82-SBE-122

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
EUGENE I. INGRUM)

For Appellant: Eugene I. Ingrum, in pro. per.

For Respondent: Mark McElvily Counsel.

OPINION

This appeal is made pursuant to section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Eugene I. Ingrum against a proposed assessment of additional personal income tax in the amount of $1,822.51 for the year 1978.

Appellant filed a California personal income tax return for the year 1978 wherein he reported an actual net loss of $14,792.75 on the sale of capital assets held for not more than one year and an actual net gain of $89,273.08 on the sale of capital assets held more than five years. Accordingly, appellant's 1978 capital asset transactions resulted in an actual total net capital gain of $74,480.33 ($89,273.08 - $14,792.75). However, as will be explained below, by virtue of the preferential tax treatment accorded capital gains under Revenue and Taxation Code section 18162.5, 1/ appellant was required to recognize a capital gain of only $29,843.79 in 1978.

Appellant did not report any items of tax preference on his 1978 return. Upon review of that return, respondent concluded, pursuant to former section 17063, subdivision (h), 2/ that appellant had an item of capital gains tax preference in the amount of $44,636.54. That amount represents the difference between appellant's actual total net capital gain for 1978 and the total net capital gain recognized by virtue of section 18162.5. Appellant's protest of the proposed assessment subsequently issued by respondent has resulted in this appeal.

The issue presented by this appeal is whether respondent properly computed appellant's item of capital gains tax preference for the year in issue.

Section 17062 of the Revenue and Taxation Code provides, in pertinent part:

> In addition to the other taxes imposed by this part, there is hereby imposed ... taxes . . . on the amount (if any) of the sum of the items of tax preference in excess of the amount of net business loss for the taxable year ....

During the year in issue, section 17063 provided, in part:

1/ Hereinafter, all references are to the Revenue and Taxation Code unless otherwise indicated.

2/ AB 93 (Stats. 1979, ch. 1168), operative for taxable years beginning on or after January 1, 1979, rewrote subdivision (h) of section 17063 as subdivision (g).

> For purposes of this chapter, the items of tax preference are:
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> * * *
>
> (f) An amount equal to one-half of the amount by which net long-term capital gain exceeds the net short-term capital loss for the taxable year. 3/
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> * * *
>
> (h) Subdivision (f) of this section shall apply only to taxable years beginning after December 31, 1970, and ending on or before November 30, 1972. For taxable years beginning after December 31, 1971, the amount of the tax preference income with respect to capital gains shall be an amount (but not below zero) equal to the difference between (1) the taxpayer's total net capital gains and losses (determined without regard to any capital loss carryover) for the taxable year, and (2) the taxpayer's net capital gains and losses recognized by virtue of Section 18162.5 for the same taxable year. (Footnote added.)

Appellant argues that he properly calculated his reported capital gains for 1978. Furthermore, he apparently contends that it is unconstitutional to impose the minimum tax on preference items against any portion of his capital gain.

Section 17062, the section setting forth the minimum tax on tax preference items, was enacted as part of a comprehensive legislative plan designed to conform California income tax law to the federal reforms enacted by the Tax Reform Act of 1969. (See Assem. Com. on Rev. and Tax. Tax Reform: 1971; Detailed Explanation of AB 1215 and ACA 44, As Amended May 20, 1971, p. 85.) The federal counterpart to section 17062, section 56 of the Internal Revenue Code of 1954, imposes a minimum tax on items of tax preference. It was enacted to reduce

3/ Subdivision (f) of section 17063 is applicable with respect to "taxable years beginning after December 31, 1970, and ending on or before November 30, 1972." (Rev. & Tax. Code, § 17063, subd. (h).) Since the subject taxable year is 1978, subdivision (f) is of no direct relevance to the instant appeal.

the advantages derived from otherwise tax-free preference income and to insure that those receiving such preferences pay a share of the tax burden. (1969 U.S. Code Cong. & Ad. News 2143.)

The federal minimum tax on tax preference items is imposed only with respect to those preference items which actually produce a tax benefit. Similarly, as we observed in the Appeal of Richard C. and Emily A. Biagi, decided May 4, 1976, the intent of the California Legislature in enacting section 17062 was to apply the minimum tax on items of tax preference only with respect to those preference items which actually produce a tax benefit; when items of tax preference do not produce a tax benefit, they are not subject to the minimum tax. (See also Appeal of Harold S. and Winifred L. Voegelin, Cal. St. Bd. of Equal., Feb. 3, 1977.)

Former subdivision (h) of section 17063 dealt with the preferential tax treatment accorded capital gains for taxable years beginning on or after January 1, 1972. For such years, with the enactment of section 18162.5 and the repeal of the previously existing capital gains deduction (Rev. & Tax. Code, §§ 18152 and 18162, repealed by Stats. 1972, ch. 1150, in effect Nov. 27, 1972), California established a new method for according preferential tax treatment to capital gains. Section 18162.5 provides as follows:

> (a) In the case of any taxpayer, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing taxable income:
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> (1) One hundred percent if the capital asset has been held for not more than one year;
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> (2) Sixty-five percent if the capital asset has been held for more than one year but not more than five years;
>
> (3) Fifty percent if the capital asset has been held *more than* five *years*.

