BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
ALFRED W. AND ALICE SMALLING)

For Appellants: Alfred W. and Alice Smalling, in pro. per.

For Respondent: John R. Akin
Counsel

O P I N I O N

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 Alfred W. and Alice Smalling against a proposed assessment of additional personal income tax and penalty in the total amount of $1,348.99 for the year 1976.

The primary issue presented is whether appellants" transfer of the amount distributed to Mr. Smalling from an employees' qualified trust to individual retirement accounts qualified as a tax-free rollover under section 17503 of the Revenue and Taxation Code.

Prior to 1976, Mr. Smalling (hereinafter referred to as "appellant") was employed in California by McDonnell Douglas Corporation (MDC). While so employed, he participated in the MDC Employee Savings Plan, which is qualified under section 17501 of the Revenue and Taxation Code and exempt from tax under section 17631 of the Revenue and Taxation Code.[1] Appellant and MDC both made contributions to this plan.

In early 1976, appellant terminated his employment with MDC and, on February 27, 1976, received a distribution of cash and MDC stock from the MDC Savings Plan. The cash distribution consisted of $17,724.34, of which $10,313.50 represented appellant's contribution. The balance of the cash distribution, $7,410.84, which represented MDC's contribution and the earnings of the account, was deposited into an individual retirement account (IRA) with Republic Savings and Loan Association in Westminster, California, on March 18, 1976. The stock distribution consisted of 671 shares, of which 218.9 were allocable to appellant's contribution and 452.1 were allocable to MDC's contribution and the earnings of the account. Sometime prior to March 31, 1976, appellant deposited all 671 shares of MDC stock with Certified Plans, Inc. (CPI). Appellant intended that CPI transfer the 452.1 shares allocable to MDC's contribution and the account earnings to an IRA and distribute the remaining shares to appellant. However, CPI transferred all the shares to an IRA, In July, 1976, CPI attempted to distribute to appellant the stock which was allocable to his contribution, but it distributed 235 shares rather than 218.9.

Appellants did not report the MDC plan distribution on their 1976 California income tax return. Consequently, when respondent was notified of the, plan

1/ Unless otherwise noted, all references to the Revenue and Taxation Code refer to the statutes as in effect in 1976.

distribution, it issued a proposed assessment, taxing the distribution in accordance with subdivision (a) of section 17503 of the Revenue and Taxation Code. It also imposed a 5 percent negligence penalty. Appellant protested the proposed assessment, contending that he had made a tax-free rollover of the MDC plan distribution. Respondent determined that appellant had not met the conditions for a tax-free rollover under subdivision (e) of section 17503 and affirmed its proposed assessment, giving rise to this appeal. Respondent has conceded that the negligence penalty was incorrectly imposed. Therefore, if respondent's position is upheld, the proposed assessment will be modified to eliminate the penalty.

Section 17503 provides, in general, that distributions from an employees' trust described in section 17501 which is exempt from tax under section 17631, in excess of the employee's contributions, are taxable to the distributee in the year of the distribution. An exception to this rule is made if the employee receives all of his vested interest in the employees' trust in a lump sum distribution and, within 60 days of the distribution, makes a valid rollover contribution to an IRA. (Rev. & Tax. Code, § 17503, subd. (e).) Until its amendment in 1979, subdivision (e) of section 17503 provided that in order to make a valid rollover to an IRA, the employee had to contribute the portion of the distribution from the trust which represented the employer contributions and earnings on the account; if he failed to transfer this minimum amount, the rollover was invalid, and the distribution from the employees' trust, less the employee contributions. was taxable in accordance with subdivision (a) of section 17503. (Appeal of Michael J. and Jody S. Moroso, Cal. St. Bd. of Equal., March 4, 1980.)" Respondent contends that the same result should follow when, as in this appeal, an employee contributes to the IRA more than the minimum amount.

Initially, we belive it necessary to clarify that the basic issue before us is the validity of the tax-free rollover; respondent has not claimed that the resulting IRAs are invalid. We also note that the parties agree that appellant should not have rolled over his previously taxed employee contributions and that, by doing so, he made an excess contribution to one of his IRAs.[2/] The issue before us is whether this excess contribution invalidated the rollover. This issue is solely an issue of law; there is no dispute concerning any factual matters. For this reason, the presumption of correctness which usually attaches; to respondent's factual determination is not present. (Ray v. Commissioner, 283 F.2d 337 (5th Cir. 1960).)

Subdivision (e) of section 17503 states that in order to make a valid tax-free rollover from an employees' qualified trust, the employee must contribute to the IRA "all the property he receives in such distribution [from the employees' qualified trust] . . . to the extent the fair market value of such property exceeds the employee contributions." This language is not clear as to whether or not an employee can contribute more than the minimum contribution without invalidating the tax-free rollover. We decide this ambiguity in favor of the taxpayer for a number of reasons.

What little legislative history there is concerning the question before us tends to support appellant's position. Where the language of a statute is unclear, as is subdivision (e) of section 17053, it is appropriate to examine the legislative history of the statute to ascertain legislative intent. (California Manufacturers Association v. Public Utilities Commission, 24 Cal.3d 836 [157 Cal.Rptr. 676] (1979).) In a case such as this, where the state statute was enacted to conform to a federal statute, the legislative history surrounding the enactment of the federal statute is relevant to the proper interpretation of its state counterpart. (Appeal of California Rifle and Pistol Association, Cal. St. Bd. of-Equal., Jan. 3, 1983.)

