

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
ARTHUR W. HORSTMIER )

For Appellant: Arthur W. Horstmier, in pro. per,

For Respondent: Crawford H. Thomas  
Chief Counsel

Marvin J. Halpern  
Counsel

OPINION

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Arthur W. Horstmier against proposed assessments of additional personal income tax in the amounts of \$1,499.67, \$601.19, and \$882.17 for the years 1968, 1969, and 1970, respectively. Subsequent to the filing of this appeal, and in response to appellant's request, respondent reviewed its computation with respect to the proposed deficiency assessment for 1968 and conceded that the assessment for that year should be \$740.01, not \$1,499.67.

Appeal of Arthur W. Horstmier

In May of 1967, appellant entered into an annuity agreement with Aruba Bonaire Curacao Trust Company Limited which provided that, in consideration for the transfer of certain assets, appellant was to receive annual payments for life, commencing in 1968. He received the first annuity payment in January 1968. On his California personal income tax returns for 1968, 1969, and 1970, appellant reported the amounts received under the annuity agreement but did not include these amounts in the computation of his taxable income for those years, since he had not recovered the adjusted basis of the transferred property. Following a routine audit of appellant's returns for 1968, 1969, and 1970, respondent increased appellant's taxable income for those years by amounts equal to three percent of the consideration paid for the annuity, pursuant to former section 17101 of the Revenue and Taxation Code. The increase in appellant's taxable income resulted in the assessment by respondent of additional tax for each of the years in question.

Whether those deficiency assessments were proper is the sole issue for our determination.

In 1968, the Legislature amended the sections of the California' Revenue and Taxation Code relating to the taxation of annuities, bringing them into conformity with existing federal law. Of particular importance to the instant case was the deletion of the three percent provision of former section 17101. It is respondent's contention that the law as it existed prior to the 1968 amendments applies to the case at hand. Appellant, on the other hand, suggests that neither the law as it read prior to the 1968 amendments nor as it now reads applies to his situation, or, alternatively, that if any law is applicable it is the amended law. The question thus becomes: which of the laws, if either, applies to this case.

The answer to that question lies in the interpretation to be given section 26, chapter 1417, page 2801 of the 1968 California Statutes, which provides:

Notwithstanding the provisions of Section 27, Sections 17101 to 17108, inclusive, and Section 18802 of the Revenue and Taxation Code, as amended by this act, and Sections 17109 to 17112, inclusive, of that code, as added by

Appeal of Arthur W. Horstmier

this act, shall be applied in the computation of taxes on annuities with an annuity starting date (as defined by subdivision (d) of Section 17103 of that code) on or after January 1, 1968, and Sections 17101 to 17108, inclusive, and Section 18802 of that code, as were in effect immediately prior to the amendments made by this act, shall continue to be applied in the computation of taxes on annuities with payments commencing prior to January 1, 1968.

Subdivision (d) of section 17103 of the Revenue and Taxation Code, referred to above, provides:

(d) For purposes of Sections 17101 to 17112, inclusive, the annuity starting date in the case of any contract is the first day of the period for which an amount is received as an annuity under the contract.

It is respondent's position that the annuity starting date in the instant case was in May 1967, notwithstanding the fact that the first annuity payment was not received by appellant until the following January, since, the period "for which" the first payment was received began in May 1967. If respondent's position is correct, it would follow that the law as amended in 1968 could not be applied in this case since section 26 limits application of the amended law to "... annuities with an annuity starting date (as defined by subdivision (d) of Section 17103 of that code) on or after January 1, 1968, .."

The California definition of "annuity starting date" was modeled after the definition of that term contained in subdivision (c)(4) of section 72 of the Internal Revenue Code of 1954. Further illumination of the meaning of "annuity starting date" is found in the Treasury Regulations, which provide:

(b) Annuity starting date. (1) Except as provided in subparagraph (2) of this paragraph, the annuity starting date is the first day of the first period for which an amount is received as an annuity, except that if such date was before January 1, 1954, then the annuity starting date is January 1, 1954. The

Appeal of Arthur W. Horstmier

first day of the first period for which an amount is received as an annuity shall be whichever of the following is the later:

(i) The date upon which the obligations under the contract became fixed, or

(ii) The first day of the period (year, half - year, quarter, month, or otherwise, depending on whether payments are to be made annually, semiannually, quarterly, monthly, or otherwise) which ends on the date of the first annuity payment. (Treas. Reg. § 1.72-4(b)(1).)

Applying this regulation to the present situation, the date upon which the obligations under the contract became fixed, and the first day of the period which ended on the date of the first annuity payment, were the same date, i.e., that date in May 1967 when the annuity contract became binding. Accordingly, that date would be the annuity starting date under federal law. Because of the basic similarity between California and federal law in this area, we believe that the federal regulation supports respondent's position with respect to the annuity starting date. It follows that the law as amended in 1968 does not apply to the instant case.

Appellant suggests that the provision in section 26 that the old law "... shall continue to be applied in the computation of taxes on annuities with payments commencing prior to January 1, 1968, " limits application of the old law to situations where payments were received prior to January 1, 1968. He argues that this language, when coupled with the previously discussed language of section 26 limiting application of the new law to annuities with starting dates on or after January 1, 1968, precludes the application of either law. Such a result is inconceivable to us, since to interpret the law in this manner would result in the exemption from taxation of a select group of taxpayers who by chance had annuity starting dates before January 1, 1968, but who had not received payments from their annuities prior to that time. We do not believe that such a result was intended by the Legislature. In our opinion, the only logical interpretation to be given section 26 is that the language contained therein referring to application of the unamended law was not meant to be an all inclusive statement limiting application of that

Appeal of Arthur W. Horstmier

law exclusively to situations where annuity payments commenced prior to January 1, 1968. Rather, we construe this language as nonlimiting and merely illustrative of a particular situation wherein the unamended law is to be applied.

Based upon the foregoing, it is our conclusion that section 17101 of the Revenue and Taxation Code as it read prior to the 1968 amendment was properly applied by respondent to the facts of this case. Accordingly, we sustain respondent's determination.

ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

Appeal of Arthur W. Horstmier

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 Arthur W. Horstmier against proposed assessments of additional personal income tax in the amounts of \$1,499.67, \$601.19, and \$882.17 for the years 1968, 1969, and 1970, respectively, be and the same is hereby modified with respect to the year 1968 in accordance with respondent's concession. In all other respects the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 23rd day of September, 1974, by the State Board of Equalization.

George J. Kelly, Chairman  
John W. Lynch, Member  
John C. Gentry, Member  
William C. Burnett, Member  
\_\_\_\_\_, Member

ATTEST: W. W. Dunlop, Secretary