BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
HOMER B. AND LENNIE MAE DAVIS)

For Appellants: Lennie Mae Davis,
in pro. per.

For Respondent: Bruce W. Walker
Chief Counsel

John A. Stilwell, Jr.
Counsel

O P I N I O N

This appeal is made pursuant to section 19059 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of Homer B. and Lennie Mae Davis for refund of personal income tax in the amount of **$4,285.74** for the year 1972.

The question presented is the constitutionality of legislation limiting the offset against **current** capital gains of certain pre-1972 capital losses when carried over from previous years.

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Appellants are California residents who filed a 1972 joint state income tax return. On Schedule D accompanying the return they showed a net gain of $141,967.37 from the 1972 sales of capital assets held for not more than one year. They took 100 percent of this amount into account in computing taxable income. More than $125,000.00 of this gain was derived-from the sales of capital assets held in excess of six months. Appellants also reported a net gain of $7,146.73 from the sales of capital assets held for more than one year but not in excess of five years, 65 percent of which they took into account in computing taxable income. Appellants thereby complied with section 18162.5 of the Revenue and Taxation Code, enacted December 8, 1971, and by its, terms applicable to years beginning after December 31, 1971.1/

Until section 18162.5 became applicable, the full amount of all capital gains and losses was taken into account, but a deduction was allowed for 50 percent of the excess of any net long-term capital gain over the net short-term capital loss. (See Rev. & Tax. Code, § 18151 as it read prior to its repeal on November 27, 1972.) Capital gains and losses were considered "long-term" where the capital asset was held for more than six months prior to its sale and "short-term" where the holding period was six months or less., (See Rev. & Tax. Code, § 18162 as it read prior to its repeal on November 27, 1972.)

1/ Section 18162.5, subd. (a), provides:

> In the case of any taxpayer, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing taxable income:
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> (1) One hundred percent if the capital asset has been held not more than one year;
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> (2) Sixty-five percent if the capital asset has been held for more than one year but not more than five years;
>
> (3) Fifty percent if the capital asset has been held more than five years.

Prior to 1972, appellants incurred capital losses totaling $85,714.81 in excess of the amount that they could apply against capital gains or against ordinary income for those years. The assets which were the subject of those losses had all been held for more than six months but not in excess of five years, and almost all of the $85,714.81 represented losses from the sales of assets where the holding period did not exceed one year. Under prior law, all those capital losses would have been carried over and fully applied (as if they were "long-term" capital losses) against current capital gains. However, pursuant to an amendment to section 18152 of the Revenue and Taxation Code enacted November 27, 1972, and applicable to years beginning after December 31, 1971, only 50 percent of established pre-1972 capital loss carryovers resulting from the sale of capital assets held for more than six months could be carried over and offset against capital gains. Only where the pre-1972 carryover was derived from the sale of capital assets held six months or less could the loss be fully offset against such gains.[2/]

2/ Specifically, Revenue and Taxation Code section 18152, subd. (e), provides:

> In the case of a net capital loss which a taxpayer is entitled to carry over from any taxable year beginning before January 1, 1972--
>
> (1) If the net short-term capital loss (as defined prior to the repeal of Section 18162 by the 1972 session of the Legislature) exceeded the net long-term capital gain (as defined prior to the repeal of Section 18162 by the 1972 session of the Legislature), the excess shall be carried over at 100 percent.
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> (2) If the net long-term capital loss (as defined prior to the repeal of Section 18162 by the 1972 session of the Legislature) exceeded the net short-term capital gain (as defined prior to the repeal of Section 18162 by the 1972 session of the Legislature), the excess shall be carried over at 50 percent.

Appellants complied with this legislation by offsetting $42,857.40, 50 percent of their pre-1972 net capital loss carryover, against the percentages of current capital gains taken into account. Consequently, almost all current net capital gain was taken into account at 100 percent in computing 1972 taxable income, although the offset of the pre-1972 capital loss carryover was limited to 50 percent. This was true notwithstanding the' fact that the length of the asset holding periods prior to sale for both the current net capital gains and the carryover capital losses was almost entitely within the same "over six months through one year" range.

Thereafter, appellants filed a claim for refund maintaining that they should be entitled to apply 100 percent of the pre-1972 capital loss carryover against the net capital gain taken into account for 1972. Respondent denied the claim, and this appeal followed.

Appellants contend' that the legislation limiting the right to apply 100 percent of the pre-1972 capital loss carryover against capital gains is unconstitutional. Their views are summarized as follows: (1) The amendment discriminated against persons in their position, i.e., the formerly self-employed elderly with no retirement pension whose sole income is derived from investments and.from the sale of capital assets; (2) Taxing their investment activity in this manner is confiscatory; (3) The 50 percent reduction in allowable carryover loss is a tax on losses rather than on income; and (4) This legislation, when combined with the legislation establishing new holding periods and percentages, caused cruel and unusual punishment.

In addition, appellants point out that the statutory changes adversely affecting them were not made in the federal law. Therefore, for the year in issue, appellants' taxable capital gain for state purposes was $103,755.34, while their capital gain for federal purposes was only $45,082.34. Appellants claim that these differences between state and federal law also unfairly increase the burden of bookkeeping and record keeping. They urge that the state law should coincide with federal law in handling capital gains and losses.

While we recognize that the effect of the legislation upon appellants was decidedly unfavorable, we must conclude that none of their constitutional rights were violated.

First, we do not find unconstitutional discrimination. In asserting unconstitutionality on this ground, appellants contrast the plight, of persons in their category with those in other endeavors earning considerably higher income and entitled to many deductions and tax benefits. They maintain that the taxation of those latter persons should have been the source of additional revenue needs.