2/ We note that although both parties to this appeal apparently assume that the excess contribution consisted of a portion of the MDC stock, it actually consisted of a portion of the cash rolled over. This is because subdivision (e)(3) of Revenue and Taxation Code section 17503 provides that where the employee receives property other than cash, he must transfer all the property to the IRA, to the extent the fair market value of the property does not exceed the amount which is required to be transferred to the IRA.

Respondent contends that certain language contained in the House Conference Committee Report accompanying the enactment of the Employee Retirement Income Security Act of 1974, which contained section 402, supports its position, but we do not agree. The language cited by respondent is:

> Also, in the case of rollovers from a qualified plan, the amount contributed to the individual retirement account is to be the amount received, less the amount contributed to the plan by the individual as an employee contribution. (This is because the employee must always have a zero basis in his individual retirement account.)

(H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. (1974), [1974 U.S. Code Cong. & Ad, News 5038, 51211.)

That language merely indicates that the correct amount of a rollover contribution from a qualified plan to an IRA is the amount distributed reduced by employee contributions. It does not discuss what results follow if a taxpayer contributes more than the correct amount. The House Report, which addresses that issue, does not indicate that the result would be to invalidate the rollover. It states only that: "If the rollover contributions to a retirement account are greater than the amount allowed, then the 6 percent excise tax is to apply to the excess contributions." (H.R. Rep. No. 807, 93d Cong., 2d Sess. (1974), [1974 U.S. Code Cong. & Ad. News 4670, 4805].)[3]

When the California Legislature enacted its deferred compensation program, which was patterned after the federal legislation, it did not impose an excise tax on excess contributions. However, it enacted section 17503 without altering the language of Internal Revenue Code section 402 and did not add any provision stating that an excess contribution would invalidate a rollover from a qualified employees' trust. Without such a provision and in light of the absence of any legislative history supporting respondent's interpretation, we are led to agree with appellant's interpretation of section 17503.

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[3] The excise tax referred to is the tax imposed by Internal Revenue Code section 4973 on excess contributions to individual retirement accounts.

We are further led to our conclusion by the fact that Congress and the California Legislature enacted substantially similar provisions in 1978 and 1979, respectively, which presuppose that an excess rollover contribution to an IRA can be made without invalidating the rollover. (I.R.C. § 408, subd. (d)(5)(B); Rev. & Tax. Code, § 17530, subd. (d)(5)(B).) These sections exempt from taxation a distribution from an IRA in an amount equal to the amount of an excess contribution made in connection with a rollover if certain conditions are fulfilled. These sections would be meaningless if an excess rollover contribution invalidated the rollover to an IRA; therefore, they support our conclusion that an excess contribution from a qualified employees' trust to an IRA does not invalidate the rollover.

We conclude that an excess contribution made in connection with a tax-free rollover from a qualified employees' trust does not invalidate the rollover. While none of the reasons discussed above would, alone, compel us to reach this conclusion, in the aggregate, we believe they demonstrate appellant's position to be more reasonable. A taxing agency must enforce statutes as written and in accordance with legislative intent; it is not free to impose upon the taxpayer additional conditions not contained in the statutes. (Boykin v. Commissioner, 260 F.2d 249 (8th Cir. 1958).) Since respondent has produced absolutely no authority to support its interpretation and there are indications that appellant's interpretation is correct, we must agree with appellant. Respondent has not asserted that appellant's rollover was defective in any manner other than the excess contribution, Since we have held that this did not invalidate the rollover, we conclude that respondent erred when it determined that the distribution from the MDC plan was not tax-free.

In view of our holding that appellant's rollover to the IRA was valid, we are faced with the question of to what extent the July distribution of 235 shares of MDC stock from the IRA was taxable. Subdivision (d)(1) of section 17530 states that, except as otherwise provided by that subdivision, any amount distributed from an IRA is included in the distributee's gross income for the taxable year in which the distribution is received. Subdivision (d), as in effect for the year in issue, contained no provision for the tax-free withdrawal of an excess contribution made in connection with a rollover contribution. Although, as discussed above, such a provision was enacted in 1979 (Rev. & Tax. Code, § 17530, subd. (d)(5)(B)), it was operative only for tax years beginning on or after

January 1, 1979, and does not apply in this case. Accordingly, the entire amount appellant receives from his IRA in any year is fully included in his gross income for that year. Appellant received 235 shares of MDC stock in the year at issue; thus, the fair market value of those 235 shares of MDC stock must be included in his gross income for that year.

For the foregoing reasons, the action of respondent must be modified to reflect our conclusion that the distribution from the MDC Employee Savings Plan was not taxable but that the later distribution of 235 shares of MDC stock from appellant's IRA was taxable.

Appeal of Alfred W. and Alice Smalling

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 Alfred W. and Alice Smalling, against a proposed assessment of additional personal income tax in the amount of $1,348.99 for the year 1976, be and the same is hereby modified to reflect our determination, as stated in the foregoing opinion, that the only taxable event connected with the rollover from the MDC Employee Savings Plan was the July distribution of 235 shares of MDC stock from appellant's Individual Retirement Account.

Done at Sacramento, California, this 17th day of August, 1983, by the State Board of Equalization, with Board Members Mr. Bennett, Mr. Collis, Mr. Dronenburg, Mr. Nevins and Mr. Harvey present.

William M. Bennett, Chairman

Conway H. Collis, Member

Ernest J. Dronenburg, Jr., Member

Richard Nevins, Member

Walter Harvey*, Member

*For Kenneth Cory, per Government Code section 7.9