*79-SBE-071*

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )
)
ARNOLD E. AND MILDRED H. GALEF )

Appearances:

For Appellants: Arnold E. Galef, in pro. per.

For Respondent: Jeffrey Vesely
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 Arnold E. and Mildred H. Galef against a proposed assessment of additional personal income tax of $16.20 for the year 1975.

Appellants were both employed in California in 1975. Their employers withheld $166 from appellants' wages in that year and contributed that amount to the California State Disability Insurance Fund (SDI). On their 1975 state tax return, appellants claimed their SDI contributions as itemized deductions. Respondent disallowed the deductions on the grounds that SDI contributions are nondeductible personal expenses rather than deductible taxes or medical expenses. After their protest against this action was denied, appellants filed this timely appeal.

Appellants' main contentions when this appeal was filed were: (1) that SDI contributions are deductible as taxes for federal income tax purposes and California law should conform; and (2) that the imposition of interest on the assessment pending resolution of this appeal amounts to a penalty. At the oral hearing in this matter, appellants withdrew their objection to the imposition of interest. Therefore the sole issue remaining for decision concerns the deductibility of appellants' SDI contributions.

In many respects, the California and federal tax laws are in conformity and, at one time, both taxing entities denied the deductibility of SDI contributions.. But because the federal and state positions now differ, we believe a brief history of the tax treatment of SDI contributions would be helpful here.

Prior to 1975, employee contributions to the California state disability fund were deductible for state income tax purposes under Revenue and Taxation Code section 17204, subdivision (a), as taxes paid or accrued in carrying on a trade or business, or expenses incurred for the production of income. The same type of contributions had been deductible as "taxes" for federal income tax purposes since 19.44. (See I.T. 3663, 1944 Cum. Bull. 110.) However, in 1975 the Internal Revenue Service, in Revenue Ruling 75-148, 1975-1 Cum. Bull. 64, changed its position in a case involving contributions to the Rhode Island disability insurance fund, stating that such contributions "do not qualify as any of the types of taxes specified in section 164(a) of the Code[1/] and are not paid or accrued in carrying on a trade or business" but are' "nondeductible personal expenses." That same year, the Internal Revenue Service also ruled that amounts. withheld from employees' wages pursuant to the

1/ Internal Revenue Code of 1954, § 164 is the federal counterpart of Revenue and Taxation Code, § 17204.

California Unemployment Insurance Act were no longer deductible for federal income tax purposes. (Rev. Rul. 75-149, 1975-1 Cum. Bull. 65.)

Following these actions, respondent amended its own regulations to conform with the federal ruling and, thereafter, SDI contributions were no longer deductible in California. (FTB LR 3'88, Aug. 25, 1975.) Thus, as applied to the taxable year in issue here, the applicable regulation stated: "Amounts withheld from employees' wages or other compensation and paid to the State Disability Fund ... 'are nondeductible personal expenses." (Cal. Admin. Code, tit. 18, reg. 17204 (f).)

In 1976 the issue of the deductibility of state disability contributions' under the federal income tax law reached the United States Tax Court. (James R. McGowan, 67 T.C. 599 (1976).) In McGowan the court held that contributions to the Rhode Island disability fund were deductible "income taxes" within the meaning of section 164 (a)(3) of the Internal Revenue Code of 1954. The following year, the Tax Court considered the issue of state disability contributions under California's unemployment insurance law and reached the same result. (Anthony Trujillo, 68 T.C. 670 (1977).) It is this latter case upon which appellants rely but, as we shall explain, their reliance is misplaced.

Despite the otherwise substantial conformity between the federal and California statutes relating to deductibility of taxes, there is one difference in the California law which precludes the application of the Trujillo result to the instant case. California does not allow a deduction for "Taxes on or according to or measured by income or profits ...." (Rev. & Tax. Code, § 17204, subdivision (c)(2).) The court in Trujillo, and in McGowan, specifically denominated the state disability contributions involved therein as income taxes, deductible as such under federal law. Although appellants do not agree that SDI contributions are 'income taxes", recent California cases cited in Trujillo have so classified those payments. (Anthony Trujillo, supra, at 675, 676.) The fact that some taxpayers may be exempt from the withholding of SDI contributions does not alter their nature.

Finally, we note that the fact that the federal government now allows the deduction of SDI contributions does not compel the same result in California. (See Appeal of Mil and Olive Schluter, Cal. St. Bd. of Equal., Jan. 11, 1978.) With respect to the deductibility of state income taxes paid or accrued, the California Legislature has not seen fit to follow the federal law, and appellants' objections to the existing state 'law would therefore properly be addressed to that body.

For the above stated reasons, we must affirm respondent's action in this matter.

## 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 Arnold E. and Mildred H. Galef against a proposed assessment of additional personal income tax in the amount of $16.20 for the year 1975, be and the same is hereby sustained.

Done at Sacramento, California, this 10th day of April, 1979, by the State Board of Equalization.

William M. Bennett, Chairman

Richard Nevins, Member

Geo. R. Reilly, Member

________________, Member

________________, Member