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9 **BOARD OF EQUALIZATION**
10 **STATE OF CALIFORNIA**

11 In the Matter of the Appeal of:) **HEARING SUMMARY**
12) **PERSONAL INCOME TAX APPEAL**
13 **PAULA TRUST**) Case No. 759422
14)
15)
16)

17 Claim for Refund

<u>Year</u>	<u>Amount</u>
2007	\$150,655.00

18 Representing the Parties:

19 For Appellant:	Edwin P. Antolin, Silverstein and Pomerantz, LLP Amy L. Silverstein, Silverstein and Pomerantz, LLP
20 For Franchise Tax Board:	Sonia Woodruff, Tax Counsel III ¹

21
22 **QUESTION:** Whether appellant Paula Trust was subject to California income tax on all of its
23 income as California source income, as contended by respondent Franchise Tax
24 Board (FTB), or, alternatively, whether appellant's amended return correctly
25 apportioned 50 percent of its income to California on the basis that only one of its
26 two fiduciaries was a California resident.

27
28 ¹ Respondent's counsel was formerly known as Sonia C. Deshmukh.

1 HEARING SUMMARY

2 Background

3 Paula Trust is an irrevocable trust created in 1971. During the year at issue, the trust had
4 two co-trustees. One of the trustees was a California resident and the other was a resident of another
5 state. The trust has a single beneficiary, who is a California resident. The trustees have authority to
6 distribute net income or principal to the beneficiary as they deem to be in his best interests. (App. Op.
7 Br., p. 2; Resp. Op. Br., p. 2.)

8 During the 2007 tax year, Paula Trust recognized a substantial amount of income as a
9 result of the sale of stock in Century Theatres, Inc. by a partnership in which it was a limited partner. It
10 also recognized income from the sale in its capacity as a shareholder in an S corporation that served as
11 the general partner of the partnership. (App. Op. Br., p. 3; Resp. Op. Br., p. 3.)

12 Appellant states that, for purposes of this appeal, it has agreed not to dispute whether all
13 of its income was from a California source. (App. Reply Br., p. 7, fn. 4; see Resp. Op. Br., pp. 3 – 4.)

14 On its original 2007 California income tax return, Paula Trust apportioned all of its
15 income to California. In 2012, appellant filed an amended tax return that apportioned only half of its
16 income to California on the ground that only one of its two fiduciaries resided in California.² This
17 amended tax return sets forth the refund claim at issue in this appeal. (App. Op. Br., pp. 2 – 3;
18 Resp. Op. Br. p. 3.)

19 On August 30, 2013, appellant filed this timely appeal pursuant to Revenue and Taxation
20 Code (R&TC) 19331 on the basis that its refund claim should be deemed denied as respondent had not
21 mailed a notice of action on the refund claim within six months after the claim had been filed.
22 (App. Op. Br., p. 3.)

23 Contentions

24 Key Statutory and Regulatory Provisions

25 To assist in reviewing the contentions of the parties, the key statutory provisions and key
26

27 ² Appellant notes that its amended tax return also included other changes which, among other things, corrected its reporting
28 of tax-exempt interest income. (App. Op. Br., p. 3 and Exhibit D [copy of amended return].) In its briefing, respondent has
not disputed these other changes, which appear to be relatively minor.

1 regulation are set forth below. The Applicable Law section of this Hearing Summary sets forth these
2 provisions again, together with relevant portions of associated regulations and case law.

3 *R&TC Section 17742.* (a) Except as otherwise provided in this chapter, the income of an
4 estate or trust is taxable to the estate or trust. The tax applies to the entire taxable income
5 of an estate, if the decedent was a resident, regardless of the residence of the fiduciary or
6 beneficiary, and to the entire taxable income of a trust, if the fiduciary or beneficiary
(other than a beneficiary whose interest in such trust is contingent) is a resident,
regardless of the residence of the settlor. . . .

7 *R&TC section 17743.* Where the taxability of income under this chapter depends on the
8 residence of the fiduciary and there are two or more fiduciaries for the trust, the income
9 taxable under Section 17742 shall be apportioned according to the number of fiduciaries
10 resident in this state pursuant to rules and regulations prescribed by the Franchise Tax
Board.

11 *Regulation 17743. Taxability of Trust Dependent upon Residence of Fiduciary.*

12 If there are two or more fiduciaries of a trust, and one or more are residents and one or
13 more are nonresidents, and all the beneficiaries are nonresidents, the trust is taxable upon
14 (a) all net income (less the deductions allowed under Article 1 of Chapter 9
15 (Section 17731 and following)) from business carried on within this State, from real or
16 tangible personal property located in this State, and from intangible personal property
17 having a business or taxable situs in this State (see Reg. 17952); and (b) that proportion
of the net income (less the deductions allowed under Article 1 of Chapter 9
(Section 17731 and following)) from all other sources which the number of fiduciaries
who are residents of this State bears to the total number of fiduciaries.

18 . . . [see Applicable Law for examples provided by the regulation]

19 Summary of Contentions

20 Appellant argues that the plain language of R&TC section 17743 requires that taxable
21 income be apportioned “. . . *according to the number of fiduciaries resident in this state* pursuant to
22 rules and regulations prescribed by the [FTB]. [emphasis added]” Appellant therefore argues that
23 California Code of Regulations, title 18, section (Regulation) 17743 is invalid to the extent that it
24 determines taxable income by first taxing all income from sources within the state (such as income from
25 a sale of California property) and only then apportions non-California source income according to the
26 number of fiduciaries resident in the state. Appellant contends that respondent is applying a sourcing
27 methodology that the Legislature removed from the statute in 1937. Appellant also contends that, in any
28 event, Regulation 17743 does not apply to appellant by its terms as the regulation only addresses

1 situations where there is no California beneficiary and, here, appellant’s beneficiary is a California
2 resident.

3 Respondent argues that R&TC section 17743 is ambiguous and contends that the statute
4 provides a broad grant of rule-making authority by providing that taxable income will be apportioned
5 “. . . according to the number of fiduciaries resident in this state *pursuant to rules and regulations*
6 *prescribed by the [FTB]. [emphasis added]*” Respondent argues that, in light of the foregoing,
7 Regulation 17743 reasonably applies a sourcing methodology that is consistent with general sourcing
8 principles reflected throughout the Revenue and Taxation Code and has been consistently applied since
9 1935. Respondent contends that appellant’s interpretation of R&TC section 17743 would lead to absurd
10 results and potential abuse. Respondent further contends that the Legislature’s 1937 amendment did not
11 change the law and likely reflected a determination that the deleted sourcing language was no longer
12 necessary. Respondent argues that Regulation 17743 applies to appellant because the intent of the
13 regulation is to address situations where the residence of beneficiaries is not relevant to determining the
14 tax and the regulation language pre-dates a 1963 change to R&TC section 17742 that distinguishes
15 between contingent and noncontingent beneficiaries.

16 Appellant’s Opening Brief

17 Appellant first notes that R&TC section 17742, subdivision (a), states that the tax on a
18 trust applies “. . . to the entire taxable income of a trust, if the fiduciary or beneficiary (other than a
19 beneficiary whose interest in such trust is contingent) is a resident” Appellant argues that it cannot
20 be taxed on the basis of the residence of its beneficiary on the ground that its beneficiary has only a
21 contingent interest in trust income and principal. It therefore contends that its taxation is dependent on
22 the residence of its fiduciary. (App. Op. Br., p. 4.)

23 Appellant then notes that R&TC section 17743 applies by its terms “[w]here the
24 taxability . . . depends on the residence of the fiduciary” and provides that if there are two or more
25 fiduciaries, taxable income “*shall be apportioned according to the number of fiduciaries resident in this*
26 *state pursuant to rules and regulations prescribed by the [FTB]. [appellant’s emphasis]*” Appellant
27 argues that, under this provision, 50 percent of its income is taxable by California because it has only
28 two fiduciaries and only one of these fiduciaries is a California resident, citing *McCulloch v. FTB* (1964)

1 61 Cal.2d 186, 191, footnote 5. (App. Op. Br., pp. 4 – 5.)

2 Appellant argues that Regulation 17743 does not apply for two reasons. First, appellant
3 contends, the regulation does not apply by its terms because the regulation states that it applies where
4 “all the beneficiaries are nonresidents[,]” and here the sole beneficiary is a California resident.
5 Appellant further notes that both examples provided by the regulation expressly specify a situation in
6 which all beneficiaries are nonresidents. (App. Op. Br., pp. 5 – 6.)

7 Second, appellant argues, if the FTB contends that the regulation applies even though its
8 beneficiary is not a nonresident, “then the provisions in Reg. 17743 relating to sourcing of income not
9 based on apportionment are invalid because they conflict with express statutory language of
10 Section 17743, the statute it purports to implement.” Appellant contends that, where taxation is based
11 solely on the residence of multiple fiduciaries, the plain language of R&TC section 17743 requires
12 apportionment based on the number and residence of fiduciaries, rather than sourcing on the basis of
13 presence of property in the state, etc., as the regulation provides. Citing Government Code
14 section 11342.2 and *Nortel Networks, Inc. v. SBE* (2011) 191 Cal.App.4th 1259, 1276-78 (*Nortel*),
15 appellant argues that Regulation 17743 is invalid because it conflicts with R&TC section 17743.
16 (App. Op. Br., pp. 6 – 7.)

17 Appellant further contends that the legislative history of R&TC section 17743 confirms
18 its interpretation of the provision. Appellant notes that the predecessor to R&TC section 17743,
19 Section 12(b), expressly provided that the taxable income of a trust included income from sources within
20 the state, as follows:

21 . . .

22 The taxable income of the estate or trust shall include the following:

- 23 (1) The income from real property and tangible personal property located and from
24 business transacted in this State.
25 (2) The income from intangible property with a situs in this State.
26 (3) The income from real property and tangible personal property located outside this
27 State and the income from intangible property with a situs outside this State in the
28 following cases: [Where the beneficiary, the fiduciary, or the settlor are California
residents.]

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1 Where the taxability of income under this section depends on the residence of the
2 fiduciary and there are two more fiduciaries for the estate or trust, the income taxable
3 under this section shall be apportioned according to the number of fiduciaries resident in
4 this State, such apportionment being determined according to rules and regulations
5 prescribed by the commissioner.

6 . . . [App. Op. Br., p. 7 and exhibit E.)

7 Appellant further notes that Section 12 was substantially amended in 1937. Appellant
8 contends that the 1937 amendment “repealed the dual sourcing method” and provided for taxation
9 “based only on the residence of the fiduciary or beneficiary, as is the case today” In support,
10 appellant notes that the revised version of the statute provided in Section 12(c) that:

11 (c) Except as otherwise provided in subsections (d), (g) and (h) of this section, the
12 income of an estate or trust shall be taxable to the estate or trust. The tax shall apply to
13 the entire net income if . . . in the case of both estates and trusts, if the fiduciary or
14 beneficiary is a resident, regardless of the residence of the settlor.

15 Where the taxability of income under this subsection depends on the residence of
16 the fiduciary and there are two or more fiduciaries for the estate or trust, the income
17 taxable under this subsection shall be apportioned according to the number of fiduciaries
18 resident in this State, such apportionment being determined according to rules and
19 regulations prescribed by the commissioner.

20 . . . [App. Op. Br., p. 8.]

