BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
ROBERT H. AND JOSEPHINE BORCHERS)

Appearances:

For Appellants: William P. **Hickey**
Attorney at Law

For Respondent: Brian W. Tcman
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 Robert H. and Josephine **Borchers** for refund of personal income **tax** in the amount of **$1,392.00** for the year 1971.

The primary question, for decision is whether certain monthly pension benefits received by appellant Robert H. Borchers were partially **excludible** from taxable income for purposes of the California personal income tax. The answer to that question will turn on whether or not the pension benefits had accrued as income, within the meaning of section 17596 of the Revenue and Taxation Code, prior to the time appellants became California residents.

Appellants, husband and wife, established residence in California in January 1971. Prior to that time they had lived in Illinois. In 1966, while a resident of **Illinois,** appellant husband retired from an executive position with Armour and Company. That company's pension plan, to which both appellant husband and the company had contributed, offered retiring employees several options with respect to payment of pension benefits. Among those options were a lump sum settlement, computed on *the basis* of both the employee's and the company's contributions **to** the **pension** fund, or a monthly pension benefit with a survivor annuity payable to the employee's spouse. Appellants elected the monthly benefits *with the* survivor annuity and they had recovered all of appellant husband's contributions to the pension plan prior to their move to California in 1971.

On their 1971 California personal income tax return, appellants included all pension payments received from Armour and Company during that year as taxable income. Thereafter, they filed an amended 1971 return in which they excluded a portion of the total pension payments on the ground that the excluded portion represented a part of appellants' cost basis in the annuity, being a return of Armour and Company's contributions to which appellants allegedly had a nonforfeitable right prior to becoming California residents. Respondent disallowed the refund claimed, and this timely appeal followed.

Except as otherwise provided in the law, the California personal income tax is imposed upon the entire taxable income of every resident of California and upon the income of nonresidents which is derived from sources within California. (Rev. & Tax. Code, **§ 17041.)** Where a change in residency occurs, as in the instant case, section 17596 of the Revenue and Taxation Code provides:

> 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.

This accrual treatment referred to above applies even though the taxpayer may be on the cash receipts and disbursements accounting basis. (Cal. Admin. Code, tit. 18, reg. 17596.)

Respondent's regulations provide, as do the federal income tax regulations and the case law, that under an accrual method of accounting, income is includible in gross income when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy. (Cal. Admin. Code, tit. 18, reg. 17571(a); Treas. Reg. § 1.446-1(c) (1) (ii); Spring City Poundry Co. v. Commissioner, 292 U.S. 182 [78 L. Ed. 1200] (1934)) If there are substantial contingencies as to the taxpayers right to receive, or uncertainty as to the amount he is to receive, an item of income does not accrue until the contingency or events have occurred and fixed the fact and amount of the sum involved. (Midwest Motor Express, Inc., 27 T.C. 167 (1956), aff'd, 251 F.2d 405 (1958); San Francisco Stevedoring Co., 8 T.C. 222 (1947).)

Keeping the above legal principles in mind, we must determine whether the monthly pension benefits received by appellant husband had accrued as income prior to the time appellants moved to California. If so, they would be partially excludible from taxable income in California under the pre-1968 rules regarding the taxation of annuities. (See former section 17101 et seq. of the Revenue and Taxation Code; see also FTB LR 137, Dec. 5, 1958.) If not, they would be totally includible in taxable income, since

appellant husband had recovered all of his own contributions to the pension plan prior to the time appellants became residents of California.

The issue posed by this appeal is not new to us. We believe our decision here is controlled by our opinion in Appeal of Henry D. and Rae Zlotnick, decided May 6, 1971. On substantially similar facts we there determined that Mr. Zlotnick's monthly retirement benefits did not accrue as income, for purposes of section 17596 of the Revenue and Taxation Code, until they were actually received, since his and his wife's potential rights to those payments were subject to the substantial contingency of their survival through each monthly period. (See also Appeal of Edward B. and Marion R. Flaherty, Cal. St. Bd. of Equal., Jan. 6, 1969; Appeal of Lee J. and Charlotte Wojack, Cal. St. Bd. of Equal., Mar. 22, 1971; Appeal of Frank F. and Vee Z. Elliott, Cal. St. Bd. of Equal., March 27, 1973; Appeal of Kenneth Ellington and Estate of Harriet Ellington, Deceased, Cal. St. Bd. of Equal., Oct. 17, 1973.)

Although appellants have attempted to distinguish their case from Zlotnick and our other opinions presenting this issue, we are not persuaded that the alleged distinctions are valid. Appellants seem to find some significance in the fact that several of our earlier decisions involved government pensions rather than pensions paid by private employers. In view of our reasoning in Zlotnick, we fail to see the significance of that factual distinction. Appellants also stress that in none of the earlier opinions did the retiring employee have the right to a lump sum withdrawal of contributions made by him and by his employer, as did appellant husband. They argue that his right to elect that option established a nonforfeitable property interest in the employer contributions which accrued at the time of his retirement, and that the value of those contributions by Armour and Company should therefore be included in the cost basis of the annuity to appellants.

We do not deny that if appellant husband had taken the lump sum benefit, that amount of income would have accrued prior to his becoming a California resident. His

right to that sum of money would have been nonforfeitable prior to his move to California. The fact is, however, that he did not choose that option, and we agree with respondent that the situation must be viewed in light of what he did do and not what he might have done.

Upon his retirement appellant husband selected a lifetime monthly pension for himself, with a survivor annuity to his wife if he predeceased her. By that action he presumably forfeited any right he might have had to a lump sum payment from Armour and Company. By 1971, the taxable year in question, appellants had recovered all of the contributions which appellant husband had made to the pension plan. At that point they were therefore in a position substantially similar to that of the taxpayers in the Appeal of Henry D. and Rae Zlotnick, supra. Appellants' rights to their monthly pension benefits in 1971 were subject to the substantial contingency of their continued lives from month to month. For the reasons stated herein and in the Zlotnick appeal, we must conclude that respondent properly determined that no portion of the pension payments received by appellants in 1971 was excludible from their taxable income. Under identical facts, our conclusion would be the same with respect to later taxable years.

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,

Appeal of Robert H. and Josephine Borchers

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 19660 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of Robert H. and Josephine Borchers for refund of personal income tax in the amount of $1,392.00 for the year 1972, be and the same is hereby sustained.

Done at Sacramento, California, this 6th day of April, 1977, by the State Board of Equalization.

William M. Bennett, Chairman

Member

Robt. Gillis, Member

Iris Sankey, Member

, Member

ATTEST: W. W. Dunlop, Executive Secretary