

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)	
)	No. 94A-0895
Sonia G. Drimmer, Zara Eliash and)	No. 94A-0891
Oscar and Marilyn Golodetz ¹)	No. 95N-0236

Representing the Parties:

For Appellants:	Alan D. Bollinger, KPMG Peat Marwick LLP
For Respondent:	Kendall E. Kinyon, Assistant Chief Counsel

Counsel for Board of Equalization:	Craig R. Shaltes, Staff Counsel
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O P I N I O N

These appeals are made pursuant to section 19045 of the Revenue and Taxation Code from the actions of the Franchise Tax Board on the protests of Sonia G. Drimmer, Zara Eliash and Oscar and Marilyn Golodetz against proposed assessments of additional personal income tax and pursuant to section 19324² from the actions of the Franchise Tax Board in denying the claims of Sonia G. Drimmer, Zara Eliash and Oscar and Marilyn Golodetz for refund of personal income tax in the amounts and for the years as follows:

<u>Appellants</u>	<u>Years</u>	<u>Proposed Assessments</u>	<u>Claims For Refund</u>
Sonia G. Drimmer 94A-0895	1990	\$3,284	\$14,905
Zara Eliash 94A-0891	1990 1991	4,847 148	18,185 101
Oscar and Marilyn Golodetz	1990	9,733	30,503

¹ These appeals, which all include the same issues, were consolidated at the request of the appellants, which consolidation was agreed to by the respondent.

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

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The issues presented for our decision in these appeals are as follows:

- (1) Whether the appellants qualified for the Farm Sales Credit found in former Revenue and Taxation Code section 17061.5.
- (2) Alternatively, whether non-California-source capital loss carryforwards, when used to compute "capital gain" in determining the applicability of the Farm Sales Credit, should also be used to determine California adjusted gross income for nonresidents under Revenue and Taxation Code section 17041, subdivision (b).

There are no disagreements as to the facts involved in these appeals. All of the appellants were nonresident partners in two California partnerships that sold California farm property at a gain during 1990. All of the appellants claimed Farm Sales Credit on their California nonresident returns based upon the sales of the partnership property. Respondent disallowed the claimed credit, pursuant to Revenue and Taxation Code section 17061.5, subdivision (b)(3)(B), because the appellants had no net capital gains includible in taxable income due to non-California source capital loss carryforwards which exceeded their shares of the capital gain from the California farm property sales.

Former Revenue and Taxation Code section 17061.5 provided a credit on the sale of certain qualified assets. The pertinent portion of that statute states:

- (b) (1) * * * *
- (2) In the case of qualified assets held for more than one year, but not more than five years, the amount of the credit shall be equal to 4 1/2 percent of the net capital gain, if any, from the sale or exchange of those assets.
- (3) If gain or losses from more than one sale or exchange of capital assets is taken into account in computing taxable income for one taxable year, each of the following shall apply:
 - (A) * * * *
 - (B) The amount of the credit allowable under paragraph (2) shall not exceed 4 1/2 percent of the excess of the net capital gain, if any, from all sales and exchanges of capital assets taken into account in computing taxable income for the taxable year over the amount of any gain for which a credit was allowed under paragraph (1). (Emphasis added.)

Respondent contends that "taxable income," as used in section 17061.5, subdivision (b)(3)(B), means taxable income from all sources, both California and non-California. (Rev. & Tax. Code, §§ 17073, 18151; I.R.C. §§ 63, 1212.) Because the appellants had non-California-source capital loss carryforwards from prior years that offset their California source gain for the appeal years,

there was no net capital gain includible in appellants' taxable income for the years on appeal. Therefore, under respondent's reading of 17061.5, subdivision (b)(3)(B), no credit was allowable.

