

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the **Matter** of the Appeal of)
WILLIS M. AND RUTH A. ALLEN) No. **84R-1022-KP**

For Appellants: Theresa Drouillard
Price Waterhouse

For Respondent: Alison M. Clark
Counsel

O P I N I O N

This appeal is made pursuant to section 19057, subdivision (a), 1 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of Willis M. and Ruth A. Allen for refund of personal income tax in the amount of \$9,241 for the year 1979.

1 Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the year in issue.

Appeal of Willis M. and Ruth A. Allen

The issue presented on appeal is whether appellants properly included the California taxes they paid on preference income in the calculation of their credit for net income taxes paid to another state in 1979.

In 1979, appellants, husband and wife, realized substantial long-term capital gains on the sale of property in Minnesota. Although they were residents of California, they were required to pay both income and preference taxes to Minnesota. As residents of California, appellants were also taxed on the Minnesota income pursuant to this state's income tax laws. As California law allowed a credit for taxes paid to another state, appellants calculated and claimed that credit on Schedule S of their 1979 California income tax return.

Thereafter, appellants recalculated their credit for that year. In an attempt to enjoy a larger credit, appellants adjusted the credit formula to include California taxes paid on their items of tax preference. Based on that recalculation, appellants filed an amended return for 1979 and a claim for refund.

Respondent reviewed appellants' claim and determined that California law prohibited the inclusion of taxes paid to California for items of tax preference when determining the allowable credit. Accordingly, the original credit was determined to be correct. The claimed refund was denied and this appeal followed.

California's income tax laws allow a credit to residents of California for net income taxes paid to another state. (Rev. & Tax. Code, § 18001.) In pertinent part, section 18001 states that:

Subject to the following conditions, residents shall be allowed a credit against the taxes imposed by this part for net income taxes imposed by and paid to another state on income taxable under this part:

(a) The credit shall be allowed only for taxes paid to the other state on income derived from sources within that state which is taxable under its laws irrespective of the residence or domicile of the recipient.

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Appeal of Willis M. and Ruth A. Allen

(c) The credit shall not exceed such proportion of the tax payable under this part as the income, subject to tax in the other state and also taxable under this part bears to the taxpayer's entire income upon which the tax is imposed by this part. (Emphasis added.)

Section 17062 imposes upon every taxpayer a tax on preference income. Section 17064.5 defines the rules for the application of the chapter dealing with the tax on preference income to the rest of California's income tax structure and provides, in subdivision (e)(2), **that:** "For purposes of Chapter 12 (relating to credit for taxes paid), the taxes imposed by this part do not include taxes imposed by this chapter." (Emphasis added.)

Appellants contend that the prohibition against including preference taxes in the credit computation is unfair because under that limitation appellants would never receive the full benefit of the taxes they paid to Minnesota, thereby subjecting part of their income to double taxation.

This contention arises from a common misunderstanding of the purpose and effect of the credit, which is designed to minimize double taxation. (See, **e.g.**, Appeal of Albert E. and Helen H. Hunt, Cal. St. Bd. of Equal., July 31, 1973; Appeal of John H. and Olivia A. Poole, Cal. St. Bd. of **Equal., Oct. 1, 1963.**) Without the credit provided for in section 18001, the taxpayers' state tax liability would be composed of three elements: the Minnesota tax on Minnesota income; the California tax on California income; and the California tax on Minnesota income. (Rev. & Tax. Code, § 17041.) It is this last element, the California tax on Minnesota income, which results in double taxation, and which the statute is designed to alleviate. This credit, however, is not intended to alleviate all possible instances of double taxation, for there are limitations imposed by the statute.. (Appeal of Albert E. and Helen H. Hunt, supra; Appeal of John H. and Olivia A. Poole, supra.) The purpose of the limitations found in section 18001 is to impose the burden of another state's higher effective tax rate upon the taxpayer rather than upon the State of California. (Appeal of Melvin D. Collamore, Cal. St. Bd. of Equal., Oct. 24, 1972.) Appellants' credit is affected by such a limitation.

Appeal of Willis M. and Ruth A. Allen

Clearly, under the express language of section 18001, appellants may not include taxes paid under California's preference tax in the calculation of the credit for net income taxes paid to another state. (Rev. & Tax. Code, § 18001, subd. (c), and § 17064.5, subd. (e)(2).) Under the guidelines of the statute, appellants correctly computed and realized the maximum allowable credit on their original return. Accordingly, respondent's action in this matter must be sustained.

Appeal of willis M. and Ruth A. Allen

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 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of Willis M. and Ruth A. Allen for refund of personal income tax in the amount of \$9,241 for the year 1979, be and the same is hereby sustained.

Done at Sacramento, California, this 4th day Of February , 1986, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Collis, Mr. Bennett, Mr. Dronenburg and Mr. Harvey present.

Richard Nevins , Chairman
Conway H. Collis , Member
William M. Bennett , Member
Ernest J. Dronenburg, Jr. , Member
Walter Harvey* , Member

*For Kenneth Cory, per Government Code section 7.9