BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
ESTATE OF RAY MURPHY, DECEASED,)
DOROTHY D. WALTON AND ADRIAN)
ARENDT, EXECUTORS

For Appellants: William J. Bird
Attorney at Law

For Respondent: Jean Harrison Ogrod
Counsel

O P I N I ON

This appeal is made pursuant to section 15593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of the Estate of Ray Murphy, Deceased, Dorothy D. Walton and Adrian Arendt, Executors, against a proposed assessment of additional personal income tax in the amount of $2,907.74 for the year ended February 23, 1974.

Appeal of Estate of Ray Murphy, Deceased,
Dorothy D. Walton and Adrian Arendt, Executors

The so-le issue presented for determination is whether respondent correctly determined that the Estate of Ray Murphy, Deceased, and Dorothy D. Walton and Adrian Arendt, Executors (hereinafter "the estate" and "the executors," respectively, and collectively referred to as "appellants") were precluded from including certain capital gains in the computation of the estate's distributable net income for the taxable year in issue.

The estate was created on April 20, 1973, upon the death of Ray Murphy. On June 25, 1973, the Orange County Probate Court ordered the executors to pay to the decedent's surviving spouse a family allowance of $4,000 per month. The Probate Court's order specified that payment was to be made from the estate's income.

On the fiduciary income tax return for the taxable year ended February 28, 1974, $44,000, the amount of the court-ordered family allowance for the year, was reported as an amount distributed to a beneficiary. A deduction was claimed for that distribution in the amount of $35,566.16 ($44,000 less net tax-exempt income). During the taxable year in issue, the estate's taxable income, excluding capital gains, was $5,342.59. Deductible expenses exceeded that income by $8,433.84. The estate, however, realized a substantial amount of capital gain from the sale of stock. The return indicated that $44,000 of the estate's capital gain had been included in the computation of its distributable net income.

Upon review of the return, respondent corrected the computation of capital gains and also determined that the capital gains were not includible in the estate's distributable net income for the taxable year in issue. In accordance with this determination, respondent computed that the estate's distributable net income, excluding the capital gains and tax-exempt income, was $2,047, an insufficient amount to cover the amount that had been deducted as distributed to a beneficiary. Accordingly, respondent reduced the amount allowable as a distribution deduction to $2,047 and issued the proposed assessment in issue. Appellants protested respondent's determination, arguing that the capital gains were properly includiblc in distributable net income. After consideration of appellants' protest, respondent affirmed the assessment, resulting in this appeal.

Generally, the amount of distributions which an estate may claim as a deduction is limited by the estate's "distributable net income" (DNI). (Rev. & Tax. Code, § 17761, subd. (a).) DNI is defined as the taxable income of an estate or trust, excluding, inter alia, capital gains which are allocated to corpus and not "paid, credited, or required to be distributed to any beneficiary during the taxable year ...." (Rev. & Tax. Code, § 17739, subd. (b)(1).) The regulation interpreting this definition provides that capital gains are excluded from DNI unless at least one of four requirements is satisfied. The requirement involved in this appeal is that capital gains be "[a]llocated to corpus and actually distributed to beneficiaries during the taxable year." (Cal. Admin. Code, tit. 18, reg. 17739(d), subd. (1)(B).) Respondent, in reliance upon the cited regulation, contends that it is necessary to trace distribution payments to capital gains in order to show actual distribution of such gain.

Mr. Murphy's will was silent on the question of whether capital gains were to be allocated to income or corpus. Consequently, those gains were properly allocable to corpus. (Civ. Code, § 730.03, subd. (b)(8); Estate of Davis, 75 Cal.App.2d 528 [171 P.2d 463] (1946).) Respondent maintains that they were excluded from DNI, however, because appellants provided no documentation tracing the family allowance payments (i.e., the distributions) to the capital gains. Appellants, on the other hand, assert that section 17739 does not require such tracing and imply that respondent's regulation is void to the extent that it imposes requirements not found in the section pursuant to which it was promulgated.

Appellants also argue, in reliance upon our decision in Appeal of John Perry Cohn Trust #1, et al., decided July 26, 1977, that the Probate Court's order to pay a family allowance to the decedent's surviving spouse was the equivalent of a "mandatory direction" to the executors to pay the family allowance from whatever funds were available so that the inclusion of capital gains in its DNI was proper under the provisions of

regulation 17739(d), subdivision (1)(B).[1] In the above cited appeal, respondent conceded that the taxpayer had actually distributed the capital gains in issue; the dispute in that case centered upon whether their distribution was required by mandatory terms of the trust agreement or was a matter of discretion in the trustees. Appellants may not prevail in this matter solely by demonstrating that the Probate Court's order amounted to a "mandatory direction" to the estate's executors to pay the family allowance from any available source. Consequently, the first question presented for our determination is whether appellants must trace the distribution payments to capital gains in order to show actual distribution of such gains. The secondary issue of whether the distributions were required by the terms of the will arises only if it is determined that tracing of the distribution payments to capital gains is not required.

