

Appeal of Yvonne C. Brown

During 1969 appellant received certain dividend distributions from the Dreyfus Fund Incorporated, and the Fidelity Management Group of Mutual Funds. Both organizations are federally regulated investment companies. Annual information statements submitted to appellant by both companies indicated that portions of the dividend distributions constituted capital gains while the remainder constituted ordinary income. In accordance with this information, appellant treated a portion of the distributions as capital gains and applied the 50 percent capital gain deduction in computing taxable income. Thereafter, respondent disallowed the 50 percent deduction and proposed the assessment in issue on the basis that California has no statutory provision which allows capital gains treatment for this type of dividend distribution. Appellant protested the proposed assessment but her protest was denied. This appeal followed.

The sole issue for determination is whether respondent properly treated the dividend distribution received by appellant from the Federally regulated investment companies as ordinary income.

Pursuant to the Internal Revenue Code of 1954, certain dividends received from regulated investment companies are specifically afforded capital gain treatment for federal income tax purposes. (Int. Rev. Code of 1954, § 852(b)(B).) There is no similar provision in the California Personal Income Tax Law. Dividend distributions by federally regulated investment companies are classified as ordinary income for purposes of the California personal income tax. (Appeal of J. Albert and Augusta F. Hutchinon, Cal. St. Bd. of Equal. , Aug. 5, 1968.)

Appellant's only argument in support of her position is that respondent's action violates the equal protection clause of the Fourteenth Amendment to the United States Constitution. More specifically, appellant asserts that a regulated investment company is a mere conduit, pooling and investing its members' funds in diversified securities and distributing the fruits of these investments to its members. As a consequence of its investment activities a regulated investment company realizes capital gains income when it sells stock held in its portfolio, and obtains

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ordinary income when it receives dividends on its securities. Thereafter, the regulated investment company is required to distribute most of its income to its members in the form of dividends.. Appellant maintains that the failure of the state to characterize the dividend distributions received by the members as either capital gains or ordinary income, the same characterization the distributed funds had while in the hands of the regulated investment company, violates the Equal Protection Clause.

It is a well established policy of this board to refrain from ruling on a constitutional question in an appeal involving a deficiency assessment. This policy is based upon the absence of any specific statutory authority which would allow the Franchise Tax Board to obtain judicial review of an unfavorable decision, and we believe that such review should be available for questions of constitutional importance. (Appeal of Harlan R. and Esther A. Kessel, Cal. St. Bd. of Equal., March 27, 1973; Appeal of C. Pardee Erdman, Cal. St. Bd. of Equal. , Feb. 18, 1970.) This policy properly applies to this appeal and disposes of the only issue raised by appellant.

ORDER

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 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Yvonne C. Brown against a proposed assessment of additional personal income tax in the amount of \$1,514.40 for the year 1969, be and the same is hereby sustained

Done at Sacramento, California, this 8th day of March, 1976, by the State Board of Equalization.

William W. Bennett, Chairman
Paul Fleming, Member
George R. Hickey, Member
_____, Member
_____, Member

ATTEST: W. W. Dunlop, Executive Secretary