21 Appellant argues that, by deleting the provisions relating to California source income, the
22 Legislature adopted a methodology that apportioned income solely on the basis of the residence of
23 fiduciaries or beneficiaries. Appellant further argues that the 1937 amendment shows that the
24 Legislature intentionally “barred taxation based on sourcing income according to the nature of the
25 income earned[.]” and cites *Eu v. Chacon* (1976) 16 Cal.3d 465, 470 for the position that an amendment
26 indicates an intent to change prior law. (App. Op. Br., p. 8.)

27 Respondent’s Opening Brief

28 As background, respondent explains that, under both Federal and California law,
non-grantor trusts are taxable at the trust level on accumulated income. Respondent states that, in
general, trusts receive a deduction for income distributed to beneficiaries with the result that tax paid by
a trust will be a tax on accumulated income. (Resp. Op. Br., p. 4.)

Respondent states that, if all fiduciaries or all “non-contingent beneficiaries of a trust are
California residents, then the trust’s income will be wholly taxable in California[.]” citing R&TC

1 section 17742. Respondent further explains that “[a] contingent beneficiary is one whose interest . . . is
2 subject to a condition precedent, such as the exercise of the sole discretion of the trustee in making trust
3 distributions[,]” citing FTB Technical Advice Memorandum 2006-2. Respondent contends that, here,
4 appellants³ “allege that the only beneficiary of the trust has a contingent interest and accordingly, that
5 the trust will only be taxable based on the proportion of resident and nonresident trustees.” (Resp. Op.
6 Br., pp. 4 – 5.)

7 Respondent contends that: “[a]lthough not explicitly stated in the relevant statutes,
8 California has long treated [rules taxing income based on the proportion of resident trustees as compared
9 to non-resident trustees] as applying only to income that is not from a California source, pursuant to
10 regulations issued by the [FTB] . . . [,]” citing Regulation 17442 and 17743. As a result, respondent
11 contends, a trust is first taxable on its California source income and then next taxable on a portion of its
12 non-California source income that reflects the proportion of California-resident fiduciaries and
13 non-resident fiduciaries.” (Resp. Op. Br., p. 5.)

14 Respondent argues that the Board of Equalization has upheld this “longstanding rule[,]”
15 citing the *Appeal of the First National Bank of Chicago*, 60-SBE-039, decided December 13, 1960.
16 Respondent also argues that this treatment is “consistent with the tax treatment of all other individuals
17 and entities under general principles of California income taxation[,]” citing R&TC sections
18 17041(i)(1)(B) and 17951. (Resp. Op. Br., p. 5.)

19 Respondent contends that the current language of R&TC sections 17742 and 17743
20 derive from language enacted in 1935 and amended in 1937. Respondent notes that, “[p]rior to 1937,
21 taxes were expressly imposed on the California source income of a trust by Section 12”
22 Respondent further notes that taxes were also imposed on non-California source income if a beneficiary,
23 fiduciary, or settlor was a California resident. Respondent argues that then, as now, the statute provided
24 for the apportionment of income in cases of multiple fiduciaries or beneficiaries and further provided
25 that apportionment would be determined according to rules and regulations prescribed by the FTB.
26 (Resp. Op. Br., pp. 5 - 6.)

27
28 ³ Respondent’s references to appellants (plural) are references to the trustees of the Paula Trust.

1 Respondent states that its regulations interpreting Section 12 “remained the same with
2 regard to California source income” both before and after the 1937 amendments and continue in the
3 current regulations.⁴ Respondent states that “[t]here appears to be no record of any explanation for the
4 Legislature’s changes to California’s taxation of trusts in 1937.” Respondent contends that “[a]ppellants
5 erroneously argue that, because the Legislature removed the express reference to California source
6 income, they must have intended to tax trusts solely on an apportionment [basis] that takes into account
7 only the residence of the fiduciaries.” (Resp. Op. Br., p. 6.)

8 Respondent first contends that appellants’ argument is incorrect because “[t]he drafters
9 most likely intended to remove superfluous language with regard to an issue that had become a
10 well-established legal principle by 1937: that states had jurisdiction to tax non-residents on income
11 from a source within the state, including trusts with non-resident fiduciaries[,]” citing in support a 1937
12 law review article by Roger John Traynor (hereinafter referred to as “the Traynor article”).⁵ Respondent
13 argues that “the drafters of the 1937 amendment . . . were likely well aware of the prevailing legal theory
14 on trust taxation and there is no reason to conclude that they determined to depart significantly from this
15 reasonable and well established principle.” (Resp. Op. Br., pp. 6 – 7.)

16 Respondent further contends that the drafters of the 1937 language “can be charged with
17 knowledge” of its 1935 regulations, which were similar to the current regulations in providing that trusts
18 with both resident and non-resident fiduciaries would first be subject to tax on all income from a
19 California source. Respondent concludes that, when the drafters continued to include statutory language
20 giving it broad powers to adopt regulations “[t]his continued grant of quasi-legislative power without an
21 express statement to the contrary amounts to a tacit approval by the Legislature of the existing
22 regulations regarding California source income.” Respondent contends that “most likely the only
23 change intended by the drafters of the 1937 amendment” was to provide that taxation would no longer
24 be taxed based on the residence of the settlor of the trust. (Resp. Op. Br., p. 7.)

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27 ⁴ A copy of the 1935 regulations is attached to respondent’s opening brief as exhibit E, and a copy of the 1937 regulations is
attached to its brief as exhibit F.

28 ⁵ The article is attached as exhibit G to respondent’s opening brief. The FTB cites in particular to pages 272 and 274 of the
article.

1 Respondent contends that “. . . the removal of the reference to California-source income
2 [by the 1937 amendments] did not alter the effect of the statute” Respondent argues that, because
3 both the 1935 statute and the 1937 statute referred only to income taxable “under this section” the
4 apportionment rule in 1935 “appears to have been applicable to all of the income described under
5 Section 12, or all of the taxable income of an estate or trust.” “Accordingly,” respondent asserts, “the
6 removal of the references to California-source income . . . did not change the existing rule with regard to
7 source and apportionment as appellants claim.” Rather, respondent contends, “[i]f anything, the
8 removal of the description . . . of California-source income suggests that the Legislature intended to
9 clarify that the apportionment rule did not apply to California source income.” (Resp. Op. Br., p. 8.)

10 Respondent argues that it acted within its authority when, effective September 17, 1982,
11 it adopted the current regulation pursuant to the California Administrative Procedure Act. Respondent
12 further argues that the regulation was enacted pursuant to a quasi-legislative power granted by the
13 language of R&TC section 17743, citing *Yamaha Corp. of America v. SBE* (1998) 19 Cal.4th 1
14 (*Yamaha*). Citing *Yamaha* at pages seven and ten, respondent contends that quasi-legislative regulations
15 are granted substantial deference and “will bind a court ‘as firmly as the statutes themselves.’”
16 Respondent further contends that a court’s review of a quasi-legislative regulation would be limited to
17 whether the regulation was (1) within the scope of authority conferred and (2) reasonably necessary to
18 effect the purpose of the statute, with the inquiry limited to whether the regulation is “arbitrary,
19 capricious, or without reasonable or rational basis.” (Resp. Op. Br., pp. 8 – 9.)

20 Here, respondent argues, its regulation “clearly falls within the scope of authority
21 conferred” by the statute. Respondent contends that R&TC section 17743 is “both broad and vague”
22 because it refers to, but does not define, “[w]here the taxability of the income under this chapter depends
23 on the residence of the fiduciary.” Also, respondent states, the statute “does not clarify the amount, type
24 or character of income that is to be included in its application.” Respondent states that the statute refers
25 to R&TC section 17742, but R&TC section 17442 does not indicate whether R&TC section 17743 was
26 intended to apply to all taxable income of the trust or some other portion of its income. Respondent
27 argues that, in light of the broadness of the language and the grant to the FTB of quasi-legislative power,
28 the Legislature intended for respondent to have “substantial interpretive power to effectuate the general

1 policy of the law.” (Resp. Op. Br., p. 9.)

2 Respondent contends that the regulation is “necessary to effectuate the purpose of the
3 statute because the statute is ambiguous as to when and how it is likely to apply.” Respondent further
4 contends that “[i]t appears likely that the statute is intended to apply to income that has not already been
5 sourced to a particular state” and that respondent exercised its regulatory power “to tax California source
6 income consistent with the treatment of California-source income for all other individuals and entities.”⁶
7 (Resp. Op. Br., p. 10.)

8 Respondent argues that it has “consistently taxed trusts on California source income since
9 1935” and quotes the *Appeal of Apple Computer, Inc.*, 2006-SBE-002 (*Appeal of Apple Computer, Inc.*),
10 decided November 20, 2006 (which itself cites *Ordlock v. FTB* (2006) 38 Cal.4th 897, 910) in stating
11 that California affords “significant weight and respect to a longstanding statutory construction – whether
12 in the form of a policy or a rule – by the agency charged with the enforcement of the statute.

13 Respondent argues that factors listed by the *Appeal of Apple Computer, Inc.*, as weighing in favor of
14 deference, apply here, including agency expertise in a complex matter, the consistency of its application,
15 and the adoption of a formal regulation. Since its interpretation has been applied for more than 75 years,
16 respondent argues that “the Legislature is presumed aware of this longstanding administrative
17 practice[,]” again citing the *Appeal of Apple Computer, Inc.* (Resp. Op. Br., pp. 10 – 11.)

18 Respondent contends that no statute or constitutional provision confers upon the
19 Board of Equalization the power to invalidate a regulation adopted by the FTB. Respondent further
20 contends that, while the Board is authorized to interpret statutes and regulations and make a
21 determination based on that interpretation, California’s Administrative Procedure Act governs the
22 adoption, amendment, and repeal of regulations and does not authorize the Board of Equalization to
23 invalidate respondent’s regulation. (Resp. Op. Br., p. 11.)

24 Respondent argues that there is no basis for the argument that the Legislature intended to
25 discontinue or limit the practice of taxing California source income earned by a trust. Respondent
26

27 ⁶ As examples of the “well established treatment of California source income,” respondent cites R&TC sections
28 17041(i)(1)(B) and 17951, *Valentino v. FTB* (2001) 87 Cal.App.4th 1284, and *Appeal of Lore Pick*, 85-SBE-066, decided
June 25, 1985.

1 reiterates its view that the Legislature “most likely” excluded language regarding California source
2 income as “superfluous and unnecessary, in light of recent legal developments and the prevailing
3 theories regarding trust taxation” at that time. (Resp. Op. Br., p. 11.)

4 Respondent disputes appellants’ contention that Regulation 17743 does not apply to the
5 Trust because the contingent beneficiary is a California resident. Respondent argues that the language
6 of the regulation precedes the 1963 amendment to R&TC section 17742 that excluded contingent
7 beneficiaries from taxation based on residency. Respondent contends that, because the regulation
8 language predates this statutory amendment, the regulation “describes only the situation where all the
9 beneficiaries are non-residents.” However, respondent argues, “[t]he purpose and intent of [the
10 regulatory language providing for the sourcing of income] is to include all situations where a trust is
11 taxable based on the residence of the fiduciaries and where the residence of the beneficiaries is not
12 relevant to determining the tax of the trust, such as here.” Further, respondent asserts, if a trust with
13 only nonresident beneficiaries is taxable on California source income, “then it follows that a trust with
14 contingent resident beneficiaries should also be taxable” on California source income. (Resp. Op. Br.,
15 p. 12.)

