92-SBE-019

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of	)	
	)	No. 90A-0555-CD
DAVID M. AND GLADYS BRYANT	)	

Appearances:

For Appellant: Dennis Maxwell
Certified Public Accountant

Donald Asperger
Attorney at Law

For Respondent: Douglas K. Powers
Counsel

O P I N I O N

This appeal is made pursuant to section 18593[2/] of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of David M. and Gladys Bryant against proposed assessments of additional personal income tax in the amounts of $9,709.04 and $12,119.71 for the years 1984 and 1985, respectively.

2/ Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the income years in issue.

The issue presented by this appeal is whether appellants' liability for preference tax with respect to excluded capital gains is appropriately deferred beyond the respective appeal years under Revenue and Taxation Code section 17064.5, subdivision (f).

On their tax returns for 1984 and 1985, appellants reported capital gains under section 18162.5, subdivisions (a)(2) and (3). In computing the amount of their tax preference income with respect to capital gains for purpose of determining their preference tax liability under section 17062, appellants offset unused capital loss carryovers from previous years against the portion of their capital gains excluded from their gross income under section 18162.5, subdivisions (a)(2) and (3). As a result, appellants reported no preference tax liability with regard to the excluded capital gain amounts. After reviewing appellants' tax returns for the appeal years, respondent concluded that appellants' offset of capital loss carryovers from previous years against the excluded capital gains was improper and issued notices of proposed assessment of additional personal income tax. Appellants filed this timely appeal after respondent's denial of their protest.

Appellants now concede that their method of computing the amount of their tax preference income with respect to capital gains was improper under section 17063, subdivision (e). However, appellants argue that the large amount of capital loss carryovers that were available from previous years made the excluded capital gains useless for purposes of reducing their regular tax liability during the appeal years. They contend that section 17064.5, subdivision (f), permits them to defer their liability for preference tax with respect to the excluded capital gains until the capital gain exclusions generate an actual tax benefit. Respondent contends that section 17064.5, subdivision (f), and the regulation prescribed under that section do not contemplate deferral of preference tax liability. We disagree with appellants' contention and agree with that of respondent.

Subdivision (f) of section 17064.5, which was the counterpart of the federal tax benefit rule for items of tax preference contained in Internal Revenue Code (I.R.C.) section 58(h), stated as follows:

> The Franchise Tax Board shall prescribe regulations under which items of tax preference shall be properly adjusted where the tax treatment giving rise to those items will not result in the reduction of the taxpayer's tax under this chapter for any taxable year.

Respondent promulgated the following regulation that was prescribed under that section:

> (a) In determining the extent to which a taxpayer's tax preference items reduce such taxpayer's tax, all nonpreference deductions will be considered to be taken into account first, followed by preference items of deduction.
>
> (b) The items of tax preference computed under Division 2, Part 10, Chapter 2.1, Revenue and Taxation Code, beginning with Section 17062, shall be reduced by an amount equal to the taxpayer's negative

> taxable income, except to the extent previously reduced by the taxpayer's "net business loss" as defined in Revenue and Taxation Code Section 17064.6.
>
> (c) The phrase "reduction of the taxpayer's tax" as used in Revenue and Taxation Code Section 17064.5(f) means the reduction of tax liability without regard to the effect of allowable tax credits.
>
> (d) This regulation shall apply to taxable years beginning on or after January 1, 1979.

(Cal. Code Regs., tit. 18, reg. 17064.5.)

This board has previously considered appellants' identical contention and resolved it against the taxpayer in the Appeal of Haddon N. and Grace Salt, decided July 29, 1986. However, appellants state that this board emphasized in its holding in Salt the absence of federal authority that permitted the deferral of the tax on preference items under circumstances that paralleled those in Salt and this appeal. Appellants call to our attention a subsequently decided federal case, First Chicago Corp. v. Commissioner, 88 T.C. 663 (1987), aff'd 842 F.2d 180 (7th Cir. 1988), in which tax preference items (accelerated depreciation on real property, percentage depletion in excess of basis, and I.R.C. section 1202 deductions) did not produce an immediate tax benefit because of the existence of substantial foreign tax credit carryovers. In First Chicago Corp., the United States Tax Court held that I.R.C. section 58(h) justified the conclusion that no minimum tax was due in that case for the years in which the then useless tax preferences arose and that the tax was properly imposed only in the taxable years and only to the extent that the taxpayer realized actual tax benefits generated by the preferences. (First Chicago Corp. v. Commissioner, supra, 88 T.C. at 668.) Appellants argue that the result that they seek under section 17064.5, subdivision (f), is compelled by the reasoning of the federal courts with regard to I.R.C. section 58(h) in First Chicago Corp. and that Salt should be overruled.

We recognize that this board has looked to the interpretation and effect given by federal courts to the federal counterparts of California statutes in construing them. However, even though the California and federal statutes under consideration here were virtually identical, each statute delegated to an appropriate revenue agency the authority to prescribe by regulation how the principles of the tax benefit rule would be applied in its jurisdiction to the context of taxing items of tax preference. It was not inevitable that the implementing federal and California regulations would be identical or even similar, and we are not inclined to accept First Chicago Corp. as persuasive authority because the federal courts in that case did not interpret an implementing federal regulation under I.R.C. section 58(h) that was essentially equivalent to the implementing regulation that respondent promulgated under section 17064.5, subdivision (f). In fact, the tax court in First Chicago Corp. emphasized that it was compelled to fashion a result under I.R.C. section 58(h) because of the failure of the Internal Revenue Service to prescribe any regulations and suggested that a different result under that statute would certainly have

been possible if pertinent regulations had been promulgated.[3/] (First Chicago Corp. v. Commissioner, supra, 88 T.C. at 676-677.)

In contrast with the situation that the tax court in First Chicago Corp. faced with regard to the regulations required under I.R.C. section 58(h), this board in Salt explicitly considered the implementing regulation that respondent had promulgated under section 17064.5, subdivision (f), and clearly stated our view that neither the statute nor the regulation provided for the deferral of liability for preference tax under the circumstances there and in this matter. Additionally, no subsequent decision of this board in interpreting the statute and regulation has suggested that they should be applied in a manner that would permit deferral of liability for preference tax. In view of appellants' failure to persuade us that we should follow First Chicago Corp. or to provide other compelling reasons why our previously stated view was incorrect, we reaffirm our holding in Salt and conclude that appellants may not defer liability for preference tax with respect to excluded capital gains beyond the respective appeal years.[4/] Accordingly, respondent's actions must be sustained.

3/ In a 1989 Treasury Decision, the Internal Revenue Service did promulgate temporary regulations under I.R.C. section 58(h). The applicability of these regulations, in any event, appears to be limited to factual patterns involving tax credits. (T.D. 8249, 1989-1 C.B. 15.)

4/ Because appellants have not raised the issue, we do not consider whether regulation 17064.5 would have permitted appellants to reduce the preference tax for which they are otherwise liable.

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 David M. and Gladys Bryant against proposed assessments of additional personal income tax in the amounts of $9,709.04 and $12,119.71 for the years 1984 and 1985, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 30th day of July, 1992, by the State Board of Equalization, with Board Members Mr. Sherman, Mr. Dronenburg, and Ms. Scott present.

Brad Sherman, Chairman

Ernest J. Dronenburg, Jr., Member

Windie Scott*, Member

____________________, Member

____________________, Member

*For Gray Davis, per Government Code section 7.9
bryant.cd