



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
FRANK W. AND HARRIET S. WALTERS)

For Appellants: Roger F. Knittel
Certified Public Accountant
For Respondent: James C. Stewart
Counsel

O P I N I O N

This appeal is made pursuant to section 19057, subdivision (a), of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claims of Frank W. and Harriet S. Walters for refund of personal income tax in the amounts of \$3,589, \$4,431, \$3,557 and \$3,860 for the years 1976, 1977, 1978, and 1979, respectively.

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The issue presented is whether certain monthly income received by Frank W. Walters (hereinafter "appellant") was **subject** to taxation by California.

Before his retirement in May of 1974, appellant was a resident of Missouri and was employed by the May Company (hereinafter "May"). During his employment with **May**, appellant elected to defer certain yearly bonus payments and to be paid in cash or May stock over a period of from one to fifteen years in the future pursuant to a plan qualified under section 401 of the Internal Revenue Code. **On** May 31, 1974, shortly after appellant's retirement, **appellants moved** from Missouri and became California residents. Appellant filed resident tax returns **for** the years at issue and included all payments from the deferred compensation plan received during those years as taxable **income**. Thereafter, appellant filed claims for **refund**, maintaining th'at the deferred compensation payments were not taxable in California. Denial of the claims resulted in this_ appeal.

Except as otherwise provided in the law, California personal income tax is imposed upon the entire taxable income of every resident of California. (Rev. & Tax. Code, § 17041.) Since appellant was a resident of California during the years at issue, respondent concluded that the payments received from the deferred compensation plan during that time were subject to taxation in California. (Rev. & Tax. Code, §§ 17071 & 17503.)

Appellant contends, however, that his income derived from such deferred compensation is not taxable by California, even though he was then a resident of this state and a cash basis **taxpayer, by** reason of Revenue and Taxation Code section 17596, which states:

When the status of a taxpayer changes from resident to nonresident, or from **nonresident to** resident, there shall be included in determining income from sources within or without this State, as the case may be, income and deductions accrued **prior to** the change of status even though not otherwise **includible** in respect of the period prior to such change, but the taxation or **deduc-**tion of items accrued prior to the change of status shall not be affected by the change.

The basic argument advanced by appellant is that the subject deferred compensation accrued while he was a

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nonresident and that section 17596 prohibits California from taxing that income.

In the Appeal of Virgil M. and Jeanne P. Money, decided by this board on December 13, 1983, we concluded that section 17596 was apparently designed-merely to prevent California from treating accrual and cash basis taxpayers differently when they change residency and are subject to taxation by California on the basis of their residency. We held that this section should be applied only when two conditions are satisfied: (a) when California's sole basis for **taxation** is the taxpayer's residency, and (2) when that taxation would differ depending on whether the taxpayer uses the cash or the accrual method of accounting.

Applying this two-pronged test to appellant's deferred income, we find that the first condition is satisfied. California's only basis for taxing the income is the taxpayer's residency in this state. However, we find that the second condition is not satisfied because California's taxation of the deferred **income** would not differ **between** cash and accrual basis taxpayers. The provisions of Revenue and Taxation Code section 17503, dealing with the taxability of distributions from qualified plans, make no distinction between cash and accrual basis taxpayers but treat all taxpayers as if they were on the same method of accounting. As these specific provisions appear to put all recipients of deferred compensation on the same method of accounting, it is not necessary to utilize the general provisions of section 17596 to achieve the same result. Appellant's deferred compensation payments are, therefore, taxable by California, and respondent's action must be sustained.