Even if we assume, without deciding, that this legislative action contained a discriminatory classification, appellants could not prevail. It is well settled that a classification, even if discriminatory, is not arbitrary, and thus does not violate the equal protection clause, if any statement of facts reasonably can be conceived that would sustain it. (Allied Stores of Ohio v. Bowers, 358 U.S. 522 [3 L. Ed. 2d 480].) The existence of such facts is presumed, and the burden of showing arbitrary action rests upon the person assailing the classification. (Burks v. Poppy Construction Co., 57 Cal. 2d 463 [20 Cal. Rptr. 609, 370 P.2d 313]; Associated Home Builders of the Greater East Bay, Inc. v. City of Newark, 18 Cal. App. 3d 107 [95 Cal. Rptr. 648].)

The Legislature could have found it impractical for many taxpayers to determine the new holding period classification with respect to each of their pre-1972 transactions, particularly taxpayers selling many capital assets with different holding periods over a number of years. Since such taxpayers had already made classifications using six months as the dividing line, the Legislature could have determined that the simplest and most practical way to convert during the transition was to allow the carryover of former excess' "short-term" capital losses at 100 percent and to reduce the carryover of former excess "long-term" capital losses by 50 percent. Another possible justification for this treatment is that it is roughly consistent with the handling of excess capital gains of taxpayers prior to 1972. On the other hand, excess losses occurring in 1972 and thereafter can easily be carried over in accordance with the applicable percentages for the three new holding periods as provided for under the present law. (Rev. & Tax. Code, §§ 18152, 18162.5.)

Thus, while we may agree that California's tax laws are imperfect, we cannot say that the increased taxation of persons in appellants' category was unconstitutionally arbitrary. Accordingly, the limitation imposed on pre-1972 capital loss carryovers was not a denial of the right of equal protection guaranteed by the Fourteenth Amendment to the federal Constitution and article I, section 7(a) of the state Constitution.

Second, we cannot conclude that the restriction was confiscatory; i.e., that it constituted taking of property without due process of law prohibited by the Fourteenth Amendment to the federal Constitution and article I, section 7(a) of the state Constitution.

It is true that taxation by legislative action may be so arbitrary and capricious as to amount to confiscation and thus violate substantive due process. (Myles Salt Co. v. Board of Commissioners, 239 U.S. 478 [60 L. Ed. 392].) For example, confiscation may exist: Where the, effect 'of a tax is arbitrary and oppressive when imposed retroactively on a vested property right (See, e.g., Coolidge v. Long, 282 U.S. 582 [75 L. Ed. 562]); Where jurisdiction-is lacking (See, e.g., Senior v. Braden, 295 U.S. 422 [79 L. Ed. 15201; or, Where property is subjected to a special assessment solely for the benefit of other property (See, e.g., Myles Salt Co. v. Board of Commissioners, supra; City of Plymouth v. Superior Court, 8 Cal. App. 3d 454 [86 Cal. Rptr. 535, 87 Cal. Rptr. 240].) However when we apply the principles enunciated in these cases'we are unable to find constitutionally impermissible confiscation. The 1972 amendment under consideration merely limits what is, in essence, a current deduction in determining income tax liability for 1972. It is settled that tax liability for a current year may be increased by reducing formerly allowable deductions, or otherwise, during that year's legislative session. Such a change is not unconstitutionally retroactive. (Fullerton Oil Co. v. Johnson. 2 Cal. 2d 162 139 P.2d 796]; see also Welch v. Henry; 305 U.S. 134 [83 L. Ed. 871; Sunset Nut Shelling Co. v. Johnson, 49 Cal. App. 2d 354 [121 P.2d 8491.)

Third, this amendment simply does not impose a tax on losses occurring in prior years, as appellants maintain. As we have indicated, it merely limits what is, in essence, a deduction for the current year.

Fourth, there is no legal authority for appellants' assertion that the combined adverse effects of both statutory changes constituted "cruel and unusual punishments" forbidden by the Eighth Amendment to the federal Constitution, or "cruel or unusual punishment" prohibited by article I, section 17 of the California Constitution. These constitutional prohibitions are directed toward application of the criminal law. Proceedings before this board are civil in nature and do not involve the exercise of criminal jurisdiction. (See Fred N. Acker, 26 T.C. 107.)

Fifth, California has no constitutional duty to conform its tax provisions to federal law. California's power to tax is inherent and separate from the taxing power granted to the federal government. (See Hetzel v. Franchise Tax Board, 161 Cal. App. 2d 224 [326 P.2d 611]; Roth Drug, Inc., v. Johnson, 13 Cal. App. 2d 720 [57 P.2d 1022].)

In addition to asserting the unconstitutionality of the legislation, appellants maintain that the refund should be granted on the basis that the amendment is unfair and unjust. We recognize why appellants consider the amendment to be of that nature. However, it is settled that income tax deductions, in general, are a matter of legislative grace within the discretion of the legislative body. (New Colonial Ice Co. v. Helvering, 292 U.S. 435 [78 L. Ed. 13481; Hetzel v. Franchise Tax Board, supra.) Consequently, allowance of such deductions does not turn on general equitable considerations. (Deputy v. du Pont, 308 U.S. 488 [84 L. Ed. 416].)

Inasmuch as we have concluded that the legislation is constitutional, we must sustain respondent's action.

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,

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IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of Homer B. and Lennie Mae Davis for refund of personal income tax in the amount of $4,285.74 for the year 1972, be and the same is hereby sustained.

Done at Sacramento, California, this 20th day of October, 1975, by the State Board of Equalization.

John W. Lynch, Chairman

Member

, Member

, Member

ATTEST: W. W. Dunlop, Secretary