BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
VIRGIL M. AND JEANNE P. MONEY)

For Appellants: Frank D. Smith, Jr.

For Respondent: Mark McEvilly
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 Virgil M. and Jeanne P. Money against a proposed assessment of additional personal income tax in the amount of $3,382.51 for the year 1977.

The question presented by this appeal is whether respondent properly included in appellants" California income pension annuity payments received by them while they were residents of California, "Appellant" herein shall refer to Virgil M. Money, Jeanne P. Money being included as an appellant only because she filed a joint tax return with her husband.

In 1974, appellant retired from the United States Air Force, and in July of that year he began to receive monthly military pension benefits. At that time he was a resident of Florida. Sometime before 1977, appellant became a California resident and has remained a resident to the present.

Appellant made no contributions to his retirement plan. He had no right to a lump sum on retirement, and his pension benefits were received in the form of an annuity. His retirement plan did not provide for survivor benefits in the event of his death, but he has apparently made monthly contributions since his retirement to a survivor benefit plan so that his wife will receive continuing, smaller annuity payments should he predecease her.

In 1977, while a California resident, appellant received -pension income of $15,032, but did not report any of that amount on his 1977 California personal income tax return. Respondent determined that the pension payments received should have been included in appellants taxable income and issued a proposed assessment reflecting that inclusion. Appellants protested, but the assessment was affirmed, and this appeal followed.

Appellant contends that his military pension benefits are not taxable by California because his benefits accrued while he was in the military, before he became a resident of California.

Section 17041 of the Revenue and Taxation Code, as it read before January 1, 1983, stated that the personal income tax is to be imposed on the entire taxable income of every resident of this state, regardless of the source of the income, and upon the income of nonresidents which is derivqd from sources within California. The policy behind California's personal income taxation of residents is to ensure that individuals who are physically present in the state, enjoying the benefits and protections of its laws and government, contribute to its support, regardless of the source of their income. (See

former Cal. Admin. Code, tit. 18, reg. 17014-17016(a) (renumbering to reg. 17014 filed Aug. 24, 1983 (Register, 83, No. 35).) Pensions and annuities are specifically included in income. (Rev. & Tax. Code, §§ 17071, 17101.) Military pensions and retirement pay are entitled to a limited exclusion which is not applicable here because appellants' income exceeded the maximum allowed for the exclusion. (Rev. & Tax. Code, § 17146.7.)

Appellant's argument that his military retirement income was not subject to tax because it accrued before he became a resident is apparently based on Revenue and Taxation Code section 17596, which states:

> 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.

For a number of years this board has been concerned with the increasing attempts to give section 17596 a broad application. It has long been our conviction that this section was never intended to override fundamental tax principles regarding the taxation of residents, who enjoy the benefits and protections afforded by this state, and considerations of fairness, i.e., treating similarly situated taxpayers the same. With these considerations in mind, we have felt that section 17596 should be as limited as possible in its application to prevent the contravention of these fundamental tax principles.

While the need for limitation has been clear to us, the delineation of limits has been troublesome, in great part because of the obscure language of section 17596. We have struggled with interpreting this statute, the purpose of which is not self-evident.

In the Appeal of Bertram D. and Glorian B. Thomas, decided November 16 1981, we attempted to interpret the provisions of section 17596 so that they were not in conflict with the principles of fairness and taxation of residents. We noted previous appeals where we had held that section 17596 was irrelevant when taxation was imposed on a source basis, because section 17596 deals

only with taxation affected by a change of residency, and both residents and nonresidents are taxable on California-source income. (See Appeal of Munson E. and Dorothy Moser, Order Denying Petition for Rehearing and Modifying Opinion, Cal. St. Bd. of Equal., June 23, 1981; Appeal of Ray R. and Nellie A. Reeves, Cal. St. Bd. of Equal., June 28, 1979; Appeal of John J. and Virginia Baustian, Cal. St. Bd. of Equal., March 7, 1979.)

By examining the language of section 17596 and other provisions of the Revenue and Taxation Code,. such as those providing credits for taxes paid to other states (Rev. & Tax. Code, §§ 18001-18002), we concluded that the section must have been intended to prevent double taxation of income on a non-source jurisdictional basis when taxpayers change their residency status. Desiring to provide a distinct, administratively feasible guideline, we set forth the broad rule that section 17596 was inapplicable unless, after a taxpayer changes residency, California and another state are taxing the same income on a non--source basis.

As we explained in the Thomas appeal, we felt that our analysis and rule were reasonable and satisfied the policies with which we were concerned. Our decision in Thomas, however, apparently engendered confusion and concern on the part of both the Franchise Tax Board and a number of taxpayers. For this reason, and because we feel it is important to have the limits of section 17596 as clearly and fairly defined as possible, we have re-examined our analysis and rule in Thomas. As more fully explained below, our re-examination has led us to believe that we ascribed too significant a purpose to section 17596 when we concluded that it was intended to prevent double taxation.

As we stated previously, the purpose of section 17596 is not self-evident. We have discovered only one commentary on that section, but it has been a very instructive one. That commentary states that section 17596 was designed merely to prevent California from treating accrual and cash basis taxpayers differently when they changed residency and were subject to taxation by California on the basis of their residency. (Altman. & Keesling, Allocation of Income in State Taxation, (2d ed. 1950) pp. 54-55.) Consistent treatment was accomplished by putting all taxpayers on the same accounting method, namely, accrual. This explanation is persuasive because it makes the otherwise obscure language of the statute more intelligible.

If this is the purpose of section 17596, it is a very limited one. So construed, this section would not consistently infringe on the application of the most fundamental principles of taxation of residents. Because of this limited purpose, it would seem that section 17596 was designed to apply only when two conditions are satisfied: (1) when California's sole basis for taxation is the taxpayer's residency, and (2) when that taxation would differ depending on whether the taxpayer used the accrual or the cash method of accounting.

Applying this two-pronged standard to appellants' annuity income, we find that the first condition is satisfied: California's only basis for taxing the income is the taxpayers' residency in this state. However, we find that the second condition is not satisfied, because California's taxation of the annuity income would not differ between cash and accrual basis taxpayers. The annuity provisions of Revenue and Taxation Code sections 17101 through 17112.7 make no distinction between cash and accrual basis taxpayers but treat all taxpayers as if they were on the same method of accounting.. These specific provisions that put all annuitants on the same method of accounting make it unnecessary to use the general provisions of section 17596 to achieve the same result. Appellants' annuity payments are, therefore, taxable by California, and respondent's action must be sustained.

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 Virgil M. and Jeanne P. Money against a proposed assessment of additional personal income tax in the amount of $3,382.51 for the year 1977, be and the same is hereby sustained.

Done at Sacramento, California, this 13th day of December, 1983, by the State Board of Equalization, with Board Members Mr. Bennett, Mr. Collis, Mr. Dronenburg and Mr. Nevins present.

William M. Bennett, Chairman

Conway H. Collis, Member

Ernest J. Dronenburg, Jr., Member

Richard Nevins, Member

_____, Member