16 Respondent argues that there is no evidence to support appellants’ suggestion that the
17 Legislature “intended to exempt certain trusts (those with multiple fiduciaries residing in and out of
18 California) from tax on California source income.” Respondent contends that this suggestion “not only
19 contradicts general principles of California taxation, but it directly conflicts with other statutory and
20 regulatory provisions of the Revenue & Taxation Code, such as [R&TC] sections 17041 and 17951,
21 which impose tax [on California source income of nonresidents].” On this basis, respondent argues
22 that “[e]ven if the Regulation were somehow found inapplicable to appellants, the Trust would still be
23 taxable on all of its [California-source income].” (Resp. Op. Br., p. 13.)

24 Respondent argues that not taxing Paula Trust on its California-source income would lead
25 to absurd results. Respondent further contends that such an approach would conflict with the principle
26 that, while trust structures may be complicated, such complication should not hinder the ability of the
27 state to tax income that could be taxed in the absence of the trust, citing *McCulloch v. FTB* (1964)
28 61 Cal.2d 186 at page 197, footnote 9 (which in turn cites the Traynor article previously cited by

1 respondent). (Resp. Op. Br., p. 13.)

2 Respondent argues that appellants' approach would exempt beneficiaries from
3 recognizing California-source income "because the trust had already paid California income tax and
4 beneficiaries are not subject to an additional layer of tax upon distribution." Respondent contends that
5 this result would treat a trust with contingent beneficiaries and multiple fiduciaries residing in and out of
6 California, such as Paula Trust, more favorably than a trust or estate with all nonresident fiduciaries and
7 beneficiaries, which would have even less connection to California than Paula Trust. Respondent notes
8 that R&TC section 17734 and Regulation 17951-1(c) both expressly provide that nonresident
9 beneficiaries must pay tax on trust income from a California source. Respondent also notes that
10 Regulation 17742, subdivision (a), provides that a trust with nonresident fiduciaries and beneficiaries
11 "must still pay tax on California source income." (Resp. Op. Br., p. 14.)

12 Discussing the *Appeal of Marilyn Monroe*, 75-SBE-032, April 22, 1975, respondent
13 argues that the Board of Equalization has "long found that an estate of a nonresident decedent is still
14 taxable . . . on its California source income, even when none of the beneficiaries of the estate reside in
15 California." Respondent notes that the Board, in that appeal, taxed an estate on California-source
16 income that would have been taxable if received by an individual. (Resp. Op. Br., pp. 14 – 15.)

17 Respondent contends that ". . . California taxes the California source income of all other
18 individuals, partners, members of an LLC, corporations and businesses." Respondent further contends
19 that treating trusts with multiple fiduciaries residing in and out of California differently would result in
20 "substantial injustice." Respondent argues that appellants' interpretation would provide "ample
21 opportunity for abuse" by allowing trusts to avoid taxation of California source income simply by
22 establishing a trust with trustees residing outside of the state and including language that distributions
23 are subject to the discretion of the trustee. (Resp. Op. Br., p. 15.)

24 Appellant's Reply Brief

25 Appellant argues that the R&TC section 17743 plainly and unambiguously provides that
26 "income taxable under Section 17742 shall be apportioned according to the number of fiduciaries in this
27 state." Appellant contends that it followed the statute by apportioning one-half of its income to
28 California and that respondent's Regulation 17743 conflicts with and "improperly expands" R&TC

1 section 17743 by first taxing California source income and then apportioning remaining non-California
2 source income based on the residence of fiduciaries. (App. Reply Br., p. 2.)

3 Appellant argues that the FTB erroneously asserts that the Legislature “did not really
4 mean what it said in Section 17743.” Appellant contends that the statute is “clear and unambiguous”
5 and that “there is no legislative history that supports the FTB’s conflicting interpretation.” Appellant
6 further contends that quasi-legislative regulations “cannot expand the scope of the relevant statute and
7 are entitled to no deference by a court or this Board.” (App. Reply Br., pp. 2 – 3.)

8 Appellant argues that the words of the statute are the best evidence of legislative intent
9 and that, “when a statute is ‘clear and unambiguous there is no need for construction[,]” quoting *In re*
10 *Lance W.* (1987) 37 Cal.3d 873, 886 and citing *Murphy v. Kenneth Cole Productions, Inc.* (2007)
11 40 Cal.4th 1094, 1103, and other cases. Appellant contends that R&TC section 17743 is clear, stating
12 that “the income taxable under Section 17742 shall be apportioned according to the number of
13 fiduciaries resident in this state.” Appellant notes that, by its terms, R&TC section 17742 applies to “the
14 entire taxable income of a trust.” Thus, appellant argues, the entire taxable income of the trust,
15 including California source income, “is apportioned according to the number of fiduciaries resident in
16 the state.” (App. Reply Br., pp. 3 – 4.)

17 Appellant argues that its interpretation is confirmed by the fact that, in 1937, the
18 Legislature deleted language in the statute that sourced the income of trusts based on property or
19 business activity in the state. Appellant further argues that, by deleting the language, “the Legislature
20 clearly communicated its intent to change the sourcing rules that were enacted in 1935.” Appellant
21 provides quotes from several cases and authorities, including *United States v. American Trucking*
22 *Association* (1940) 310 U.S. 534, 543 and *Ennabe v. Manosa* (2014) 58 Cal.4th 697, 714-715 (*Ennabe*),
23 which state that the words of a statute best express legislative intent and that, when the Legislature
24 changes a statute, it can be presumed it intended to change the law. (App. Reply Br., pp. 4 – 5.)

25 Appellant contends that the FTB wrongly argues, on page 5 of its opening brief, that the
26 income referred to and apportioned in R&TC section 17743 is only non-California source income.
27 Appellant asserts that this argument is incorrect for two reasons. First, appellant argues, the argument is
28 incorrect because, quoting from the FTB’s brief, the limitation is “not explicitly stated in the relevant

1 statutes.” Appellant argues that a court or a quasi-judicial body such as the Board of Equalization “may
2 not add to or alter [terms of a statute] to accomplish a purpose that does not appear on the face of the
3 statute or from its legislative history[.]” quoting *Ennabe, supra*, 58 Cal.4th at 719. Here, appellant
4 argues, the FTB’s interpretation does not appear in the statute and, as FTB admits, there is no legislative
5 history, other than the 1937 amendments. Second, appellant contends, “the FTB’s interpretation would
6 require a separate statute authorizing taxation of trust income with contingent beneficiaries based on
7 income from the property or business activity in the state.” Appellant argues that “[t]here is no such
8 statutory authority.” (App. Reply Br., pp. 5 – 6.)

9 Appellant further contends that, even if R&TC section 17743 were ambiguous,
10 appellant’s statutory interpretation is correct under principles of statutory construction. First, appellant
11 argues that “the FTB’s interpretation must be rejected because a tax imposition statute must be strictly
12 construed in favor of the taxpayer and against the FTB[.]” citing *Whitmore v. Brown* (1929)
13 207 Cal. 473, 482-483 (*Whitmore*). Second, appellant argues that “the FTB’s interpretation must be
14 rejected because it would render the tax facially unconstitutional, and statutes must be construed to
15 preserve constitutionality[.]” citing *People v. Roder* (1983) 33 Cal.3d 491, 505. Appellant provides the
16 following quotation from *Container Corp. of America v. FTB* (1983) 463 U.S. 159, 164: “[u]nder both
17 the Due Process and the Commerce Clauses of the Constitution, a state may not, when imposing an
18 income-based tax, ‘tax value earned outside its borders.’ [internal citation omitted]” Appellant argues
19 that the FTB cannot constitutionally first tax based on property and business activity in the state and
20 then apply a second method to the non-California source income, which, appellants contend, “has
21 already been identified as income outside the constitutional reach of the state.” Appellant asserts that
22 “[b]y definition, the income to which the FTB would apply the second apportionment method is
23 non-taxable, extraterritorial income.” Appellant further asserts that applying the two methods
24 sequentially violates the Constitution and that the Legislature could have eliminated either method “[t]o
25 restore the constitutionality of the original version of Section 17743 in 1937[.]” Appellant argues that
26 the Legislature chose to eliminate the sourcing method, “and the FTB is bound by the Legislature’s
27 choice.” (App. Reply Br., pp. 6 – 7.)

28 Appellant further contends that Regulation 17743 is invalid to the extent it is inconsistent

1 with R&TC section 17743. Appellant quotes Government Code section 11342.2, which provides that no
2 regulation is valid “unless consistent and not in conflict with the statute and reasonably necessary to
3 effectuate the purposes of the statute.” Appellant further quotes several cases and authorities to the
4 same effect, including *Nortel, supra*, 191 Cal.App.4th at 1276-78 (stating that an agency may not
5 promulgate a regulation that is inconsistent with the statute or alters it), and *Association for*
6 *Retarded Citizens v. Department of Developmental Services* (1985) 38 Cal.3d 384, 391 (*Assoc. for*
7 *Retarded Citizens*). (App. Reply Br., p. 8.)

8 Appellant argues that Regulation 17743 conflicts with R&TC section 17743 because “the
9 regulation applies income sourcing methods that are not present in the statute.” Appellant contends that
10 the statute only authorizes apportionment based on the number of fiduciaries, while Regulation 17743
11 “adds a second and entirely different sourcing or apportionment method” that is based on whether the
12 income is from business carried on in the state or property located or having a situs in the state.

13 Appellant further contends that Regulation 17743 “adds back the provision making taxable income from
14 property and business in the state, treating the 1937 amendment as though it never occurred”

15 Appellant argues that, while the statute grants authority to the FTB to make rules, the statutory language
16 only authorizes rules “related to implementing the apportionment of trust income according to the
17 residence of fiduciaries.” (App. Reply Br., pp. 9 – 10.)

18 Moreover, appellant contends, the relevant portions of Regulation 17743 “were not even
19 promulgated under the current Section 17743.” Appellant argues that the FTB “never went through the
20 process of interpreting the sourcing rules in current Section 17743, and drafting a regulation to carry
21 [out] the authority granted under Section 17743 relating to regulations.” (App. Reply Br., p. 10.)

22 Quoting from the FTB’s brief, appellant contends that the FTB is incorrect to argue that
23 the Legislature granted it “substantial interpretive power to effectuate the general policy of law.”

24 Appellant further contends that a grant of quasi-legislative authority does not provide authority to
25 promulgate a regulation that expands on the scope of a regulation, citing *Colmenares v.*

26 *Braemer Country Club, Inc.* (2003) 29 Cal.4th 1019, 1029. Appellant argues that a court, or, in this
27 case, the Board, “exercises its own independent judgment to evaluate the propriety of the regulation[,]”
28 citing *Aguilar v. Superior Court* (2009) 170 Cal.App.4th 313, 323 and *Assoc. for Retarded Citizens*,

1 *supra*, 38 Cal.3d at 391. (App. Reply Br., pp. 10 – 11.)

2 Appellant further contends that the Board “has already considered and rejected the
3 argument that it lacks authority to invalidate a regulation promulgated by the FTB[,]” citing the *Appeal*
4 *of Standard Oil Co. of California*, 1983-SBE-068, 1983 Cal. Tax LEXIS 223, decided March 3, 1983,
5 and the *Appeal of Save Mart Supermarkets*, 2002-SBE-002, 2002 Cal. Tax LEXIS 80, decided
6 February 6, 2002. (App. Reply Br., p. 11.)