(b) This section shal.l apply with respect to taxable years beginning after December 31, 1971. 4/ (Footnote added.)

The following example demonstrates the operation and effect of section 18162.5.

Example

Assume that a taxpayer with a taxable year beginning January 1, 1978, realizes actual "l-year" capital losses totaling $10,000, actual "l-to-5 year" capital gains totaling $3,000, and actual "S-year" capital gains totaling $25,000. The taxpayer's total net capital gain would be computed under section 18162.5 as follows:

	Actual Gain or Loss			§ 18162.5 Gain or Loss
" 1 -year" loss	($10,000)	x 100%	=	($10,000)
"l-to-5 year" gain	3,000	x 65%	=	1,950
"5-year" gain	25,000	x 50%	=	12,500
Total gain	$18,000			$ 4,450

As the above example demonstrates, section 18162.5 results in preferential tax treatment for certain capital gains by providing for a specified percentage reduction in the amount of such gains taken into account in computing taxable income. Accordingly, former subdivision (h) of section 17063 designated as an item of tax preference the portion of capital gains not included in taxable income by virtue of section 18162.5. By applying the provisions of former subdivision (h) to the example set forth above, we find that the taxpayer in the example has an item of tax preference in the amount of $13,550. That amount represents the difference between the taxpayer's $18,000 actual total net capital gains and. the $4,450 total net capital gains recognized by virtue of section 18162.5. It is important to note that the item of capital gains tax preference arises solely by virtue of the artificial

4/ Hereinafter, the capital gains and losses referred to in section 18162.5 will be described, according to the corresponding holding period, as "1-year," "1-to-5-year," and "5-year" capital gains or losses, respectively.

decrease in the taxpayer's actual capital gains. (Appeal of Harold S. and Winifred L. Voegelin, supra.)

The instant appeal presents a factual situation analogous to the example set forth above. In 1978, appellant realized an actual total net capital gain of $74,480.33 on his capital asset transactions. Yet, by virtue of section 18162.5, as shown below, he was required to recognize a capital gain of only $29,843.79 in 1978.

	Actual Gain or Loss			§ 18162.5 Gain or Loss
"1-year" loss	($14,792.75)	x 100%	=	($14,792.75)
"5-year" gain	89,273.08	x 50%	=	44,636.54
Total gain	$74,480.33			$29,843.79

The difference between appellant's actual total net capital gain in 1978 and the net capital gain recognized by virtue of section 18162.5 is $44,636.54. In the Appeal of Harold S. and Winifred L. Voegelin, supra, we addressed an issue identical to the one presented here and concluded that this amount constitutes an item of tax preference as defined in former subdivision (h) of section 17063. As noted above, the minimum tax on items of tax preference applies only with respect to those preference items which produce a tax benefit. Accordingly, former subdivision (h) identified as an item of tax preference only that portion of appellant's capital gain which was shielded from ordinary taxation by operation of section 18162.5, in this case, $44,636.54.

Appellant has argued that he correctly calculated his reported capital gains. This is not an item at issue in this appeal; rather, as discussed above, the question presented here concerns the proper computation of his item of capital gains tax preference. With respect to appellant's contention that it is unconstitutional to subject any portion of his capital gain to the tax imposed by section 17062, we believe that the adoption of Proposition 5 by the voters on June 6, 1978, adding section 3.5 to article III of the California Constitution; precludes our determining that the statutory provisions involved are unconstitutionalor unenforceable. Furthermore, this board has a well established. policy of abstention from deciding constitutional questions in appeals involving deficiency assessments.

(Appeal of Ruben B. Salas, Cal. St. Rd. of Equal., Sept. 27, 1978; Appeal of Iris E. Clark, Cal. St. Bd. of Equal,., March 8, 1976.) This policy is based upon the absence of specific statutory authority which would allow respondent to obtain judicial review of an adverse decision in a case of this type, and our belief that such review should be available for questions of constitutional importance.

For the reasons stated above, we conclude that respondent correctly determined, pursuant to the express provisions of former subdivision (h) of section 17063, that appellant had an item of capital gains tax preference in the amount of $44,636.54 for the year 1978. Respondent's action in this matter will, therefore, be sustained.

ORDER

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 protest of Eugene I. Ingrum against a proposed assessment of additional personal income tax in the amount of $1,822.51 for the year 1978, be and the same is hereby sustained.

Done at Sacramento, California, this 29th day of June , 1982, by the State Board of Equalization, with Board Members Mr. Bennett, Mr. Dronenburg and Mr. 'Nevins present.

William M. Bennett, Chairman

Ernest J. Dronenburg, Jr., Member

Richard Nevins, Member

, Member

, Member