



Appeal of Sherwood R. and Marion S. Gordon

Appellants, Sherwood R. and Marion S. Gordon, were residents of Switzerland during 1975, 1976, and 1977. For purposes of California reporting, they filed non-resident tax returns for those years. Appellants did not report the gain resulting from payments received under an installment sale contract. The installment sale had taken place in 1972 when the appellants were residents of California and involved the sale of stock in appellant husband's wholly owned corporation, which had operated a radio station in San Diego.

Upon examination of appellants' returns for the above years, respondent determined that appellants should have reported the installment income on their 1975 and 1976 returns. Accordingly, respondent adjusted appellants' taxable income for 1975 and 1976 in the amounts of \$91,540.00 and \$352,666.00, respectively, and increased preference income by \$91,541.00 and \$352,667.00, reflecting capital gains not taken into account by operation of section 18162.5 of the Revenue and Taxation Code.

For 1975, an additional adjustment of \$3,206.00 was made on the basis of a federal adjustment for that year. This adjustment does not appear to be contested by appellants.

For 1976 and 1977, respondent also reclassified certain expenses claimed on Schedule C as trade or business expenses. They were recharacterized as expenses for the production of income, an itemized deduction. These expenses related to appellants' former business activity concerning another radio station sold in 1975. These adjustments did not result in a normal tax effect for 1976 or 1977, but had the effect of increasing preference income in 1977 by \$1,243.00 and increasing preference tax by \$55.00.

An additional minor adjustment of \$1,384.00 for medical expenses was made for 1977 on the basis that a medical expense is not deductible by a nonresident. Appellants do not appear to contest this adjustment.

Proposed assessments were issued on the basis of the above adjustments, and appellants protested. After consideration, respondent affirmed the original assessments, resulting in the filing of this appeal.

It is first noted that respondent has withdrawn its disallowance of appellants' trade or business expenses claimed in connection with the 1975 sale of the second radio station. As respondent's disallowance had no tax effect for 1976, the question is moot for that year. In 1977, however, the effect is \$55.00 relative to the preference income adjustment for that year. Accordingly, respondent's proposed assessment for 1977 should be reduced from \$97.12 to \$42.12. The primary question remaining for decision, therefore, is whether the gain on installment payments collected by appellants in

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1975 and 1976, after they became residents of Switzerland, is includable in income subject to tax in California.

It is respondent's position that the gain received by appellants in 1975 and 1976, after they became residents of Switzerland, had its source in California and was therefore subject to California income tax because it "accrued," pursuant to section 17596 of the Revenue and Taxation Code, in 1972 when appellants were California residents. Respondent relies on the Appeal of Christian M. and Lucille V. McCririe, and on the authorities cited therein, decided by this board on December 6, 1977.

Appellants, on the other hand, reject the application of section 17596 to their situation. They cite the McCririe decision as holding that section 17596 does not apply to years subsequent to the year residence was changed. Appellants also contend that section 17571 in allowing them, as cash basis taxpayers, to report collection of their installment sale payments as such payments are received, works to prevent California's taxation thereof. Finally, appellants maintain that California lacks jurisdiction under the U.S. Constitution to impose a tax on the installment payments at issue. For the reasons outlined below, we believe respondent's position in this matter to be well founded.

The California personal income tax is imposed upon the entire taxable income of residents of California and, upon the income of nonresidents which is derived from sources within California. (Rev. Tax. Code, §§ 17041, 17951.) Where a taxpayer's residency status changes, section 17596 of the Revenue and Taxation Code provides:

When the status of a taxpayer changes from resident to nonresident, or from nonresident to resident, there shall be included in determining income from sources within or without this State, as the case may be, income and deductions accrued prior to the change of status even though not otherwise includible in respect of the period prior to such change, but the taxation or deduction of items accrued prior to the change of status shall not be affected by the change. . . .

This accrual treatment applies even though the taxpayer may be on the cash receipts and disbursements accounting basis. (Cal. Admin. Code, tit. 18, reg. 17596.)