The fundamental rule of statutory construction is that the intent of the Legislature should be ascertained so as to effectuate the purpose of the law. (Select Base Materials v. Board of Equalization, 51 Cal.2d 640 [335 P.2d 672] (1959).) When there exists doubt as to the legislative intent of a statute that has been adopted, recourse may be made to the history or purpose underlying its enactment. (County of Alameda v. Carleson, 5 Cal.3d 730 [97 Cal.Rptr. 385] (1971), app. dism., 406 U.S., 913 [32 L.Ed.2d 112] (1972); Rocklite Products v. Municipal Court, 217 Cal.App.2d 638 [32 Cal.Rptr. 183] (196x) Revenue and Taxation Code section 17739 was enacted in 1955 following the enactment of its federal counterpart, section 643(a) of the Internal Revenue Code, in 1954. Accordingly, the legislative history behind the enactment of section 643(a) is a relevant factor to be considered in determining the proper interpretation of section 17739. (State v. Mitchell, 563 S.W.2d 18 (Mo. 1978).)

1/ While appellants have cited regulation 17739(d), subdivision (1)(C), in support of this contention, it is evident from their arguments on appeal that this citation is in error and that they are actually relying upon subdivision (1)(B) of regulation 17739(d).

Prior to the enactment of section 643(a), tracing was required under section 162 of the Internal Revenue Code of 1939 both for the purpose of determining whether a particular distribution represented amounts of current or accumulated trust income as well as for the purpose of showing whether a capital gain allocated to corpus had in fact been distributed.. (Kamin, Surrey, and Warren, The Internal Revenue Code of 1954: Trusts, Estates and Beneficiaries, 54 Col.L.R. 1237, 1242.) The legislative history of section 643(a) reveals that, while Congress intended to eliminate the first tracing requirement, there was no intent to eliminate the necessity for tracing in the latter instance. The House of Representatives Report. states, in pertinent part:

> This approach represents a basic departure from the general rule of the existing law that taxable distributions must be traced to the income of the estate or trust for the current year.
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> The approach adopted by the bill eliminates the necessity, in determining the taxability of distributions, of tracing such distributions to the income of the estate or trust for the current taxable year. The simplicity of this general principle makes it possible to eliminate the so-called 65-day and the 12-month rules of existing law. Under the bill, except to the limited extent provided under the throwback rule (discussed later) which is designed to eliminate a loophole of existing law, amounts distributed in 1 year will not be considered to have been distributed in a preceding year, and the source of a distribution, whether made from the income of the current year or of a preceeding year, is immaterial in determining the taxability of the distribution in the hands of the beneficiary. Furthermore, amounts not included in the gross income of the estate or trust will generally not be taxable to the beneficiaries. (H.R. Rep. No. 1337, 83d Cong., 2d Sess. (1954) [1954 U.S. Code Cong. & Ad. News, pp. 4086-4087]. A similar statement is found in S. Rep. No. 1622, 83d Cong., 2d Sess. (1954) [1954 U.S. Code Cong. & Ad. News, p. 4715].)

The above quoted material reveals that the tracing problem sought to be avoided was with respect to determining whether a distribution was out of current income as opposed to accumulated income, not with respect to determining whether the distribution was out of current ordinary income as opposed to current capital gains. As the reports later state:

> Instead of determining whether a particular distribution represents amounts of current or accumulated trust income, this revision, broadly speaking, provides that any distribution is considered a distribution of the trust or estate's current income to the extent of its taxable income for the year. (Emphasis added.) (H.P. Rep. No. 1337, 83d Cong., 2d Sess. (1954) [1954 U.S. Code Cong. & Ad. News, p. 43391. A similar statement is found in S. Rep. No. 1662, 83d Cony., 2d Sess. (1954) [1954 U.S. Code Cong. & Ad. News, p. 49901.)

That Internal Revenue Code section 643(a) did not eliminate the subject tracing requirement has also been recognized by the commentators. (See, e.g., Kamin, Surrey, and Warren, The Internal Revenue Code of 1954: Trusts, Estates and Beneficiaries, supra; Joyce, The Income Taxation of the Capital Gains of a Trust, 23 Tax L.R. 361 (1968).)

Since respondent's interpretation of section 17739 and regulation 17739(d) is in accord with the legislative history of section 17739's federal counterpart and is also supported by the comments of noted tax authorities, there is no reason to conclude that it is, contrary to the Legislature's intent in enacting section 17'739, at least in the absence of any evidence suggesting otherwise. Consequently, as appellants have provided no documentation tracing the family allowance payments to the estate's capital gains, we must conclude that respondent's action in this matter was correct. This conclusion makes it unnecessary to consider the subsidiary question of whether the subject distributions were required by virtue of the Probate Court's order.

Appeal of Estate of Ray Murphy, Deceased, Dorothy D. Walton and Adrian Arendt, Executors

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 protest of the Estate of Ray Murphy, Deceased, Dorothy D. Walton and Adrian Arendt, Executors, against a proposed assessment of additional personal income tax in the amount of $2,907.74 for the year ended February 28, 1974, 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