BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
MARION MALOUF)

Appearances:

For Appellant: Adam Y. Bennion
Attorney at Law

For Respondent: Richard Watson
Counsel

OPINION

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Marion Malouf against a proposed assessment of additional personal income tax in the amount of $9,502.88 for the year 1965.

Two issues are presented: First, whether a surviving wife who elected to take under her husband's will is taxable on capital gain resulting from the sale of community property by her husband's estate; and second, if she is, whether her basis in the property for determining the gain is its cost or its fair market value on the date of her husband's death.

Bert Malouf, the husband of appellant Marion Malouf, died testate on March 14, 1964. His will placed into trust all of his separate property and all of the spouses' community property, except for household furnishings and other personal belongings. In form the property was to be divided among four separate trusts, with Bert's three children and Marion each to be the beneficiary of one of the trusts. The will named Marion and a bank as co-trustees, and gave them extensive powers to administer the trust property.

Under the terms of the will Marion's trust was composed of 55% of the total trust estate. She was to receive all of the net income from this trust, and was guaranteed a minimum of $24,000.00 per year. If the net income should fall below that amount, the trustees were directed to make up the difference out of the trust corpus. The corporate trustee was further authorized to invade the corpus to pay Marion any additional money needed to keep her in comfort and health. The will also granted Marion a limited testamentary power of appointment over the trust property in favor of Bert's children,. but this was later changed by a codicil to a general testamentary power of appointment.

At the 'time the will was drafted, Marion executed a consent to take under the will, waiving all claims to her share of the community property. She also consented to the terms of the codicil in 1969, after Bert's death. Thereafter the estate was closed and the property apparently was distributed'according to the provisions of the will. The report of the inheritance tax appraiser reflects that California inheritance taxes were payable on the portion of the estate passing to the children, but not on the portion passing to Marion.

During 1965, prior to the final distribution of the estate, a portion of the spouses' community property was sold for $802,083. 35. The proceeds from the sale were reported in full on the estate's California income tax return, and not reported on Marion's return. In computing the capital gain from the sale, furthermore, the estate used the property's fair market value on the date of Bert's death as its basis. Respondent determined, however, that the estate was taxable on only half of this income, and that Marion was taxable on the other half. It also determined that Marion's basis in her share of the property was its adjusted cost, not its fair market value on the date of Bert's death. Marion challenges both determinations on this appeal.

California Administrative Code, title 18, regulation 17742-17745(a), subdivision (6) provides that "[i]ncome received by the estate, but derived from the surviving wife's share of the community property (acquired after July 28, 1927) is taxable to the wife." The federal authorities follow a similar formula to determine taxability under the Internal Revenue Code. (See, e. g., Sneed v. Commissioner, 220 F. 2d 313; Rev. Rul. 131, 1953-2 Cum. Bull. 112.) The rule is based on the principle that ownership is the test of taxability: While the surviving wife's share of the community property may be subject to administration in her husband's estate under local law, she nonetheless remains its "owner" for income tax purposes, and thus is taxable on the income which it earns. (Bishop v. Commissioner, 152 F. 2d 389.)

In Wells Fargo Bank & Union Trust Co. v. United States, 245 F. 2d 524, the Court of Appeals for the Ninth Circuit applied the "ownership" test to a case where the widow had elected to take under her husband's will. The will established a trust comprised entirely of the spouses' community property, and named the widow as the trust's income beneficiary. It also allowed her the right to withdraw her share of the community property from the trust at any time. The court held that although she had elected to take under the will, the widow remained the "owner" of her share of the community property, and was thus taxable on one-half of the income earned by the property during the estate's administration. In reaching this conclusion the court relied heavily on the fact that the widow had the right to withdraw her property from the trust.

Since appellant herein had no absolute right to withdraw her share of the community property from the trust, the Wells Fargo decision is not conclusive as to the ownership of the community property involved in this case. Basing her argument on this distinction, appellant contends that absent such a right an electing widow is not taxable on income earned from her share of the community property during the administration of her husband's estate. Her position seems to be that, because of the election, she can no longer be considered the "owner" of the property for income tax purposes. We disagree.

Although appellant elected to take under her husband's will, her share of the community property never became a part of her husband's estate. (Estate of Carson, 234 Cal. App. 2d 516 [44 Cal. Rptr. 360].) The election operated instead as an inter-vivos conveyance directly from appellant to the trust. Appellant is thus a co-grantor of the trust to the extent of her interest in the community property. (Wells Fargo Bank & Union Trust Co. v. United States, supra.) Revenue and Taxation Code section 17790 provides, in relevant part:

> The grantor shall be treated as the owner of any portion of a trust... whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be.. ..
>
> (a) Distributed to the grantor. ...

Appellant is to receive all the income from the trust, and the corporate trustee is not an adverse party (Morton v. Commissioner, 109 F. 2d 47). Furthermore, even though c-gains may be allocable to the corpus of the trust, the corporate trustee is authorized, at its discretion, to distribute the entire corpus of the trust to appellant, and appellant has a general testamentary power of appointment over the corpus. Under these circumstances section 17790 requires that she be treated as the owner of the half of the community property which she contributed to the trust. Accordingly, appellant is properly taxable on half of the gain from the sale of the community property. (Bishop v. Commissioner, supra.)

We turn now to the second issue, concerning appellant's basis in the property. Revenue and Taxation Code sections 18041 and 18042 state the general rule that the basis of property is its adjusted cost. Under section 18044, however, the basis of property acquired from a decedent is its fair market value on the date of the decedent's death. For purposes of this rule, subdivision (e) of section 18045 provides that a surviving spouse's share of the community property is deemed to have been acquired from a decedent, subject to the following proviso:

> ...if at least one-half of the whole of the community interest in such property was includable in determining the value of the decedent's gross estate under Chapter 3 of the California Inheritance Tax Law.

Briefly stated, respondent's position is that this proviso is not satisfied, and the basis of the surviving spouse's share of the community property remains cost, unless at least one-half of such property was subject to the Inheritance Tax Law. Since in this case no inheritance tax was payable on the portion of the estate which passed to appellant, respondent concluded that less than half of the community property was subject to inheritance tax. It accordingly determined that appellant's basis in the property remained its adjusted cost. Appellant contends that all the decedent's property was includable in his gross estate, without regard to whether it was subject to tax, and that Bert's half of the community property was therefore so includable. She therefore concludes that the requirement of the above quoted proviso has been satisfied, and that her basis in the property was its fair market value on the date of her husband's death.

We considered this identical question in Estate of Philip Rosenberg, et al., decided this day, and answered it adversely to appellant. In accordance with the views expressed in that opinion, we hold that appellant's basis in her half of the community property remained its adjusted cost.

Appeal of Marion Malouf

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 Marion Malouf against a proposed assessment of additional personal income tax in the amount of $9,502.88 for the year 1965, be and the same is hereby sustained.

Done at Sacramento, California, this 19 day of August 1975, by the State Board of Equalization.

John W. Lynch, Chairman

William M. Bennett, Member

George R. Reilly, Member

Robert C. Kent, Member

________________, Member

ATTEST: W. W. Dunlop, Secretary