7 Appellant notes that the FTB stated it could find no legislative history or explanation for
8 the Legislature’s 1937 amendments to R&TC section 17743. Appellant disputes the FTB’s argument
9 that the sourcing rules were removed because California source income was not subject to
10 apportionment. Appellant argues that, if this were the case, there would have to be some other statute
11 authorizing the taxation of California source income “after the provision for doing so was deleted from
12 Section 17743.” Appellant contends that “no such statute exists” and that the FTB is attempting to apply
13 a sourcing provision that was deleted. (App. Reply Br., pp. 12 – 13.)

14 Appellant argues that a “more compelling explanation for the 1937 amendment” is that
15 the 1935 version of R&TC section 17743 was unconstitutional because it applied “two sequential
16 methods of sourcing/apportionment” Appellant argues that the Traynor article cited by the FTB
17 supports this interpretation because it reports that there was “much uncertainty” with regard to
18 jurisdictional issues regarding the taxation of nonresidents on source income while also taxing residents
19 on income from activities in other states. (App. Reply Br., p. 13.)

20 Appellant dismisses the FTB’s argument that the drafters of the 1937 amendment “tacitly
21 approved” its regulation. Appellant argues that, even if the Legislature can be assumed to have
22 knowledge of the regulation when it enacted the 1937 amendment, “such knowledge establishes that the
23 Legislature disapproved of the California sourcing rules in the regulation because it deleted those rules
24 from the statute.” Citing *Nortel*, in which a regulation that had been in effect for seven years was
25 invalidated, appellant argues that “[e]ven a long-standing regulation is void if inconsistent with the
26 statute.” (App. Reply Br., pp. 14 – 15.)

27 Appellant disputes the FTB’s contention that appellant’s interpretation of R&TC
28 section 17743 would produce “absurd results.” First, appellant contests the FTB’s argument that its

1 that California has the right to tax trusts on California source income[,]” citing *Schaffer v. Carter* (1919)
2 252 U.S. 37 and the Traynor article. Respondent further contends that a state may tax all income,
3 including income from extraterritorial sources, of residents, citing *Lawrence v. State Tax Commission*
4 (1932) 286 U.S. 276 and *Guaranty Trust Co. v. Virginia* (1938) 305 U.S. 19. (Resp. Reply Br.,
5 pp. 1 - 2.)

6 Respondent further contends that “[t]here is no authority for appellants’ argument that a
7 state must choose between taxing only income produced within its borders or a portion of the intangible
8 income of a trust with a California trustee” Respondent argues that it is incorrect to argue that
9 intangible income is “non-taxable extraterritorial income.” Respondent contends that “none of the
10 authority cited by appellants supports their argument that taxing both income earned inside
11 [California’s] borders, as well as a proportion of other income bearing to the number of California
12 resident trustees, violates Due Process and the Commerce Clause.” With regard to appellants’ quotation
13 from *Container Corp., supra*, that a state may not tax value earned outside its borders, respondent argues
14 that appellants “conveniently ignore” the court went on to state that allocating value is an “elusive goal”
15 and therefore the Constitution “imposes no single formula on the States” and “the taxpayer has the
16 ‘distinct burden of showing by clear and cogent evidence’ that [the state tax] results in extraterritorial
17 values being taxed.” Respondent contends that appellants have failed to meet that burden. (Resp.
18 Reply Br., pp. 2 – 3.)

19 Respondent reiterates that R&TC section 17743 is vague and ambiguous as, among other
20 things, it does not clarify how much income is to be allocated to each resident fiduciary. Respondent
21 argues that the statute’s “reference to ‘the income taxable under Section 17742’ appears to reference
22 indirectly the ‘entire taxable income of a trust’ reflected in Section 17742, however the language of
23 Section 17743 fails to specify how this income should be apportioned” Respondent further argues
24 that, in light of the vague statutory language, and the broad grant of rule-making authority, the FTB
25 acted within the scope of its authority. (Resp. Reply Br., p. 4.)

26 With regard to appellants’ argument that a tax imposition statute must be strictly
27 construed in favor of the taxpayer, respondent notes the case cited by appellants, *Whitmore, supra*, states
28 that a “statute will not be held to have imposed a tax unless it is clear and explicit.” (*Whitmore, supra*,

1 207 Cal. at 483.) Respondent argues that the decision does not support appellants’ position because it is
2 uncontested “that R&TC section 17743 imposes a tax on appellants[,]” and the only issue presented “is
3 whether the implementation of that tax as directed by the associated regulation is correct.” (Resp. Reply
4 Br., p. 4.)

5 Respondent reiterates that Regulation 17743 is consistent with R&TC section 17743.
6 With regard to appellants’ argument that it did not go through the process of interpreting the statute,
7 respondent argues that the regulation was promulgated appropriately and the fact that the language
8 remained similar to prior versions of the regulation “is a reflection only of the fact that the law in this
9 area has not changed as appellants contend.” (Resp. Reply Br., p. 5.)

10 Respondent disputes appellants’ contention that R&TC section 17745 (which provides
11 for the taxation of beneficiaries on amounts not previously taxed) eliminates any windfall. Respondent
12 argues that, if R&TC section 17745 was “California’s only means to tax trust income earned from a
13 California source for trusts with multiple trustees residing in and out of California, beneficiaries would
14 receive the significant benefits of tax deferral and potential income shifting to lower tax rates.” (Resp.
15 Reply Br., pp. 5 – 6.)

16 Respondent contends that other trusts would be treated disparately creating a “windfall”
17 for some trust beneficiaries and “potentially impermissible constitutional violations.” Respondent
18 argues that “a trust with one California resident trustee that sold California real property and
19 accumulated the income would have to pay California income tax on the gain from that sale in the
20 current year at rates applicable to trusts.” Similarly, respondent argues, “pursuant to Section 17742 and
21 the regulation thereunder, which is not being challenged in this appeal, a trust with only out of state
22 trustees and beneficiaries would also have to pay California income tax on the very same income in the
23 year that it was earned.” (Resp. Reply Br., p. 6.)

24 Appellant’s Supplemental Brief

25 With regard to respondent’s argument that the Board may not determine whether
26 respondent’s method of taxing trusts is constitutional, appellant notes that section 3.5 of Article III of the
27 California Constitution limits the power of an agency “to declare a *statute* unconstitutional [appellant’s
28 emphasis].” Appellant contends that it is not arguing that the statute is unconstitutional; instead, it is

1 arguing “that the statute must be applied as written” and that respondent’s “*regulation*, if upheld, would
2 unconstitutionally tax extraterritorial trust income . . . [appellant’s emphasis]” Appellant argues that
3 the cases cited by the FTB regarding California’s jurisdiction to tax are irrelevant because the issue on
4 appeal “is not whether California has jurisdiction to tax Appellant but how much of Appellant’s income
5 it may tax.” (App. Supp. Br., p. 1.)

6 Appellant reiterates that the language of R&TC section 17743 is not ambiguous on the
7 ground that the statute “plainly states” that “the income taxable under Section 17742 shall be
8 apportioned according to the number of fiduciaries in the state.” Appellant cites in support *Lennane v.*
9 *FTB* (1994) 9 Cal.4th 263, 268, noting that the court in *Lennane* stated “Where the statute is clear, courts
10 will not interpret away clear language in favor of an ambiguity that does not exist.” Appellant contends
11 that, even if the statute were ambiguous, “FTB would be empowered at most to address that particular
12 ambiguity [cited by FTB], namely what it means to apportion according to the number of fiduciaries
13 resident in the state[,]” rather than adding “entirely new sourcing rules.” Appellant further contends that
14 respondent cannot avoid the rule that tax statutes should be strictly construed by “merely conceding that
15 the statute imposes a tax.” (App. Supp. Br., pp. 2 – 3.)

16 Appellant argues that the FTB’s reply brief offered “no new argument or evidence” to
17 support the FTB’s position that Regulation 17743 is not inconsistent with the statute. With regard to
18 whether Regulation 17743 was properly issued, appellant argues that the FTB “does not reconcile the
19 fact that the 1937 Act deleted from the statute the sourcing rules relied upon by the FTB”
20 (App. Supp. Br., p. 3.)

21 Appellant contends that “there is no windfall” when taxpayers “simply follow the express
22 terms of the statute, and . . . even if there was a windfall, only the Legislature can amend the statute to
23 avoid the alleged windfall.” Appellant further contends that the two windfalls identified by the FTB,
24 deferral of tax and a beneficiary paying lower rates than the trust would have paid, “apply to any

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1 complex trust⁷ with a California beneficiary and income from non-California sources.” Appellant
2 reiterates that R&TC section 17745 (regarding the taxation of beneficiaries) addresses any potential
3 windfall. (App. Supp. Br., p. 4.)

4 Appellant disputes the FTB’s assertion that similarly-situated taxpayers would be treated
5 differently. Appellant argues that both examples cited by the FTB do not involve similarly-situated
6 taxpayers. First, appellant contends that a trust with one trustee who is a California resident is not
7 similarly situated to appellant, “which has one California trustee and one non-California trustee.”
8 Appellant notes that such a trust would be taxed on all of its income pursuant to R&TC section 17742.
9 Second, appellant contends that a trust with no California trustees or beneficiaries is not similarly
10 situated to appellant. Appellant further argues that the Board should disregard respondent’s argument
11 that disparate treatment might create constitutional violations on the ground that the FTB did not
12 “explain or cite any cases to support [its] claim.” (App. Supp. Br., pp. 4 – 5.)

13 Applicable Law

14 General Trust Taxation Rules

15 In general, nongrantor trusts are subject to income tax. (See Int.Rev. Code, § 641; Rev.
16 & Tax. Code, §§ 17731 & 17742.) As set forth below, the portion of trust income taxable in California
17 depends upon whether beneficiaries and/or fiduciaries reside in California and, under respondent’s
18 regulations, on whether the income is California source income. It should be noted that the bullet points
19 below summarize the state of the law as it is interpreted and reflected in the FTB’s regulations.⁸

- 20 • If all of the trust’s fiduciaries are California residents, then all trust income is taxable in
21 California without regard to income source or the residence of the settlor. (Rev. & Tax.
22 Code, § 17742, subd. (a).)
- 23 • If all *noncontingent* beneficiaries are California residents, then all trust income is taxable in
24 California without regard to income source or the residence of the settlor. (Rev. & Tax.

26 ⁷ Generally, a trust may be a “simple trust” if, among other things, it requires that all income be distributed currently. A
27 “complex trust” is a trust that does not qualify as a simple trust. (See
28 <http://www.irs.gov/instructions/i1041/ch02.html#d0e2658>.)

⁸ Appellant contests in this appeal whether respondent has statutory authority to impose taxation based on the source of income, at least in certain circumstances.

1 Code, § 17742, subd. (a).)

- 2 • If all fiduciaries and all noncontingent beneficiaries are not residents of California, then trust
3 income is taxable in California only to the extent that it is derived from a California source.
4 (Cal. Code Regs., tit. 18, § 17742, subd. (a).)
- 5 • If all beneficiaries are nonresidents, and some fiduciaries are California residents while
6 others are nonresidents, the trust is taxed on all California-source income plus a proportionate
7 share of non-California-source income based on the ratio of resident to nonresident
8 fiduciaries. (Rev. & Tax. Code, § 17743; Cal. Code Regs., tit. 18, § 17743.)
- 9 • If all fiduciaries are nonresidents, and some beneficiaries are California residents while
10 others are nonresidents, the trust is taxed on all California-source income plus a proportionate
11 share of non-California-source income based on the ratio of resident to nonresident
12 beneficiaries. (Rev. & Tax. Code, § 17744; Cal. Code Regs., tit. 18, § 17744.)
- 13 • A similar apportionment rule applies where the trust has some California-resident
14 beneficiaries and some nonresident beneficiaries. (Rev. & Tax. Code, § 17744; Cal. Code
15 Regs., tit. 18, § 17744.)

