

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }  
EDWIN AND ANN KISSEL }  
}

Appearances:

For Appellants: Edwin Kissel, in pro. per.

For Respondent: James T. **Philbin**  
Supervising Counsel

O P I N I O N

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 Edwin and Ann Kissel against proposed **assessments** of additional personal income tax in the amounts of **\$3,633.30** and \$513.67 for the years 1969 and 1972, respectively.

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The sole issue for determination is whether a "capital gains dividend" **received** by appellants in 1969 is taxable as ordinary **income.**<sup>1</sup>

In April 1968, appellants acquired 22,408 shares of Mates Investment Fund, Inc. (Mates), a regulated investment company commonly referred to as a mutual fund. Appellants' cost basis in the shares was **\$163,510.00**. In December 1968, the Securities and Exchange Commission (SEC) commenced an investigation of Mates concerning certain violations of the securities laws. As a result of the investigation Mates was ordered by the SEC to divest itself of a portion of certain "restricted" stock which it was holding in violation of the securities laws. Thereafter, Mates complied with the SEC order and on July 2, 1969, distributed \$2.38 per share to its shareholders. The distribution **was** characterized as a "capital gains dividend". Appellants received **\$53,331.04** as a result of their shareholdings.

During the latter part of 1968 appellants had pledged their shares in Mates as collateral for a bank loan. The loan was called in 1969. Since appellants were unable to comply, they had 22,400 shares redeemed by Mates on July 22, 1969. The redemption price received from Mates was **\$114,016.00**.

1/Appellants used income averaging for 1972, with 1969 being one of the base period years. Since appellants' 1969 income was increased a corresponding adjustment was required for 1972. Accordingly, determination of appellants' 1969 income **will** automatically **control** the propriety of the 1972 adjustment.

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In their 1969 income tax return, appellants computed a capital gain on the sale of the Mates shares as follows:

Amount received from redemption	\$114,016
Capital gains dividend	<u>53,331</u>
Adjusted sales price	\$167,347
Less: Cost of redeemed shares	<u>(163,510)</u>
Gain realized	<u>\$ 3,837</u>

Upon audit, respondent determined that appellants had improperly included the "capital gains dividend" of **\$53,331.00** as part of the adjusted sales price of the Mates shares. Accordingly, respondent recomputed the transaction as follows:

Cost of stock	\$163,510
Sales price	<u>114,016</u>
Loss on sale	<u>(\$ 49,494)</u>

The loss was first applied to offset appellants' other capital gains for 1969, and the remainder was carried forward to 1970. The **\$53,331.00** "capital gains dividend" **was treated as ordinary dividend income.** Consequently, there was an increase in appellants' taxable income for 1969 which resulted in the proposed assessment in question.

Pursuant to the Internal Revenue Code of 1954, certain dividends received from regulated investment companies are specifically afforded capital gain treatment for federal tax purposes. (Int. Rev. Code of 1954, § 852(b) (3) (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 Yvonne C. Brown, Cal. St. Bd. of Equal., March 8, 1976; Appeal of J. Albert and Augusta F. Hutchinson, Cal. St. Bd. of Equal., Aug. 5, 1968.)

In support of their contention that the distribution should not be taxed as ordinary income, appellants argue that the "capital gains dividend" was

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a partial return of their original investment which constituted a nontaxable return of capital. However, the record contains no evidence **that** the distribution was other than a "capital gains dividend" which is taxable as ordinary dividend income under California law.

Next, appellants argue that sections 18131 through 18135 of the California Revenue and Taxation Code provide for the nonrecognition of gain or loss from a distribution pursuant to an SEC order. **However,** the sections relied on by appellants are narrowly limited to certain distributions made by public utility holding companies. **(See Rev. & Tax. Code, § 18133.)** In the instant matter, the distribution was made by a regulated investment company not a public utility holding company. Therefore, the **provisions** of the Revenue and Taxation Code relied upon by appellants do not apply.

Accordingly, we must conclude that the "capital gains dividend" in question is taxable as ordinary dividend income. Therefore, 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,

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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 Edwin and Ann Kissel against proposed assessments of additional personal income tax in the amounts of **\$3,633.30** and \$513.67 for the years 1969 and 1972, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 15th day of December, 1976, by the State Board of Equalization.

*William B. Smith*, Chairman  
*George R. Kelly*, Member  
*Robert J. Lee*, Member.  
*Mrs. Sankey*, Member  
\_\_\_\_\_, Member

ATTEST: *W. W. Dwyer*, Chairman