Under an accrual method of accounting, income is includible in gross income when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy. (Cal. Admin. Code, tit. 18, reg. 17571(a); Treas. Reg. § 1.446-1(c)(1)(ii); Spring City Foundry Co. v. Commissioner, 292 U.S. 182 [78 L.Ed. 1200], reh. den., 292 U.S. 613 [78 L.Ed. 1472])

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(1934).) If there are substantial contingencies as to the taxpayer's right to receive, or uncertainty as to the amount he is to receive, an item of income does not accrue until the contingency or events have occurred and fixed the fact and amount of the sum involved. (Midwest Motor Express, Inc. 27 T.C. 167 (1956), affd., 251 F.2d 405 (8th Cir. 1958); San Francisco Stevedoring Co., 8 T.C. 222 (1947).)

On the basis of the above cited authorities, we held in the Appeal of Christian M. and Lucille V. McCririe, referenced above, that a sale of securities pursuant to an installment sale was a completed transaction in the year of sale when the taxpayers were residents of California, and thus the gain therefrom had accrued, within the meaning of section 17596, at the time of the sale even though the obligation to report such gain was deferred. We believe the same conclusion must be reached here, for, as in McCririe, there were no contingencies as to price or otherwise that interfered with or obstructed appellants' right to receive the income from the installment sale.

Appellant's contention that McCririe limits section 17596 to installment payment income received in the year a taxpayer becomes a nonresident is incorrect. Nothing in the McCririe decision indicated that section 17596 was only applicable because the taxpayers therein received the final installment payment in the same calendar year they had last been California residents. Furthermore, no such conclusion can be reached on the basis of any of our previous decisions applying section 17596. (See Appeal of Edward B. and Marion R. Flaherty, Cal. St. Bd. of Equal., Jan. 6, 1969; Appeal of Lee J. and Charlotte Wojack, Cal. St. Bd. of Equal., March 22, 1971; Appeal of Henry D. and Rae Zlotnick, Cal. St. Bd. of Equal., May 6, 1971; Appeal of Dr. F. W. L. Tydeman, Jan. 5, 1950.) The rule derivable from these decisions is that income "accrues" within the meaning of section 17596, so as to connect it with the state of prior residence; as long as all events fixing the taxpayer's right to receive the income have occurred before a taxpayer changes residence status. This is the rule regardless of whether the income is actually received in the year residence is changed or in some later year.

The next of appellants' contentions, that section 17571 of the Revenue and Taxation Code somehow prevents California from imposing a tax on the income at issue, also lacks merit. Section 17571 concerns the period in which income is to be reported. The issue in this appeal is not whether appellants' are required to report the installment payments in some period other than the one of receipt, but rather whether the source of such payments is in California so that they are taxable by California when received. Consequently, section 17571 has nothing to do with the resolution of this appeal, and appellants' reliance on that provision is misplaced.

The last argument which appellants make is that the proposed application of section 17596 is unconstitutional. Pursuant to article

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3, section 3.5 of the California Constitution, we may not declare a statute unconstitutional. In any event, were we empowered to do so, we would not be inclined to so rule. We believe that since the income at issue has been characterized as California source income any constitutional nexus requirements in connection with jurisdiction to tax have been met. (Shaffer v. Carter, 252 U.S. 37 [64 L.Ed. 446] (1920).)

In summary, we sustain respondent's determination that the gain received by appellants in 1975 and 1976 was properly includible in their income from California sources for those years. Consequently, the respective adjustments to appellants' preference income tax liability for those years based primarily on such determination must also be sustained. Except for the modification mentioned above as a result of respondent's conceding the allowance of appellants' trade or business expenses claimed in 1977, respondent's remaining adjustments must also be upheld, since they were not contested.

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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 Sherwood R. and Marion S. Gordon against proposed assessments of additional personal income tax in the amounts of \$15,014.85, \$56,245.97 and \$97.12 for the years 1975, 1976, and 1977, respectively, be and the same is hereby modified to reflect the Franchise Tax Board's concession regarding the trade or business expenses claimed for 1977. In all other respects, the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 3rd day of January, 1983, 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