

was \$55,000, with a down payment of \$10,000, The remainder was payable in annual installments of \$5,000 plus interest at the rate of 5 percent per annum, with an option in the city of increasing any payment to \$10,000. As evidence of the debt, the city executed a promissory note to Faye W. Odenheimer, secured by a trust deed. The note provided that payments were to be made only out of revenues from the Parking Meter Fund and were not to be charges against the general tax revenue.

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Appellants filed claims for refund with the Internal Revenue Service and with the Franchise Tax Board, The Internal

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Revenue Service allowed the claim in accordance with section 103 of the 1954 Internal Revenue Code,, while the Franchise Tax Board rejected their claim, Respondent agrees that the income in question qualifies for the exemption in the Internal Revenue Code of interest on governmental "obligations" but contends that the California constitutional exemption is of a much narrower scope and does not reach this **income**.

Section 17137 of the Revenue and Taxation Code, provides: "Gross income does not include income which this State is prohibited from taxing under the Constitution or laws of the United States of America or under the Constitution of this State," Article XIII, section 1-3/4 of the California Constitution provides: "All bonds hereafter issued by the State of California or by any county, city and county, municipal corporation or district (including school, reclamation,, and irrigation districts) within said State, shall be free and exempt from taxation," It is on the meaning of the word "bonds" as used in this provision that the respondent bases its case.

Webster's Third New International Dictionary defines a bond as "a writing under seal by which a person binds himself', to pay a certain sum on or before an appointed day .. b: an interest-bearing document giving evidence of a *long-term* debt and issued by a government body or corporation sometimes secured by a lien on property and often designed to take care of a particular financial need,"

Commissioner v. Meyer, 104 F.2d 155, 156-157, presented a factual situation which is very close to that in the instant case. The village of Suffern, New York, purchased land from the taxpayer with a down payment, and gave promissory notes; with interest at 5 percent semiannually, for the rest. The taxpayer did not include the interest income in his tax returns and the Commissioner of **Internal Revenue** determined a deficiency. The court held that the notes were obligations created in the exercise of the borrowing power of the village and were therefore "obligations" within the meaning of the federal exemption... In so holding, the court stated that

... where credit is obtained in consideration for a promise to pay money in the future, together with interest on that money, there is no valid ground for making a **distinction between** interest 'paid on bonds duly issued and interest paid on notes duly delivered,

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There has been no litigation concerning the exemption provision in the California Constitution, but it has been discussed in 'opinions by the Attorney General.

In 1954 the respondent requested an opinion concerning the taxation of interest-bearing warrants issued by an improvement district. After comparing the nature and purposes of bonds and of warrants the Attorney General concluded that warrants are "bonds" within the meaning of article XIII, section 1-3/4 and the interest, therefore, is exempt. (23 Ops. Cal. Atty. Gen. 59.) This conclusion was based on the fact that the warrants were payable at a date certain and sold to finance improvement district projects. The promissory note in the case at hand is payable at a date certain and the land was purchased for a city parking lot, **which is** a public improvement. (City of Whittier v. Dixon, 24 Cal. 2d 664 [151 P.2d 5]; Irish v. Hahn, 208 Cal. 339 [281 P. 385].)

On November 13, 1963, the Attorney General **issued an** opinion dealing with bond anticipation notes, Declaring that the State Treasurer could be authorized to issue such notes in anticipation of sale of general obligation bonds the Attorney General also said:

The notes, therefore, while not constituting a general obligation of the state in **the** sense that they are secured by the State General Fund and *general* taxing power of the state, are nevertheless obligations of the state and may even **be** declared general obligations within the meaning of a specific statute or regulation..

Finally, since the notes are obligations of the State of California, interest thereon would be exempt from **the State** of California personal income taxes (**Const. Art. XIII, § 1-3/4**) and federal income taxes (26 **U.S.C.**, § 103, Reg. 1,103-1) under existing laws, regulations and court decisions,. (42 **Ops. Cal.** Atty. Gen. 133, 136.)

Based upon the foregoing authorities, we **conclude** that the interest **on the** promissory note given by the City of Hanford is exempt under article XIII, section 1-3/4 of 'the California Constitution,

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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 claims of M. G. and Faye W. Odenheimer for refund of personal income tax of \$40.43 and \$40.00 for the years 1957 and 1958, respectively, be reversed,

Done at Pasadena, California, this 29th day of June, 1964, by the State Board of Equalization.

Paul R. Leach, Chairman
John W. Lynch, Member
Dubaut, Member
_____, Member
_____, Member

ATTEST: R. G. Hamlin, Acting Secretary