

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
HENRY J. AND SHEILA D. KELLY )

For Appellants: Henry J. Kelly, in pro. **per.**

For Respondent: Bruce W. Walker  
Chief Counsel

Kathleen M. Morris  
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 Henry J. and Sheila D. Kelly against a proposed assessment of additional personal income tax **in the** amount of \$50.88 for the year 1976.

Appeal of Henry J. and Sheila D. Kelly

The sole question presented is whether appellants were entitled to a military retirement pay exclusion in the amount of **\$1,000.00** for the taxable year 1976.

Appellants are husband and wife. During 1976, appellant Henry J. Kelly received military retirement pay totalling **\$5,885.80** for his past services in the armed forces of the United States. Appellants filed a joint California personal income tax return for 1976 in which they reported a combined adjusted gross income of **\$20,404.22**, including those military retirement payments. In computing their tax liability for that year they excluded **\$1,000.00** of the retirement pay as a military exclusion. Respondent's determination that **they** were not entitled to that exclusion gave rise to **this** appeal.

Respondent's disallowance of the military exclusion claimed by appellants was based upon section 17146.7 of the Revenue and Taxation Code. During the appeal year that section provided:

Gross income does not include pensions and retirement pay received by an individual for his services as a member of the armed **forces** of the United States, including any auxiliary branch thereof, up to and including one thousand dollars (\$1,000) per annum in the aggregate. In the case of a taxpayer whose adjusted gross income (determined without regard to the income exclusion provided in the preceding sentence) for the taxable year exceeds fifteen thousand dollars (**\$15,000**), the amount of the exclusion allowed by this section shall be reduced by fifty cents (\$0.50) for each one dollar (\$1) of such income in excess of fifteen thousand dollars (\$15,000). For purposes of this section, if the taxpayer is married during any period of the taxable year, there shall be taken into account the combined adjusted gross income of the taxpayer and his wife for such period. However, in the case where a taxpayer and his spouse each are qualified to claim the income exemption provided by this section, half of their combined adjusted gross income shall be attributable to each spouse.

Respondent determined that since appellants were married in 1976 and their combined adjusted gross income in that year exceeded \$15,000, it was necessary to reduce the \$1,000 military exclusion to which they would otherwise

Appeal of Henry J. and Sheila D. Kelly

be entitled pursuant to the formula contained in the second sentence of section 17146.7. Respondent's application of that reduction formula to appellants' combined adjusted **gross income of \$20,404.22** resulted in total disallowance of the military exclusion claimed and a restoration of that \$1,000 to appellants' taxable income.

Appellants disagree with that action, contending that since Mr. Kelly's military retirement pay constituted community property, it was attributable to both of them and, therefore, they were both "qualified" to claim the military income exemption. That being so, appellants argue, one-half of their combined adjusted gross income, or **\$10,202.11**, should be attributed to each of them in accordance with the last sentence of section 17146.7, placing them both below the \$15,000 level specified in the section as triggering a reduction in the military exclusion. Appellants further contend that respondent's reliance on our decision in Appeal of Harold L. Challenger, decided April 21, 1966, is misplaced.

We agree with appellants that the Challenger case is 'not controlling here, as it was decided prior to the enactment in 1972 of section 17146.7 of the Revenue and Taxation Code. We nevertheless are of the opinion that appellants' interpretation of that provision is incorrect for several reasons. First, we believe that the intent of the Legislature is quite clear from the language of section 17146.7 itself. Secondly, the construction urged by appellants would render the third sentence of that section meaningless, which violates well established rules of statutory construction. (See Select Base Materials v. Board of Equalization, 51 Cal. 2d 640 [335 P.2d 672] (1959).) The third sentence clearly provides that if the taxpayer is married, the combined adjusted gross income of the husband **and** wife must be taken into account in determining eligibility for the military exclusion. The last sentence deals with a specific set of circumstances in which the combined adjusted gross income may be divided between the two spouses. If these two sentences are to be harmonized and both are to have meaning, the only possible construction to be given the final sentence of section 17146.7 is that urged by respondent.

Accordingly, we conclude that it is only when both husband and wife have served in the armed forces and both are receiving military pensions or retirement pay for their respective military services that the combined adjusted gross income will be divided equally

Appeal of Henry J. and Sheila D. Kelly

between them in determining the amount of the exclusion to which they are entitled. Those were not the facts here, and respondent's disallowance of the military exclusion claimed by appellants for 1976 therefore 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,

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 Henry J. and Sheila D. Kelly against a proposed assessment of additional personal income tax in the amount of \$50.88 for the year 1976, be and the same is hereby sustained.

Done at Sacramento, California, this 9th day of January, 1979, by the State Board of Equalization.

*William L. Brown* Chairman  
*John G. Kelly*, Member  
*Sheila D. Kelly*, Member  
\_\_\_\_\_, Member  
\_\_\_\_\_, Member