16 Relevant Statutes and Regulations

17 The following are the key statutes and regulations discussed by the parties:

18 *R&TC Section 17742.* (a) Except as otherwise provided in this chapter, the income of an
19 estate or trust is taxable to the estate or trust. The tax applies to the entire taxable income
20 of an estate, if the decedent was a resident, regardless of the residence of the fiduciary or
21 beneficiary, and to the entire taxable income of a trust, if the fiduciary or beneficiary
(other than a beneficiary whose interest in such trust is contingent) is a resident,
22 regardless of the residence of the settlor.

(b)

23 *Regulation 17742. Taxability of Estates.*

24 (a) . . . in the case of a trust, if the fiduciaries and noncontingent beneficiaries are all
25 nonresidents of this State, only income from real or personal property located in this State
26 (see Reg. 17951-3), business carried on within this State (see Reg. 17951-4), and
27 intangible personal property having a business or taxable situs in this State (see
28 Section 17952) is taxable.

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1 In computing the taxable income from these sources, only the gross income from these
2 sources is considered. From such gross income, the deductions allowed by the law are
3 subtracted. See Sections 17301-17303 and Section 17734. The amount remaining is
4 taxable income of the estate or trust to which the rates of tax specified in Section 17041
5 apply.

6 EXAMPLE. B is the executor of the estate of A, who was a nonresident of this State at
7 the time of death. All the beneficiaries are likewise nonresidents. During the year 1980,
8 the gross income of the estate from all sources amounted to \$100,000, \$50,000 of which
9 was derived from real and personal property located, and from business transacted, in this
10 State. The losses, depreciation, and depletion sustained with respect to the property in
11 California, and the taxes, licenses, expenses, bad debts, etc., properly deductible from the
12 California income amounted to \$40,000. Thus, the income from California sources, prior
13 to deducting amounts distributed to beneficiaries, amounted to \$10,000. Of this amount,
14 \$6,000 was distributed to beneficiaries during the year pursuant to a partial distribution of
15 the estate. The remaining \$4,000 is the net income of the estate, as defined in
16 Section 18411.

17 (b) A noncontingent beneficiary is one whose interest is not subject to a condition
18 precedent.

19 (c) . . .

20 *R&TC section 17743.* Where the taxability of income under this chapter depends on the
21 residence of the fiduciary and there are two or more fiduciaries for the trust, the income
22 taxable under Section 17742 shall be apportioned according to the number of fiduciaries
23 resident in this state pursuant to rules and regulations prescribed by the Franchise Tax
24 Board.

25 *Regulation 17743. Taxability of Trust Dependent upon Residence of Fiduciary.*

26 If there are two or more fiduciaries of a trust, and one or more are residents and one or
27 more are nonresidents, and all the beneficiaries are nonresidents, the trust is taxable upon
28 (a) all net income (less the deductions allowed under Article 1 of Chapter 9
(Section 17731 and following)) from business carried on within this State, from real or
tangible personal property located in this State, and from intangible personal property
having a business or taxable situs in this State (see Reg. 17952); and (b) that proportion
of the net income (less the deductions allowed under Article 1 of Chapter 9
(Section 17731 and following)) from all other sources which the number of fiduciaries
who are residents of this State bears to the total number of fiduciaries.

EXAMPLE (1). B, a resident, and C, a nonresident of this State, are the trustees of a trust
created by A. All the beneficiaries are nonresidents. During the year 1980, the trust
received \$60,000 as rent from real and tangible personal property located in, and from
business carried on in this State, from which expenses of \$10,000 were deducted,
\$60,000 from real and personal property located, and business carried on, outside this
State from which expenses of \$10,000 were deducted, and \$50,200 income from stocks

1 and bonds, none of which had a business or taxable situs in this State. None of the
2 income was paid or credited to the beneficiaries during the year. The \$50,000 income
3 from real and personal property located in, and business transacted in this State is taxable.
4 Since there are two fiduciaries, one of which is a resident of this State, one-half of the
5 balance of the income of the trust is likewise taxable to the trust. Thus, the taxable
6 income amounts to \$100,100 (\$50,000 from property located in this State, plus one-half
7 of \$100,200 which is the remainder of the trust's income).

8 EXAMPLE (2). E, a resident, and F and G, nonresidents of this State, are the trustees of
9 a trust created by D. All of the beneficiaries are nonresidents. The corpus of the trust
10 consists entirely of stocks and bonds and property located outside this State. One-third of
11 the income taxable under Section 17742 (i.e., net income less the deductions allowed
12 under Article 1 of Chapter 9), which is the proportion of total income taxable which the
13 number of fiduciaries who are residents of this State bears to the total number of
14 fiduciaries, is taxable to the trust.

11 Statutory Interpretation

12 The goal of statutory construction is to determine legislative intent, and the first step in
13 doing so is to look to the words of the statute. (*Ordlock, supra*, 38 Cal.4th at pp. 909 – 910; *Lennane v.*
14 *FTB, supra*, 9 Cal.4th 263, 268; *Lungren v. Deukmejian* (1988) 45 Cal.3d 727, 737.) The words of the
15 statute are given their ordinary meaning but considered in the context of the relevant statutory scheme.
16 (*Ordlock, supra*, 38 Cal.4th at pp. 909-910 [citing *Lungren, supra*, at p. 735].) “If the statutory language
17 is clear and unambiguous, then we need go no further.” (*Hoechst Celanese Corp. v. FTB* (2001)
18 25 Cal.4th 508, 557 [citing *Lungren, supra*, at p. 735]; see also *Lennane, supra*, 9 Cal.4th at p. 268.) In
19 determining a statute's meaning, “. . . courts should, if possible, accord meaning to every word and
20 phrase in a statute so as to better effectuate the Legislature's intent.” (*Ste. Marie v. Riverside County*
21 *Regional Park & Open-Space District* (2009) 46 Cal.4th 282, 289 (*Ste. Marie*).) “As a general
22 proposition the courts have held that ‘the very fact that the prior act is amended demonstrates the intent
23 to change the pre-existing law’ [citations omitted]” (*Eu v. Chacon, supra*, 16 Cal.3d 465, 470.)

24 While an agency's construction of a statute is reviewed independently, “significant
25 weight” is given to long-standing agency constructions of a statute. (*Hoechst Celanese Corp. v. FTB*
26 (2001) 25 Cal.4th 508, 557 [citing *Agnew v. State Bd. of Equalization* (1999) 21 Cal.4th 310, 322 and
27 other cases]; see also *Ste. Marie, supra*, 46 Cal.4th at pp. 292 – 293.) In *St. Marie*, the California
28 Supreme Court explained that “‘When an administrative interpretation is of long standing and has

1 remained uniform, it is likely that numerous transactions have been entered into in reliance thereon, and
2 it could be invalidated only at the cost of major readjustments and extensive litigation.” (*St. Marie*,
3 *supra*, at p. 293 [quoting *Whitcomb Hotel Inc. v. Cal. Emp. Com.* (1944) 24 Cal.2d 753, 757].)

4 In *Lungren v. Deukmejian* (1988) 45 Cal.3d 727, at page 737, the California
5 Supreme Court explained as follows:

6 Words used in a statute or constitutional provision should be given the meaning
7 they bear in ordinary use. (*In re Rojas* (1979) 23 Cal.3d 152, 155; [additional citation
8 omitted].) If the language is clear and unambiguous there is no need for construction, nor
9 is it necessary to resort to indicia of the intent of the Legislature (*In re Lance W.*
10 *(1985) 37 Cal.3d 873, 886; State Board of Education v. Levit* (1959) 52 Cal.2d 441, 462.)

11 But the “plain meaning” rule does not prohibit a court from determining whether
12 the literal meaning of a statute comports with its purpose or whether such a construction
13 of one provision is consistent with other provisions of the statute. The meaning of a
14 statute may not be determined from a single word or sentence; the words must be
15 construed in context, and provisions relating to the same subject matter must be
16 harmonized to the extent possible. (*Dyna-Med, Inc. v. Fair Employment & Housing*
17 *Com.* (1987) 43 Cal.3d 1379, 1386-1387.) Literal construction should not prevail if it is
18 contrary to the legislative intent apparent in the statute. The intent prevails over the
19 letter, and the letter will, if possible, be so read as to conform to the spirit of the act.
20 (*People v. Belton* (1979) 23 Cal.3d 516, 526; [additional citation omitted].) An
21 interpretation that renders related provisions nugatory must be avoided (*People v. Craft*
22 (1986) 41 Cal.3d 554, 561); each sentence must be read not in isolation but in the light of
23 the statutory scheme (*In re Catalano* (1981) 29 Cal.3d 1, 10-11); and if a statute is
24 amenable to two alternative interpretations, the one that leads to the more reasonable
25 result will be followed (*Metropolitan Water Dist. v. Adams* (1948) 32 Cal.2d 620,
26 630-631).

27 Review of Agency Regulations

28 In *Yamaha, supra*, 19 Cal.4th at pages 10 to 13, the California Supreme Court explained
as follows:

. . . [Q]uasi-legislative rules--represents an authentic form of substantive lawmaking:
Within its jurisdiction, the agency has been delegated the Legislature’s lawmaking
power. [citations omitted] Because agencies granted such substantive rulemaking power
are truly “making law,” their quasi-legislative rules have the dignity of statutes. When a
court assesses the validity of such rules, the scope of its review is narrow. If satisfied that
the rule in question lay within the lawmaking authority delegated by the Legislature, and
that it is reasonably necessary to implement the purpose of the statute, judicial review is
at an end.

1 We summarized this characteristic of quasi-legislative rules in *Wallace Berrie &*
2 *Co. v. State Bd. of Equalization* (1985) 40 Cal.3d 60, 65 “[I]n reviewing the legality
3 of a regulation adopted pursuant to a delegation of legislative power, the judicial function
4 is limited to determining whether the regulation (1) is “within the scope of the authority
5 conferred” [citation omitted] and (2) is “reasonably necessary to effectuate the purpose of
6 the statute” [citation omitted].’ [citation omitted] ‘These issues do not present a matter
7 for the independent judgment of an appellate tribunal; rather, both come to this court
8 freighted with [a] strong presumption of regularity’ [citation omitted] Our inquiry
9 necessarily is confined to the question whether the classification is ‘arbitrary, capricious
10 or [without] reasonable or rational basis.’ (*Culligan, supra*, 17 Cal.3d at p. 93, fn. 4
11 [additional citations omitted].)”

12 [Footnote 4] In one respect, our opinion in *Wallace Berrie* may overstate the level of
13 deference--even quasi-legislative rules are reviewed independently for consistency with
14 controlling law. A court does not, in other words, defer to an agency’s view when
15 deciding whether a regulation lies within the scope of the authority delegated by the
16 Legislature. The court, not the agency, has “final responsibility for the interpretation of
17 the law” under which the regulation was issued. (*Whitcomb Hotel, Inc. v.*
18 *Cal. Emp. Com.* (1944) 24 Cal.2d 753, 757; [additional citations omitted].)

