BEFORE THE STATE BOARD OF EQUALIZATION

OF TEE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
ROBERT S. AND BARBARA J. McALISTER)

Appearances:

For Appellants: Sidney R. Matorin
Attorney at Law

For Respondent: Brian W. Toman
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 Robert S. and Barbara J. McAlister against a proposed assessment of additional personal income tax in the amount of $1,917.63 for the year 1972, and, pursuant to section 19059 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of Robert S. and Barbara J. McAlister for refund of personal income tax in the amount of $38,737.00 for the year 1972.

The sole issue presented by this appeal is whether appellants incurred a net business loss in 1972 that may be applied as an offset against their income from items of tax preference for purposes of computing the tax on preference income.

Appellants filed a joint California personal income tax return for 1972 wherein they reported adjusted gross income of $1,755,033 and income from tax preference items in the total amount of $1,647,888. Pursuant to section 17062 of the Revenue and Taxation Code, appellants reduced their preference income by the $30,000 statutory exclusion plus a claimed "net business loss" of $68,428. On the basis of those computations, appellants reported preference tax liability of $38,737, and remitted that amount with their 1972 return.

After conducting an audit of their 1972 return, respondent determined that appellants were not entitled to utilize the claimed $68,428 business loss as an offset against their preference income since the purported "net business loss" did not represent an actual loss. Accordingly, on the basis of its determination that appellants were liable for preference tax in the amount of $40,447, respondent issued the proposed assessment in question. Thereafter, appellants filed a claim for refund of the entire amount of preference tax remitted with their 1972 return,

During 1972, section 17062 of the Revenue and Taxation Code provided, in pertinent part:

> In addition to other taxes imposed by this part, there is hereby imposed...a tax equal to 2.5 percent of the amount (if any) by which the sum of the items of tax preference in excess of thirty thousand dollars ($30,000) is greater than the amount of net business loss for the taxable year. (Emphasis added.)

Section 17064.6 was added to the Revenue and Taxation Code in 1972 to provide the following definition of the term "net business loss":

> For the purposes of this chapter, the term "net business loss" means adjusted gross income (as defined in Section 17072) less the deductions allowed by Section 17252 (relating to expenses for the production of income.) (Stats. 1972, ch. 1065, p. 19'80.)

Section 17064.6 was amended in 1973 to add the words 'only if such net amount is a loss" to the above definition. (Stats. 1973, ch. 655, p. 1204.) The amendment was enacted 'merely to clarify the meaning and application of Section 17064.6." (Stats. 1973' ch, 655, p. 1208.)

Appellants contend that they incurred a "net business loss" in 1972 equal to their adjusted gross income less the deductions allowable by section 17252, and that such amount is allowable as a complete offset against their 1972 preference income in accordance with the express language of section 17064.6 as it read prior to its amendment in 1973. Appellants further contend that any attempt by respondent to apply the amended version of section 17064.6 for purposes of computing their 1972 preference tax liability would constitute an unconstitutional retroactive application of the amendment.

It is our opinion that appellants have misinterpreted the phrase "net business loss" as it originally appeared in section 17062. This board was called upon to interpret that phrase in the Appeal of Richard C. and Emily A. Biagi, decided May 4, 1976, wherein we stated:

> It seems clear that section 17062, like its federal counterpart, was enacted to equalize the general tax burden between those who enjoy the advantages of tax preference items and those who cannot afford such benefits. It seems equally clear that section 17062 was constructed to allow an offset of business losses against preference income only when a taxpayer's total "business" activity for a particular year results in an overall or "net" loss. In that situation, to the extent of the "net business loss," the tax benefit otherwise produced by all or part of a tax preference item is neutralized. (Emphasis added.)

The above interpretation of the phrase "net business loss," as used in section 17062, was based upon the legislative purpose for the allowance of an offset against preference income, and not upon the subsequent definition of the phrase as provided in section 17064.6. Specifically, the decision in Biagi was based primarily upon the evident legislative intent to allow an offset against preference income only to the extent that a taxpayer's preference income fails to produce a tax benefit. As indicated in that appeal, section 17064.6

was added to the code merely to designate or clarify those situations where a taxpayer's preference items do not produce a tax benefit. Thus, the enactment and amendment of section 17064.6 represented mere restatements of the intended definition of the phrase "net business loss" as initially used in section 17062. It follows, therefore, that the amendment of section 17064.6 did not change existing law, and application of that amendment for purposes of computing a taxpayer's preference tax liability for the year 1972 does not constitute retroactive statutory application.

Finally, appellants' interpretation of the phrase "net business loss" would result in complete frustration of the intended effect of the tax on preference income. If the offset against preference income is allowed in direct proportion to the taxpayer's adjusted gross income without consideration of the extent to which the preference items produce a tax benefit, then those taxpayers who benefit most by the preferential tax treatment accorded preference income would be most able to avoid entirely the tax imposed on such income. Clearly, the Legislature did not intend to achieve such a result when it enacted section 17064.6.

Accordingly, since appellants' adjusted gross income less the deductions allowable pursuant to section 17252 did not constitute a "loss" for the year *in* question, we must conclude that appellants are not entitled to offset that amount against their preference income for purposes of computing their 1972 preference tax liability under section 17062. Respondent's action in this matter 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,

Appeal of Robert S. and Barbara J.. McAlister

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 Robert S. and Barbara J. McAlister against a proposed assessment of additional personal income tax in the amount of **$1,917.63** for the year 1972, and, pursuant to section 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the **claim** of Robert S. and Barbara J. McAlister for refund of personal income tax in the amount of **$38,737.00** 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.

_____ **Chairman**

_____, **Member**

_____, **Member**

_____, **Member**

_____, Member

ATTEST: _____, Executive Secretary