during his or her lifetime. After the death of the income beneficiary, the principal of the trust estate and any accumulations were to be distributed to the surviving children of the income beneficiary when the youngest child reached the age of 21 years. If there were no such children, then the principal and accumulations were to be distributed equally to the other trusts or, if they had been terminated, to those persons who had received the principal of the other trusts. In the event all of the other trusts had terminated and no children survived any of the income beneficiaries, the principal and accumulations were to be distributed to the heirs at law under the laws of succession of the State of Illinois.

Billy James Cord died in 1945, leaving an only child, Christopher Stephen Cord, who was nine years old in 1949. During the years on appeal, Charles Errett Cord had two minor children. The **settlor's** three daughters, Nancy, Sally and Susan, were all unmarried minors in this period.

The trusts derived most of their income from intangibles, the physical evidences of which were held by the trustee without this State during the years on appeal. During each of these years, however, income was derived from rentals and sales of real estate within this State. Appellant reported only the latter income on its fiduciary returns. The 1951 returns for all trusts and the 1949 and 1950 returns for the Susan Errett Cord Trust were filed more than five months after the dates they were due.

The **Franchise Tax** Board determined that the trusts were taxable on all of their income, from whatever source derived. It imposed penalties with respect to those returns that were not timely filed.

Appellant first contends that the Revenue and Taxation Code does not permit the imposition of a tax upon income of a trust from sources outside the State unless the trustee is a resident of the State.

During the period in question, Section 18102 (now 17742) provided, in part, as follows:

"... The tax applies to the entire net income of ... a trust, if the fiduciary or beneficiary is a resident, regardless of the residence of the **settlor**." (Emphasis added.)

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Provisions were made for apportionment if **taxability** depended upon residence of the beneficiary and some of the beneficiaries were not residents. (Section 18104, now 17744.)

Regulation 18101-18106(a), pursuant to the above section, provided in part:

"(1) . . . if all the beneficiaries are residents of this State, a trust is taxable upon all of its net income . . . regardless of the source of the income and regardless of the residence of the settlor and the fiduciary or fiduciaries." (Title 18, California Administrative Code, Reg. **18101-18106(a).**)

Appellant points to Sections 17052 and 18131 of the Revenue and Taxation Code. During the years involved, Section 17052 provided for a tax on the net income of every nonresident from sources within this State. Section 18131 stated that the net income of a **trust** shall be computed in the same manner and on the same basis as in the case of an individual. Appellant concludes from these provisions that a trust was taxable only on income from sources in this State if the trustee was a nonresident.

Section 18131 was contained in Article 2, Chapter 8 of the Personal Income Tax Law, which related to deductions in computing net income.. That section was concerned only with the manner of computing net income, regardless of its source. It did not deal in any manner with the question of whether the entire net income of a trust or only the portion derived from California should be taxed. Section 18102 specifically dealt with that question by providing that the entire net income of a trust is taxable if the beneficiary is a resident.

(It is clear to us that the tax was intended to apply to all of the net income of a trust if all of the beneficiaries were residents of California, regardless of the residence of the trustee or the settlor. This view is in accord with an opinion issued by the Attorney General. (31 Ops. Cal. Atty. Gen. 234.)

Appellant next contends that E. L. Cord, the settlor, was not a resident and that therefore his wife and his minor daughters, comprising four of the beneficiaries, were not residents. This Board has previously determined that E. L. Cord and his wife were California residents during the years in question. (Appeal of E. L. and Virginia K. Cord, Cal. St. Bd. of Equal., July 22, 1958 (CCH, 2 Cal. Tax Cases,, Par. 200-900), (P-H, St. & Loc. Tax Serv., Cal., Par. 58,128).) Appellant has offered no evidence to support the contrary contention now made. We thus conclude that for purposes of the question before us, E. L. Cord's wife and his minor daughters were residents of this State.

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It is also urged by Appellant that the out of State income should not be taxed because it was in the form of capital gain which was added to the principal of the trusts and might be distributed to unborn and unascertained beneficiaries who are not California residents. In the present case, all of the ascertainable and existing beneficiaries are residents. Each of them has an interest in any addition to the principal of a trust, because of a right to the trust income or a conditional right to share in the corpus upon distribution. Until such time as other beneficiaries are born and ascertained they cannot reasonably be regarded as beneficiaries whose residence is material under Section 18102. It thus seems clear that the section prescribes taxation by this State of all of the income of the trusts.

Appellant argues that Section 18102 is unconstitutional if it purports to tax trust income from sources outside the State when the trustee is a nonresident. It is noted that the Attorney General is not in agreement with that view. (31 Ops. Cal. Atty. Gen. 234.) In any event, in accordance with our well established policy, we shall not pass upon the constitutionality of a statute in an appeal involving unpaid assessments, since a finding of unconstitutionality could not be reviewed by the courts. This rule was recently applied in Appeal of Joseph Patrick Gilio, et al., Cal. St. Bd. of Equal., Dec. 16, 1959 (CCH, 2 Cal. Tax Cases, Par. 201-444), (P-H, St. & Loc. Tax Serv., Cal., Par. 58,165).

The Franchise Tax Board has imposed penalties under Section 18681 of the Revenue and Taxation Code, which requires such penalties for failure to file returns on or before the due dates "unless it is shown that the failure is due to reasonable cause and not due to wilful neglect." The only reason advanced by Appellant for the tardy filings is that there was reasonable cause for believing that the trusts were not taxable on their entire income., However, there could have been no doubt that returns were due with respect to the income which was derived from California sources. (See Section 18405 of the Code.) We conclude that the penalties were properly imposed,

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 pursuant to Section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of The First National Bank of Chicago, as Trustee for the Charles Errett Cord Trust and