19 STAFF COMMENTS

20 It appears to staff that the first issue is whether Regulation 17743 applies to appellant. If
21 the Board finds that the regulation does not apply to appellant, it would not need to reach the subsequent
22 issue of whether the application of the regulation to the facts of this appeal would exceed the statutory
23 authority granted by R&TC section 17743.

24 As background, R&TC section 17742 provides that trusts with a California beneficiary,
25 other than a contingent beneficiary, are subject to California income tax on their entire taxable income.
26 Appellant argues that R&TC section 17742 does not apply because its beneficiary is contingent. Unlike
27 R&TC section 17742 and Regulation 17742, Regulation 17743 does not distinguish between contingent
28 and noncontingent beneficiaries. Regulation 17743 states that it applies where there are multiple
fiduciaries, including both resident and nonresident fiduciaries, and “all the beneficiaries are
nonresidents.” Appellant therefore contends that, because its only beneficiary is a California resident, it
is not covered by Regulation 17743. Respondent argues that the regulation should apply on the ground
that the purpose of the regulation is to cover situations where taxation depends on the residence of the
fiduciaries (such as where all beneficiaries are nonresidents or the only California beneficiary is a
contingent beneficiary).

1 As a threshold matter, staff notes that, while respondent’s argument appears to accept that
2 appellant’s sole beneficiary is a contingent beneficiary, respondent has not expressly confirmed whether
3 it agrees that appellant’s only beneficiary is contingent. For example, on pages four to five of its
4 opening brief, respondent states that appellant “allege[s] that the only beneficiary of the trust has a
5 contingent interest” At the hearing, respondent should be prepared to confirm whether it agrees
6 that appellant’s beneficiary is contingent and to discuss further its position that Regulation 17743 should
7 apply to appellant based on the purpose of the regulation.⁹

8 If the Board determines that Regulation 17743 applies to appellant, the next issue would
9 be whether the application of the regulation to appellant would exceed the statutory authority granted by
10 R&TC section 17743. Respondent will want to demonstrate that its interpretation of R&TC
11 section 17743 is consistent with the plain language of the statute when considered in the context of the
12 overall statutory scheme. As noted above, when construing statutes, courts strive to give meaning and
13 effect to every word in the statute. (See, e.g., *Ste. Marie, supra*, 46 Cal.4th at p. 289.) Respondent
14 should be prepared to address the purpose and effect of the phrase “according to the number of
15 fiduciaries resident in this state[,]” which is used in the statute in the following context: “. . . the income
16 taxable under Section 17742 shall be apportioned *according to the number of fiduciaries resident in this*
17 *state* pursuant to rules and regulations prescribed by the [FTB].” Here, appellant has one resident
18 fiduciary and one nonresident fiduciary, and respondent has determined that all of appellant’s income is
19 taxable on the ground that the income arises from a California source. Respondent should be prepared
20 to explain how its application of the statute to the facts here apportions taxable income “according to the
21 number of [resident] fiduciaries.”

22 Respondent should also be prepared to discuss further the 1937 amendment to a
23 predecessor of R&TC section 17743 (Section 12). The statute originally applied a methodology in
24 which all California source income was taxed and only non-California source income was apportioned
25 based on the residence of fiduciaries. Respondent’s original regulation followed that methodology. In
26 1937, the Legislature amended the statute to remove the language that provided for the taxation of
27

28 ⁹ Staff notes that, according to the Franchise Tax Board’s Technical Advice Memorandum 2006-2, “[a] resident beneficiary whose interest in a trust is subject to the sole and absolute discretion of the trustee holds a contingent interest in the trust.”

1 California source income, but respondent's regulation continued to apply (and continues to apply) a
2 methodology that first taxes all California source income before then apportioning non-California source
3 income on the basis of the number of resident fiduciaries.¹⁰

4 Appellant will want to address the fact that respondent has consistently applied its
5 interpretation of R&TC section 17743 for more than 75 years, and staff is not aware of any cases or
6 authorities that have questioned the validity of respondent's position that all California source income of
7 trusts is subject to tax without apportionment based on the residence of fiduciaries or beneficiaries, and
8 with only non-California source income apportioned based on the residence of fiduciaries or
9 beneficiaries. Appellant should be prepared to discuss the *Appeal of Marilyn Monroe*, 75-SBE-032,
10 April 22, 1975, and the *Appeal of the First National Bank of Chicago*, 60-SBE-039, decided
11 December 13, 1960. In the former appeal, the Board found that the estate, which was not resident in
12 California, was taxable on California source income.

13 Both parties should be prepared to discuss the relevance, if any, of the statement in
14 former R&TC section 12, subdivision (a), as in effect in both 1935 and after the 1937 amendments, that
15 "[t]he taxes imposed by this act upon individuals shall apply to, and be imposed upon, the income of
16 estates or of any kind of property held in trust . . . including . . . (4) income which, in the discretion of
17 the fiduciary[,] may be either distributed . . . or accumulated." Does this subdivision suggest, perhaps,
18 that the intent of the Legislature was to tax trusts to the same extent individuals were subject to tax,
19 including, when applicable, tax based on source? Or, does the provision suggest, perhaps, that the
20 individual income tax rate shall apply to trusts, but leave the determination of what income is taxable to
21 subsequent subdivisions of Section 12?

22 Staff further requests that the parties be prepared to address the relevance, if any, of the
23 following in determining the Legislative intent behind the 1937 amendments and the current statutory
24 regime:

25 ///

27 ¹⁰ Staff notes that the Preface to the 1938 amended regulations, written by the Franchise Tax Commissioner (the predecessor
28 to the FTB), describes the Legislature's 1937 amendments to the statute's trust provisions as "minor." (See App. Op. Br.,
exhibit H, p. 2.) Thus, it appears the Commissioner considered the 1937 statutory amendments to the trust provisions prior to
promulgating the 1938 amended regulations, which retained a source-based taxation rule for trusts.

- 1 • Both the 1935 version of the Personal Income Tax Act and the 1937 version state that “[t]he
2 net income of the estate or trust shall be computed in the same manner and on the same basis
3 as in the case of an individual, except that”¹¹ IRC section 641, subsection (b), states that
4 “[t]he taxable income of an estate or trust shall be computed in the same manner as in the
5 case of an individual, except as otherwise provided in this part.”¹² Both the 1935 version and
6 the 1937 version further state, in part, that net income is determined by taking deductions
7 from gross income, and that gross income of nonresidents includes only California-source
8 income, with gross income from sources within and without the state “allocated and
9 apportioned under rules and regulations to be prescribed by the commissioner.”¹³ Similarly,
10 under R&TC sections 17041 and 17951, nonresidents (and part-year residents while not a
11 resident) are taxed on California-source income, and, under R&TC section 17954,
12 gross income from sources within and without the state is “allocated and apportioned under
13 rules and regulations prescribed by the Franchise Tax Board.”
- 14 • The 1937 amendments added a provision in subsection (c) of Section 12 stating that
15 beneficiaries will be taxed on distributable income of trusts if the trust did not pay tax that
16 was owed on the basis of the fiduciary or beneficiary being a California resident,¹⁴ except
17 that nonresident beneficiaries would only be subject to tax on California source income
18 (compare current R&TC section 17745). (See Exhibit B, p. 15.) This subsection (c) of
19 Section 12 cross-references to subsection (f) of Section 7, which, in additional language
20

21 ¹¹ The Personal Income Tax Act of 1935 is attached as Exhibit A. The 1937 amendments are attached as Exhibit B. The
22 quoted language is set forth in subsection (c) of Section 12 of the 1935 act (p. 17 of Exhibit A). The language is set forth in
23 subsection (d) of Section 12 as amended in 1937 (p. 16 of Exhibit B).

24 ¹² Pursuant to R&TC section 17731, California generally conforms to the federal trust provisions.

25 ¹³ See Section 6 (defining “net income”) of the 1935 act and, in both versions of the act, Section 7 (defining “gross income”)
26 and subsection (f) of Section 7 (providing that gross income of nonresidents includes only California-source income with
27 gross income from sources within and without California allocated and apportioned according to regulations). (For the 1935
28 version, see pp. 6 – 7 of Exhibit A; for the 1937 amendments, see pp. 5 – 6 of Exhibit B (the 1937 amendments do not amend
Section 6).)

¹⁴ The parties may wish to discuss the purpose of the language of this provision, and in the current version of R&TC
section 17745, which appears to limit the application of the provisions to situations in which the basis for taxing the trust is
the residence of the fiduciary or beneficiary.

1 added by the 1937 amendments, sets forth rules for sourcing of intangibles and states that
2 income received by nonresident beneficiaries from trusts constitutes California source
3 income if the trust derived the income from sources within the state (compare current R&TC
4 section 17734). (See Exhibit B, p. 6.)

5 It appears that R&TC section 17743 and predecessor statutes with similar language were
6 reenacted multiple times. The parties should address whether such reenactments suggest that the
7 Legislature has accepted respondent's interpretation. (See *Western Oil & Gas Assn. v. Air Resources*
8 *Board* (1984) 37 Cal.3d 502, 520; *Division of Industrial Safety v. Municipal Court* (1976)
9 61 Cal.App.3d 696, 701.) Both parties should address, and provide any available evidence regarding,
10 whether the Legislature considered respondent's interpretation of trust-sourcing rules when R&TC
11 section 17743 or predecessor statutes were reenacted. Staff notes that there are 171 other appeals
12 pending at the Board that involve similar issues and related facts. With the consent of the parties to
13 those appeals, those appeals are currently deferred pending the outcome of this appeal.

14 If either party has any additional evidentiary exhibits to provide, any such materials
15 should be provided at least 14 days prior to the oral hearing pursuant to Regulation 5523.6,
16 subdivision (b), in order to facilitate an orderly and productive hearing.

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20 Paula Trust_gst

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Exhibit A

Statutes of California
1935

CONSTITUTION OF 1879
AS AMENDED

MEASURES SUBMITTED TO VOTE
OF ELECTORS 1933, 1934, 1935

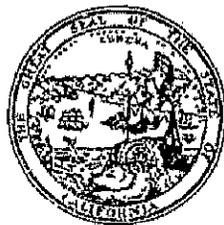
GENERAL LAWS, AMENDMENTS TO CODES,
RESOLUTIONS AND CONSTITUTIONAL
AMENDMENTS

PASSED AT THE

EXTRA SESSION OF THE FIFTIETH
LEGISLATURE, 1934

AND THE

REGULAR SESSION OF THE FIFTY-FIRST
LEGISLATURE, 1935



CALIFORNIA STATE PRINTING OFFICE
GEORGE H. MOORE, STATE PRINTER
SACRAMENTO 1935

C1-22095

Exhibit: A
Page 1 of 35

CHAPTER 329.

"Personal
Income Tax
Act of
1935."

An act to provide for the levy and collection of a tax upon the incomes of individuals, estates and trusts, and to provide for the disposition of the revenues therefrom, and to provide that this act shall take effect immediately.

[Approved by the Governor June 13, 1935. In effect immediately.]

The people of the State of California do enact as follows:

Short title.

SECTION 1. Short title. This act shall be known and may be cited as "The Personal Income Tax Act of 1935."

Definitions

SEC. 2. Definitions. For the purposes of this act and unless otherwise required by the context:—

(a) The word "commissioner" as used in this act and the word "commissioner" as used in the "Revenue Act of 1934," when any part of that act is incorporated herein by reference, mean the Bank and Corporation Franchise Tax Commissioner.