Appellants argue that they are entitled to the Farm Sales Credit by virtue of Revenue and Taxation Code section 17055, subdivision (b), which states that any credits that are conditional on a transaction occurring within California (such as the Farm Sales Credit) are allowed in full to nonresidents. The appellants also contend that, in construing section 17061.5, subdivision (b)(3)(B), only California-source capital losses should be used to determine their net capital gain. Finally, appellants argue that the use of non-California-source gains and losses for purposes of section 17061.5, subdivision (b)(3)(B), violates the provisions of Revenue and Taxation Code section 17041, subdivision (b), which provides that nonresidents are taxed upon their taxable income which is derived from sources in California.³

Revenue and Taxation Code section 17073, subdivision (a), states: "Taxable income shall be defined by Section 63 of the Internal Revenue Code, except as otherwise provided." (Emphasis added.) While it is true that under Internal Revenue Code (I.R.C.) section 63, taxable income would include the net capital gain from all of a taxpayer's sources, we believe that the second phrase of section 17073, subdivision (a), applies when construing the applicability of section 17061.5, subdivision (b), because section 17041, subdivision (b) provides that California nonresidents' "taxable income" is income "derived from sources in this state." Nowhere in section 17041 does it provide that a California nonresident's "taxable income" is computed by using the nonresident's net capital gains from all sources.⁴ Moreover, this board has consistently held that the use of a nonresident's non-California source income to determine the nonresident's California tax liability, pursuant to the formula set forth in section 17041, subdivision (b), results in the taxation of only California-source income. (See Appeal of Louis N. Million, 87-SBE-036, May 7, 1987.)

Therefore, we agree with the appellants' argument that only California-source capital losses would be used to determine net capital gain for the purposes of section 17061.5, subdivision (b)(3)(B). This is because that is the amount used to compute a nonresident's California taxable income.

In addition to arguing that they are entitled to the Farm Sales Credit, the appellants alternatively contend that they are entitled to refunds, based upon the argument that if non-California-source capital loss carryforwards are used to compute net capital gain in determining the applicability of the Farm Sales Credit, then those same capital loss carryforwards should also be used to compute California adjusted gross income under Revenue and Taxation Code section 17041, subdivision (b). Appellants have failed to provide any other legal support for this second, alternative, argument.

Respondent contends that appellants' alternative argument must fail, based upon the language of section 17041, which does not allow for the deduction of non-California source loss

³ The tax for nonresidents under section 17041, subdivision (b), is equal to the tax that would be imposed if the nonresident were a resident, multiplied by the ratio of California adjusted gross income to total adjusted gross income from all sources.

⁴ Section 17041, subdivision (b), does provide that a California nonresident's non-California source income is used in computing the nonresident's ultimate California tax liability.

carryforwards in the computation of California source income. The respondent is correct in its contention.

Therefore, because the appellants were entitled to the use of the entire Farm Sales Credit (see Rev. & Tax. Code, § 17055, subd. (b)), the actions of the respondent in issuing the proposed assessments are hereby reversed. Further, because we have decided in favor of the appellants on the first issue, we need not address the appellants' alternative refund claims, except to say that said claims were properly denied, because California-source adjusted income is not computed by allowing capital loss carryforward from non-California sources. (Rev. & Tax. Code, § 17041, subd. (b).)

ORDER

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 19047 of the Revenue and Taxation Code, that the actions of the Franchise Tax Board on the protests of Sonia G. Drimmer, Zara Eliash, and Oscar and Marilyn Golodetz, against proposed assessments of additional personal income tax in the amounts and for the years as follows:

<u>Appellants</u>	<u>Years</u>	<u>Proposed Assessments</u>
Sonia G. Drimmer 94A-0895	1990	\$3,284
Zara Eliash 94A-0891	1990 1991	4,847 148
Oscar and Marilyn Golodetz 95N-0236	1990	9,733

be and the same are hereby reversed, and the actions of the Franchise Tax Board in denying the claims of Sonia G. Drimmer, Zara Eliash, and Oscar and Marilyn Golodetz for refund of personal income tax in the amounts and for the years as follows:

<u>Appellants</u>	<u>Years</u>	<u>Claims For Refund</u>
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Oscar and Marilyn Golodetz 95N-0236	1990	30,503

be and the same are hereby sustained.

Done at Sacramento, California, this 22nd day of February, 1996, by the State Board of Equalization, with Board Members Mr. Klehs, Mr. Dronenburg, Mr. Andal, Mr. Sherman and Mr. Halverson present.

Johan Klehs _____, Chairman

Ernest J. Dronenburg, Jr. _____, Member

Dean F. Andal _____, Member

Brad Sherman _____, Member

Rex Halverson* _____, Member

*For Kathleen Connell, per Government Code section 7.9.