

Appeal of Lloyd C. and Beatrice M. Graybill

The question presented is whether an annual payment received from the State of California's deferred compensation plan constitutes "earned income" for purposes of computing the credit for the elderly.

Appellants are husband and wife, and both were under 62 years of age in 1978. During that year, Mr. Graybill received a pension from the State of California, as well as an annual payment in the amount of **\$2,876.06** from a deferred compensation plan established by the state for its employees in **accordance** with the provisions of section 17585 of the Revenue and Taxation Code and section 457 of the Internal Revenue Code.

Appellants filed a timely joint personal income tax return for 1978 on which they claimed a **\$389.32** credit for the elderly. After reviewing the return, respondent determined that appellants had improperly computed the credit **because** of their failure to include in "earned income" the deferred compensation payment and \$770.06 in net profit from Mr. Graybill's law practice. Inclusion of these amounts in the computation reduced the allowable credit by \$103.74, and respondent issued a deficiency assessment in that amount. On appeal, appellants contest only the inclusion of the deferred compensation in "earned income".

Under certain conditions, Revenue and **Taxation** Code section 17052.9, subdivision (e), allows a credit for individuals under age 65 who **receive pensions** under a public retirement system. For such individuals who file a joint return, the allowable credit, generally speaking, is 15 percent of the first \$3,750 of public pension income, after reducing such amount (\$3,750) by any **tax-exempt** pensions and by certain amounts of "earned income". (Rev. & Tax. Code, § 17052.9, subd. (e)(5) - (e)(7).) Since appellants were not yet 62 years of age by the end of 1978, any "earned income" in excess of \$900 **must be** offset against the credit base of \$3,750. (Rev. & Tax. Code, § 17052.9, subd. (e)(5)(B)(i).)

Section 17052.9 does not specifically define the term "earned income," except to say that it "does not include any amount received as a pension or annuity." (Rev. & Tax. Code, § 17052.9, subd. (e)(8)(B).) The term is defined more comprehensively, however, in section 37 of the Internal Revenue Code, which is the federal counterpart of our section 17052.9. Subsection **(e)(9)(B)** of section 37 states: "The term 'earned income' has the meaning assigned to such term by section **911(d)(2)**,"

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except that such term does not include any amount received as a **person** or annuity." (Int. Rev. Code of 1954, § 37 (e)(g)(B).) In pertinent part, section 911(d)(2) defines "earned income" as "wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered." (Int. Rev. Code of 1954, § 911(d)(2)(A).)

Appellants contend that the deferred compensation payment does not constitute "earned income" because it was received as a "pension or annuity." This position is based principally on the argument that the deferred compensation payment was part of a retirement "annuity" payable at regular intervals over a period of years pursuant to a plan established by the State of California **for** retirement purposes. Respondent argues, on the other hand, that the payment is "earned income" because it is compensation for services, and that it does not lose its character as compensation merely **because** payment was postponed under the plan.

Although there does not appear to be any authority directly in point on this issue, there are several tax court decisions which lend some support to respondent's position in this matter. These cases, Thomas A. DePaolis, 69 T.C. 283 (1977), and William I. Woodford, 71 T.C. 991 (1979), both held that disability retirement benefits, to the extent they exceeded the "sick pay" exclusion, did not qualify as a "pension or annuity" within the meaning of Internal Revenue Code section 37, **but** rather were **amounts** received as compensation for services. In DePaolis, the court stated specifically that the words "pensions and annuities" as used in section 37 refer only to pensions and annuities whose taxability is determined under section 72 of the Internal Revenue Code. (Thomas A. DePaolis, supra, 69 T.C. at 286.) Thus, since the taxation of disability annuities is governed by Internal Revenue Code section 105, not by section 72, the court concluded that such annuities were not annuities excludable from earned income under section 37.

Applying similar reasoning to the present case, we conclude that the deferred compensation payment is not from a "pension or annuity" within the meaning of Revenue and Taxation Code section 17052.9, since the taxability of such amounts is governed by Revenue and Taxation Code section 17585 and not by sections 17101-17112.7, which are the California equivalent of Internal Revenue Code section 72. Although we recognize that deferred compensation payments bear some of the attributes of normal

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retirement pensions or annuities, we are constrained, by the above-cited authority, to hold that such payments are compensation for such services and thus constitute "earned income" within the meaning of section 17052.9.

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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 Lloyd C. and Beatrice M. **Graybill** against a proposed assessment of additional personal income tax in the amount of \$103.74 for the year 1978, be and the same is hereby sustained.

Done at Sacramento, California, this 26th day of October, 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