(b) The word "taxpayer" includes any individual, fiduciary, estate, or trust subject to the tax imposed by this act.

(c) The word "individual" means a natural person.

(d) The word "fiduciary" means a guardian, trustee, executor, administrator, receiver, conservator, or any person, whether individual or corporate, acting in any fiduciary capacity for any person, estate or trust.

(e) The word "person" includes individuals, fiduciaries, partnerships and corporations.

(f) The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this act, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

(g) The word "corporation" includes joint-stock companies or associations, insurance companies, business trusts or so-called "Massachusetts trusts."

(h) The words "taxable year" mean the calendar year or the fiscal year, upon the basis of which the net income is computed under this act; if no fiscal year has been established they mean the calendar year.

"Taxable year" includes, in the case of a return made for a fractional part of a year under the provisions of this act or under regulations prescribed by the commissioner, the period for which such return is made.

(i) The words "fiscal year" mean an accounting period of twelve months ending on the last day of any month other than December

(j) The words "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under this act.

(k) The word "resident" includes every natural person domiciled in the State of California and every other natural person who maintains a permanent place of abode within this State or spends in the aggregate more than six months of the taxable year within this State. The word "nonresident" includes every natural person other than a resident.

(l) The words "foreign country" mean any jurisdiction other than one embraced within the United States. The words "United States," when used in a geographical sense, include the States, the Territories of Alaska and Hawaii, the District of Columbia and the possessions of the United States.

(m) The words "Revenue Act of 1934" mean the act of Congress of the United States, approved May 10, 1934, and known and cited as the "Revenue Act of 1934."

(n) The words "trade or business" include the performance of the functions of a public office.

(o) The words "personal holding company" means any corporation (other than a corporation exempt from taxation under section 101 of the Federal Revenue Act of 1934, and other than a bank or trust company incorporated under the laws of the United States or of any State or Territory, a substantial part of whose business is the receipt of deposits, and other than a life insurance company or surety company) if (1) at least eighty per centum of its gross income for the taxable year is derived from royalties, dividends, interest, annuities, and (except in the case of regular dealers in stock or securities) gains from the sale of stock or securities, and (2) at any time during the last half of the taxable year more than fifty per centum in value of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals. For the purpose of determining the ownership of stock in a personal holding company—(3) stock owned, directly or indirectly, by a corporation, partnership, estate, or trust shall be considered as being owned proportionately by its shareholders, partners or beneficiaries; (4) an individual shall be considered as owning, to the exclusion of any other individual, the stock owned, directly or indirectly, by his family, and this rule shall be applied in such manner as to produce the smallest possible number of individuals owning, directly or indirectly, more than fifty per centum in value of the outstanding stock; and (5) the family of an individual shall include only his brothers and sisters (whether by the whole or half blood) spouse, ancestors, and lineal descendants.

(p) The words "State board" mean the State Board of Equalization.

SEC. 3. Who Shall File Returns. (a) Every person taxable under this act shall make a return to the commissioner, ^{who shall} _{file returns.} stating specifically the item of his gross income and the deductions and credits allowed by this act, if having a net income of—

(1) \$1,000 or over, if single, or if married and not living with husband or wife;

(2) \$2,500 or over, if married and living with husband or wife; or

(3) If having a gross income of \$5,000 or over, regardless of the amount of net income.

(b) If a husband and wife living together have an aggregate net income for the taxable year of \$2,500 or over, or an aggregate gross income for such year of \$5,000 or over—

(1) Each shall make such a return, or

(2) The income of each shall be included in a single joint return, in which case the tax shall be computed on the aggregate income.

(c) If the taxpayer is unable to make his own return, the return shall be made by a duly authorized agent or by the guardian or other person charged with the care of the person or property of such taxpayer

(d) Every resident or nonresident, taxable under this act, who is a beneficiary of an estate or trust taxable hereunder, shall include in his gross income, the distributive share of the net income of the estate or trust received by him or distributable to him during the taxable year; provided, however, the income of an estate or trust with respect to which the tax is imposed upon the estate or trust shall not be so included when distributed to the beneficiary.

Fiduciary
returns.

SEC. 4. Fiduciary Returns. (a) Every fiduciary (except a receiver appointed by authority of law in possession of part only of the property of an individual) shall make a return for any of the following individuals, estates or trusts, taxable hereunder, for which he acts, stating specifically the items of gross income thereof and the deductions and credits allowed under this act—

(1) Every individual having a net income for the taxable year of \$1,000 or over, if single, or if married and not living with husband or wife;

(2) Every individual having a net income for the taxable year of \$2,500 or over, if married and living with husband or wife;

(3) Every individual having a gross income for the taxable year of \$5,000 or over, regardless of the amount of his net income;

(4) Every estate or trust the net income of which for the taxable year is \$1,000 or over;

(5) Every estate or trust the gross income of which for the taxable year is \$5,000 or over, regardless of the amount of the net income.

(b) Under such rules and regulations as the commissioner may prescribe, a return filed by one of two or more joint fiduciaries shall be sufficient compliance with the above requirement. Such fiduciary shall state under oath (1) that he has sufficient knowledge of the affairs of the individual, estate, or trust, for which the return is made, to enable him to make the return, and (2) that the return is, to the best of his knowledge and belief, true and correct.

(c) Any fiduciary required to make a return under this act shall be subject to all the provisions of this act which apply to individuals.

SEC. 5. Imposition of Tax on Residents and Nonresidents.

Imposition
of tax on
residents and
nonresidents

(a) There shall be levied, collected and paid for each taxable year upon the entire net income of every resident of this State and upon the net income of every nonresident which is derived from sources within this State, taxes in the following amounts and at the following rates upon the amount of net income in excess of credits against net income provided in section 10:

Upon net incomes not in excess of \$5,000, 1 per centum of such net incomes.

\$50 upon net incomes of \$5,000; and upon net incomes in excess of \$5,000 and not in excess of \$10,000, 2 per centum in addition of such excess.

\$150 upon net incomes of \$10,000; and upon net incomes in excess of \$10,000 and not in excess of \$15,000, 3 per centum in addition of such excess.

\$300 upon net incomes of \$15,000; and upon net incomes in excess of \$15,000 and not in excess of \$20,000, 4 per centum in addition of such excess.

\$500 upon net incomes of \$20,000; and upon net incomes in excess of \$20,000 and not in excess of \$25,000, 5 per centum in addition of such excess.

\$750 upon net incomes of \$25,000; and upon net incomes in excess of \$25,000 and not in excess of \$30,000, 6 per centum in addition of such excess.

\$1,050 upon net incomes of \$30,000; and upon net incomes in excess of \$30,000 and not in excess of \$40,000, 7 per centum in addition of such excess.

\$1,750 upon net incomes of \$40,000; and upon net incomes in excess of \$40,000 and not in excess of \$50,000, 8 per centum in addition to such excess.

\$2,550 upon net incomes of \$50,000; and upon net incomes in excess of \$50,000 and not in excess of \$60,000, 9 per centum in addition of such excess.

\$3,450 upon net incomes of \$60,000; and upon net incomes in excess of \$60,000 and not in excess of \$70,000, 10 per centum in addition of such excess.

\$4,450 upon net incomes of \$70,000; and upon net incomes in excess of \$70,000 and not in excess of \$80,000, 11 per centum in addition of such excess.

\$5,550 upon net incomes of \$80,000; and upon net incomes in excess of \$80,000 and not in excess of \$100,000, 12 per centum in addition of such excess.

\$7,950 upon net incomes of \$100,000; and upon net incomes in excess of \$100,000 and not in excess of \$150,000, 13 per centum in addition of such excess.

\$14,450 upon net incomes of \$150,000; and upon net incomes in excess of \$150,000 and not in excess of \$250,000, 14 per centum in addition of such excess.

\$28,450 upon net incomes of \$250,000; and upon net incomes in excess of \$250,000, 15 per centum in addition of such excess.

Net Income

SEC. 6. Net Income. The words "net income" mean the gross income computed under section 7 of this act less the deductions allowed by section 8 of this act. ←

Gross
Income.

SEC. 7. Gross Income. (a) Gross income includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever, and includes any salary, wages or compensation of any officer or employee of this State, or any political subdivision, district or municipality thereof. ←

Exemptions.

(b) The following items shall not be included in gross income and shall be exempt from taxation under this act:

(1) Amounts received under a life insurance contract paid by reason of the death of the insured, whether in a single sum or otherwise (but if such amounts are held by the insurer under an agreement to pay interest thereon, the interest payments shall be included in gross income);

(2) Amounts received (other than amounts paid by reason of the death of the insured and interest payments on such amounts and other than amounts received as annuities) under a life insurance or endowment contract, but if such amounts (when added to amounts received before the taxable year under such contract) exceed the aggregate premiums or consideration paid (whether or not paid during the taxable year) then the excess shall be included in gross income. Amounts received as an annuity under an annuity or endowment contract shall be included in gross income; except that there shall be excluded from gross income the excess of the amount received in the taxable year over an amount equal to 3 per centum of the aggregate premiums or consideration paid for such annuity (whether or not paid during such year), until the aggregate amount excluded from gross income under this act in respect of such annuity increased by the amount which would have been excluded from gross income in respect of such annuity had this act been in effect continuously from and after the date at which payments under such annuity were first received equals the aggregate premiums or consideration paid for such annuity. In the case of a transfer for a valuable consideration, by assignment or otherwise, of a life insurance, endowment, or annuity contract, or any interest therein, only the actual value of such consideration and the amount of the premiums and other sums subsequently paid by the transferee shall be exempt from taxation under paragraph (1) or this paragraph;

(3) The value of property acquired by gift, bequest, devise, or inheritance (but the income from such property shall be included in gross income);

(4) Amounts received, through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received whether by suit or agreement on account of such injuries or sickness;

(5) The rental value of a dwelling house and appurtenances thereof furnished to a minister of the gospel as part of his compensation;

(6) 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.

(c) Whenever in the opinion of the commissioner the use of Inventories inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the commissioner may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

(d) In the case of a sale or other disposition of property, Computation of gain or loss the gain or loss shall be computed as provided in sections 111, 112, and 113 of the Revenue Act of 1934 which sections and the sections referred to therein are hereby referred to and incorporated with the same force and effect as though fully set forth herein; provided, however, that the words "with the approval of the secretary" in said sections shall be deemed omitted.

(e) In the case of sales or exchanges of capital assets, the gain or loss shall be taken into account in computing net income in the manner provided in section 117 of the Revenue Act of 1934 which section and the sections of the Revenue Act of 1934 referred to therein are hereby referred to and incorporated with the same force and effect as though fully set forth herein.

(f) In the case of taxpayers other than residents the Gross income of nonresidents gross income includes only the gross income from sources within this State. Gross income from sources within and without this State shall be allocated and apportioned under rules and regulations to be prescribed by the commissioner.

(g) (1) The term "dividend" when used in this act means Dividends any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.

(2) For the purposes of this act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-

Dividends.

free distribution shall be applied against and reduce the adjusted basis of the stock provided in subsection (d) of this section.

