94-SBE-001

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

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| In the Matter of the Appeal of | ) | |
| | ) | No. 90A-1327-DB |
| JOSEPH DAKS | ) | |

Appearances:

For Appellant: Joseph Daks

For Respondent: Richard Gould<br>Counsel

# O P I N I O N

This appeal is made pursuant to section 18593[1/] of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Joseph Daks against proposed assessments of additional personal income tax in the amounts of $1,503, $1,501, $408, and $481 for the years 1984, 1985, 1986, and 1987, respectively.

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

The question presented is whether pension income appellant earned while he was a resident of New York but received while he was a resident of California is taxable by this state.

From 1948 through 1981, appellant was employed in New York by United Merchants and Manufacturers, Inc., or one of its subsidiaries. During that period, he was a participant in his employer's noncontributory, qualified, defined-benefit pension plan. Upon his retirement on January 1, 1982, appellant elected to receive 100 guaranteed monthly payments, i.e., these payments were required to be paid either to appellant or to his estate or designated beneficiaries if he died before receiving all 100 payments. If appellant lived longer than 100 months from retirement, the pension plan provided that he would continue to receive monthly payments for the remainder of his life.

Appellant began receiving his pension payments in January 1982 while living in New York. In May 1982 he moved to California, where he continues to reside. On his California personal income tax returns for the years 1984-1987, appellant excluded from his taxable income the portion of the initial 100 pension payments he had received in those years, on the theory that these pension payments had "accrued" while he was a resident of New York and, therefore, weren't taxable in California under section 17554. Respondent Franchise Tax Board determined, however, that section 17554 was not controlling and that the payments were fully taxable by California under the normal statutory rules which tax California residents on their income from all sources. (See Rev. & Tax. Code, § 17041.) Whether this decision was correct is the subject of this appeal.

Since there are no California judicial decisions directly on point, respondent's determination in this case was based on this board's opinion in the Appeal of Virgil M. and Jeanne P. Money, decided December 13, 1983. The Money opinion established a two-pronged standard to be met before section 17554 (then numbered section 17596) is given controlling effect:

> (1) California's sole basis for taxing the income must be the taxpayer's California residency, and
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> (2) that taxation must differ depending on whether the taxpayer uses the accrual or cash method of accounting.

This interpretation of the limited scope of section 17554 was based on our conclusion that the section's original purpose was merely to prevent California from treating accrual-method and cash-basis taxpayers differently when they changed residency. The statute imposes consistent treatment in such cases by putting all taxpayers who change their residency on the accrual method of accounting. However, because the statutes governing the taxation of beneficiaries of qualified pension plans specify that amounts distributed are taxable only when received or made available to the recipient (I.R.C. § 402(a)(1), made applicable in California by Rev. & Tax. Code, § 17501; Treas. Reg. § 1.402(a)-(1)(a)), it makes no difference whether the recipient is an accrual- rather than a cash-method taxpayer. Regardless of the taxpayer's accounting method, distributions from qualified plans are taxable only when actually received by or made available to him. Consequently, the second prong of the Money test is not satisfied, and section 17554, therefore, does not apply to allow or require[2/] pension beneficiaries such as appellant to use the accrual method of accounting for their pension benefits.

The case of Borchers v. Franchise Tax Board, 151 Cal.App.3d 504 [198 Cal.Rptr. 734] (1984), upon which appellant relies so heavily, and which was decided shortly after we issued our opinion in Money, does not require that the Money line of authority be abandoned. In Borchers, the taxpayer-husband had earned his pension in Illinois and, upon retiring, had elected a monthly pension benefit with a survivor annuity payable to his wife if he predeceased her. The taxpayers began receiving the monthly pension in Illinois, but then moved to California, where they continued to receive monthly benefits. Relying on section 17596 (now section 17554), the taxpayers argued that California could not tax their pension payments because those payments had "accrued" in Illinois prior to the taxpayers' move to California. The court rejected this position, however, holding that the survivorship feature prevented accrual prior to actual receipt of the payments, because the amount which would ultimately be received by the taxpayers was unknown. The same result is reached if the Money analysis is used.

The case now before us presents a different issue than the court considered in Borchers. Here, when he retired in New York, appellant elected a retirement option that guaranteed that he or his successors would receive at least 100 monthly payments. Because the amount of these 100 payments was fixed and their receipt was certain, they "accrued," within the meaning of section 17554, before appellant became a California resident. Under section 17554, therefore, these payments are not taxable by California. Under the normal rules governing the taxation of distributions from qualified plans, however, they are taxable by California to the extent that appellant was a California resident when they were "received or made available to" him. (I.R.C. § 402(a)(1); Rev. & Tax. Code, § 17041.) The question presented is which statute controls, a question that the Borchers court did not have to consider or resolve, since it held that there was no accrual under section 17554.

While this statutory conflict did not arise in Borchers, it has been ever present in the Money line of cases. Our position was, and is, that the conflict should be resolved in favor of giving controlling effect to any specific statutory rules governing the time for reporting the particular item of income in question, and not to the general rules of section 17554, which purport to apply to all classes of income and deductions, without exception. This comports with the long-established rule of statutory

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[2/] It may be instructive to note here what might happen to a taxpayer whose change in residency status is the exact reverse of appellant's, if appellant's view of section 17554 were to be adopted. If such a taxpayer retired as a California resident, made the same election as appellant did under an identical pension plan, and then became a nonresident of California after receiving only a few of the 100 guaranteed payments, it would seem that the sum total of all the remaining guaranteed payments would be taxable by California in the year the residency status changes, even though the taxpayer would actually receive that amount only as monthly payments spread over a period of many years. The resulting hardship of being required to pay tax on large amounts of income not yet received is obvious, but this is the result that would appear to be indicated by the unfettered application of standard "accrual" accounting concepts under section 17554. Such problems are largely avoided if the Money test is used to determine when section 17554 is the controlling statute.

construction that a specific provision relating to a particular subject will govern as against a more general provision that broadly covers the same subject. (See Wilson v. Board of Retirement, 156 Cal.App.2d 195, 211 [319 P.2d 426] (1957); Sutherland, Statutes and Statutory Construction, § 51.05 (5th Ed.).)

As we indicated in Money and its progeny, giving section 17554 the type of broad application that appellant seeks here would clash with fundamental notions of fairness and with the most basic principles underlying the taxation of residents. One need look no further than to compare appellant's situation with Mr. Borchers'. If appellant is correct that section 17554 controls, then he escapes California tax on a substantial part of his income while Mr. Borchers pays tax on all of his, even though both were physically present in California, equally enjoying all the benefits and protections that California has to offer. We cannot believe that California law requires such disparate and inequitable consequences solely because of the payout option that a taxpayer has elected under his retirement plan.

For the above reasons, respondent's action in this matter will be sustained.

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 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Joseph Daks against proposed assessments of additional personal income tax in the amounts of $1,503, $1,501, $408, and $481 for the years 1984, 1985, 1986, and 1987, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 5th day of January, 1994, by the State Board of Equalization, with Board Members Mr. Sherman, Mr. Dronenburg, Mr. Fong and Ms. Scott present.

Brad Sherman, Chairman

Matthew K. Fong, Member

Ernest J. Dronenburg, Jr., Member

Windie Scott*, Member

______________________, Member

*For Gray Davis per Government Code section 7.9.

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