Capital gain
% reported
Law changed

65-SBE-020

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
)
WILLIAM S. AND CAMILLA A. ANDREWS,)
ESTATE OF PERRY G. M. AUSTIN, DECEASED,)
AND CAMILLA AUSTIN.)

Appearances:

For Appellants: William S. Andrews
Attorney at Law

For Respondent: Peter S. Pierson
Associate Tax Counsel

O P I N I O N

These appeals are made pursuant to section 19059 of the Revenue and Taxation Code from the action of the Franchise Tax Board on claims for refund of personal income tax by William S. and Camilla A. Andrews in the amount of $126.35 for the year 1959 and by Estate of Perry G. M. Austin, Deceased, and Camilla Austin in the amount of $1,315.61 for the year 1960.

All of the appellants are represented by the same attorney, who presented the appeals to us on a consolidated basis because similar issues were involved.

The questions presented concern the application of a statutory change with respect to gains from sales made prior to the change. Before its amendment in 1959, section 18151 provided that in the case of any taxpayer, 40 percent of the recognized gain or loss on the sale of a capital asset held more than five but not more than ten years, should be taken into account. It also provided that as to assets held more than ten years, 30 percent of the gain or loss should be taken into account, As amended, effective June 8, 1959, the section provided that "If for any taxable year the net long-term capital gain exceeds the net short-term capital loss, '50 percent of the amount of such excess shall be a deduction from gross income...."

Appeal of William S. and Camilla A. Andrews

William S. Andrews was a member of a partnership which had adopted a fiscal year ending August 31. In November 1958 and March 1959 the partnership sold certain properties which had been held more than five but not more than ten years. In the partnership return for the year ended August 31, 1959, 40 percent of the gain was reported. Appellants similarly reported 40 percent of the gain in their individual joint return for the calendar year 1959. This was the amount to be taken into account under section 18151 of the Revenue and Taxation Code as it read prior to its amendment in 1959. Respondent contends that the amended section controls and that 50 percent of the gain should be included'in appellants* income for 1959.

A proper understanding of the issue requires an analysis of the personal income tax law as it applies to partnerships. By statute, the individual partner, and not the partnership, is the taxpayer. (Rev. & Tax. Code, § 17851.) The partnership, however, has a "taxable year" for purposes of determining income (Rev. & Tax. Code, § 17862) and it files returns. (Rev. & Tax. Code,. § 17932.)

In computing the taxable income of a partner for his taxable year, there are to be included, among other items, the capital gains and losses of the partnership for any taxable year of the partnership that ends within or with the taxable year of the partner. (Rev. & Tax. Code, §17861.) The capital gains and losses are to be separately stated in the partnership return (Rev. & Tax. Code, §17854), and each partner is to take into account separately his distributive share of those gains and losses. (Rev. & Tax, Code, §17852.)

The purpose of the special treatment of partnership gains and losses is to permit the partner to combine those items with his individual gains and losses for tax purposes. (John G. Scherf, Jr., 20 T.C. 346,349.) In other words, capital gains and losses, as such, do not enter into the computation of partnership net income. As to such items, the partnership return serves only as a conduit, segregating the gains and losses for treatment on the return of the partner in the same way as similar pains and losses realized by the partner as an individual. (6 Mertens, Law of Federal Income Taxation, § 35.27.)

Applying the foregoing provisions to appellants' situation, the capital gains of the partnership for its taxable year ended August 31, 1959, are to be included in computing appellants' taxable income for the calendar year 1959. The purpose of the statutes which segregate capital gains and losses of a partnership, that of permitting 'their combination with gains and losses of the partner as an individual, would not be served if the two types of gains and losses were subject to incompatible treatment. Such incompatibility would result if the treatment of the partnership gains were controlled by section 18151 prior to its amendment, while any gains or losses that might have been realized by appellants on their own account in 1959 were controlled by the amended language.

According to section 17034 of the Revenue and Taxation Code, any law effecting changes in the computation of taxes is to be applied in the computation of taxes for taxable years beginning after December 31 of the year preceding enactment, unless otherwise 'specifically provided. No contrary provision was made in enacting the 1959 amendment of section 18151. (See Stats. 1959, pp. 2868, 2881.) It is clear that the amendment would have applied to any gains or losses realized by appellants on their own account in their taxable year 1959. Since the capital gains of the partnership were to be included as distinct items in the computation of their taxes for that year, the amendment applies to those' gains in the same manner.

Appeal of Estate of Perry G. M. Austin and Camilla Austin

In 1956 the Austins sold real property which they had held more than ten years and elected to report the gain through use of the installment method, reporting as income a portion of the installment payments received each year. (See Rev. & Tax. Code', § 17578.) The question is whether section 18151, as amended in 1959, applies in computing the taxes on an installment received in 1960.

As we have pointed out with respect to the Andrews' appeal,.' the 1959 amendment is to be applied in the computation of taxes for taxable years ending after December 31, 1958. When a taxpayer elects to use the installment method, he takes the risk of changes in the law as to future installments. (Snell v. Commissioner, 97 F.2d 891; Harry B. Golden, 47 B.T.A. 94.) It must be concluded that section 18151, as amended in 1959, does apply to the installment received in 1960.

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, Appeals of William S. and Camilla A. Andrews, et al.

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 on claims for refund of personal income tax by William S. and Camilla A. Andrews in the amount of $126.35 for the year 1959 and by Estate of Perry G. M. Austin, Deceased, and Camilla Austin in the amount of $1,315.61 for the year 1960 be and the same is hereby sustained.

Done at Pasadena, California, this 28th day of June, 1965, by the State Board of Equalization.

John W. Lynch, Chairman

, Member

, Member

, Member

, Member

Attest: , Secretary