(3) Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under subsection (d) of this section, but shall be recognized only to the extent provided in subsection (d) of this section. Despite the provisions of subsection (e) of this section, 100 per centum of the gain so recognized shall be taken into account in computing net income. In the case of amounts distributed (whether before January 1, 1934, or on or after such date) in partial liquidation (other than a distribution within the provisions of subdivision (8) of this subsection or stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of subdivision (2) of this subsection for the purpose of determining the taxability of subsequent distributions by the corporation.

(4) If any distribution (not in partial or complete liquidation) made by a corporation to its shareholders is not out of increase in value of property accrued before March 1, 1913, and is not out of earnings or profits, then the amount of such distribution shall be applied against and reduce the adjusted basis of the stock provided in subsection (d) of this section, and if in excess of such basis, such excess shall be taxable in the same manner as a gain from the sale or exchange of property.

(5) Any distribution made by a corporation, which was classified as a personal service corporation under the provisions of the Federal Revenue Act of 1918 or the Federal Revenue Act of 1921, out of its earnings or profits which were taxable in accordance with the provisions of section 218 of the Federal Revenue Act of 1921, shall be exempt from tax to the distributees.

(6) A stock dividend shall not be subject to tax.

(7) If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

(8) The distribution before January 1, 1934, in pursuance of a plan of reorganization, by or on behalf of a corporation a party to the reorganization, of its stock or securities or

stock or securities in a corporation a party to the reorganization, if no gain to the distributee from the receipt of such stock or securities was recognized under the Federal Revenue Act applicable to such distribution, shall not be considered a distribution of earnings or profits within the meaning of this subsection for the purpose of determining the taxability of subsequent distributions by the corporation. As used in this subdivision, the terms "reorganization" and "party to the reorganization" shall have the meanings assigned to such terms in section 112 of the Federal Revenue Act of 1932.

(9) As used in this subsection the term "amount distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

SEC. 8. Deductions from Gross Income In computing net income there shall be allowed as deductions:

(a) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

In the case of any taxpayer the deductions permitted by this subsection shall not be allowed if, and to the extent that they are connected with the production of income not taxable under this act, and proper apportionment and allocation of such deductions with respect to taxable and nontaxable income shall be determined under rules and regulations to be prescribed by the commissioner.

(b) All interest paid or accrued within the taxable year on indebtedness of the taxpayer; provided, however, in the case of any taxpayer the deduction permitted by this subdivision shall not be allowed if, and to the extent that such deduction is connected with income not taxable under this act; and provided further, no such deduction shall be allowed or taken for interest paid or accrued within the taxable year on indebtedness incurred or continued to purchase or carry obligations, the interest upon which is wholly exempt from taxes imposed by this act. The proper apportionment and allocation of such deductions with respect to taxable and nontaxable income shall be determined under rules and regulations to be prescribed by the commissioner.

(c) Taxes or licenses paid or accrued during the taxable year, other than taxes paid to the State under this act, and other than taxes on or according to or measured by income or profits paid or accrued within the taxable year imposed by the

Deductions
from gross
income

authority of (1) the Government of the United States or any foreign country, (2) any State, Territory, county, city and county, school district, municipality or other taxing subdivision of any State or Territory, and other than estate, inheritance, legacy, succession and gift taxes, and other than taxes assessed against local benefits of a kind tending to increase the value of the property assessed, but this shall not exclude the allowance as a deduction of so much of said taxes assessed against local benefits as is properly allocable to maintenance or interest charges.

Deductions.

(d) Losses sustained during the taxable year and not compensated for by insurance or otherwise:

- (1) If incurred in trade or business; or
- (2) If incurred in any transaction entered into for profit, though not connected with the trade or business; or
- (3) Of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft.

The basis for determining the amount of deduction for losses sustained, to be allowed under this subsection shall be the adjusted basis provided in section 7 of this act for determining the loss from the sale or other disposition of property.

(e) Losses from wagering transactions shall be allowed only to the extent of the gains from such transactions.

(f) Debts ascertained to be worthless and charged off within the taxable year (or in the discretion of the commissioner a reasonable addition to a reserve for bad debts) and when satisfied that a debt is recoverable only in part, the commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction.

(g) In the case of any loss claimed to have been sustained from any sale or other disposition of shares of stock or securities where it appears that, within a period beginning thirty days before the date of such sale or disposition and ending thirty days after such date, the taxpayer has acquired (by purchase or by an exchange upon which the entire amount of gain or loss was recognized by law) or has entered into a contract or option so to acquire, substantially identical stock or securities, then no deduction for the loss shall be allowed. If the amount of stock or securities acquired (or covered by the contract or option to acquire) is less than the amount of stock or securities sold or otherwise disposed of, then the particular shares of stock or securities the loss from the sale or other disposition of which is not deductible shall be determined under rules and regulations prescribed by the commissioner.

If the amount of stock or securities acquired (or covered by the contract or option to acquire) is not less than the amount of stock or securities sold or otherwise disposed of, then the particular shares of stock or securities the acquisition of which (or the contract or option to acquire which) resulted in the nondeductibility of the loss shall be determined under the rules and regulations prescribed by the commissioner.

(h) Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in subsection (d) of section 117 of the Revenue Act of 1934 which subsection is hereby referred to and incorporated with the same force and effect as though fully set forth herein. Deductions.

(i) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

(j) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the commissioner. In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, then such prior estimate (but not the basis for depletion) shall be revised and the allowance under this subsection for subsequent taxable years shall be based upon such revised estimate. In the case of leases the deductions shall be equitably apportioned between the lessor and the lessee. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each. The percentage of depletion allowable under this subsection shall be computed in accordance with the provisions of subdivisions (3) and (4) of subsection (b) of section 114 of the Revenue Act of 1934 which subdivisions and the sections of said revenue act referred to therein are hereby referred to and incorporated with the same force and effect as though fully set forth herein.

(k) The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114 of the Revenue Act of 1934 which section and all sections of said revenue act referred to therein are hereby referred to and incorporated with the same force and effect as though fully set forth herein, provided,

Deduction. however, that the words "with the approval of the secretary" shall be deemed omitted.

(1) In the case of an individual, contributions or gifts made within the taxable year to or for the use of:

(1) The United States, any State, Territory or any political subdivision thereof, or the District of Columbia, for exclusively public purposes;

(2) A corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganāa, or otherwise attempting to influence legislation;

(3) The special fund for vocational rehabilitation authorized by section 12 of the World War Veterans' Act, 1924;

(4) Posts or organizations of war veterans, or auxiliary units or societies of any such posts or organizations, if such posts, organizations, units, or societies are organized in the United States or any of its possessions, and if no part of their net earnings inures to the benefit of any private shareholder or individual; or

(5) A fraternal society, order, or association; operating under the lodge system, but only if such contributions or gifts are to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals. The deductions under this subsection shall be allowed to an amount which in all the above cases combined does not exceed fifteen per centum of the taxpayer's net income as computed without the benefit of this subsection. Such contributions or gifts shall be allowed as deductions only if verified under rules and regulations prescribed by the commissioner.

In the case of an individual if in the taxable year and in each of the ten preceding taxable years the amount of the contributions or gifts described in this subsection plus the amount of income, war profits, or excess profits taxes paid during such year in respect of preceding taxable years, exceeds ninety per centum of the taxpayer's net income for each such year, as computed without the benefit of this subsection then the fifteen per centum limit imposed herein shall not be applicable.

In the case of a taxpayer other than a resident the deductions under this subsection shall be allowed only as to contributions or gifts to corporations or associations incorporated by or organized under the laws of this State or to the vocational rehabilitation fund above mentioned or to this State or any political subdivision thereof for exclusively public purposes.

(m) An employer establishing or maintaining a pension trust to provide for the payment of reasonable pensions to his employees (if such trust is exempt from tax under subsection

(f) of section 12, relating to trusts created for the exclusive benefit of employees) shall be allowed as a deduction (in addition to the contributions to such trust during the taxable year to cover the pension liability accruing during the year, allowed as a deduction under subsection (a) of this section) a reasonable amount transferred or paid into such trust during the taxable year in excess of such contributions, but only if such amount (1) has not theretofore been allowable as a deduction, and (2) is apportioned in equal parts over a period of ten consecutive years beginning with the year in which the transfer or payment is made.

(n) In the case of a taxpayer other than a resident the deductions allowed by this section shall unless otherwise provided in this section be allowed only if and to the extent that they are connected with the income arising from sources within this State and taxable under this act to a nonresident taxpayer, and the proper apportionment and allocation of the deductions with respect to sources of income within and without the State shall be determined under rules and regulations to be prescribed by the commissioner.

Sec. 9. Items Not Deductible.

Items not
deductible

(a) In computing net income no deduction shall in any case be allowed in respect of—

(1) Personal, living, or family expenses;

(2) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate.

(3) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made;

(4) Premiums paid on any life insurance policy covering the life of any officer or employee, or of any person financially interested in any trade or business carried on by the taxpayer, when the taxpayer is directly or indirectly a beneficiary under such policy;

(5) Any amount otherwise allowable as a deduction which is allocable to one or more classes of income other than interest (whether or not any amount of income of that class or classes is received or accrued) wholly exempt from the taxes imposed by this act; or

(6) Loss from sales or exchanges of property, directly or indirectly, (A) between members of a family, or (B) except in the case of distributions in liquidation, between an individual and a corporation in which such individual owns, directly or indirectly, more than fifty per centum in value of the outstanding stock. For the purpose of this paragraph—(C) an individual shall be considered as owning the stock owned, directly or indirectly, by his family; and (D) the family of an individual shall include only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants.

(b) Amounts paid under the laws of any State, Territory, District of Columbia, possession of the United States, or foreign country as income to the holder of a life or terminable interest acquired by gift, bequest, or inheritance shall not be reduced or diminished by any deduction for shrinkage (by whatever name called) in the value of such interest due to the lapse of time, nor by any deduction allowed by this act (except the deductions provided for in subsections (i) and (j) of section 8) for the purpose of computing the net income of an estate or trust not allowed under the laws of such State, Territory, District of Columbia, possession of the United States, or foreign country for the purpose of computing the income to which such holder is entitled.

(c) The obligor of a covenant bond shall not be allowed a deduction for the payment of the tax imposed by this act, or any other tax pursuant to the tax-free covenant clause, nor shall such tax be included in the gross income of the obligee.

Credits of individual against net income.

SEC. 10. Credits of Individual Against Net Income.

There shall be allowed for the purpose of the tax herein imposed:

(a) Personal Exemptions.—In the case of a single person, a personal exemption of \$1,000; or in case of the head of a family or a married person living with husband or wife, a personal exemption of \$2,500. A husband and wife living together shall receive but one personal exemption. The amount of such personal exemption shall be \$2,500. If such husband and wife make separate returns, the personal exemption may be taken by either or divided between them;

Credit for dependents

(b) Credit for Dependents.—\$400 for each person (other than husband or wife) dependent upon and receiving his chief support from the taxpayer if such dependent person is under eighteen years of age or is incapable of self-support because mentally or physically defective;

Change of status.

(c) Change of Status.—If the status of the taxpayer, in so far as it affects the personal exemption or credit for dependents changes during the taxable year, the personal exemption and credit shall be apportioned, under such rules and regulations as are prescribed by the commissioner, in accordance with the number of months before and after such change. For the purpose of such apportionment a fractional part of a month shall be disregarded unless it amounts to more than half a month in which case it shall be considered as a month.

Installment basis

SEC. 11. Installment Basis.

(a) Under regulations prescribed by the commissioner a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price.

(b) In the case (1) of a casual sale or other casual disposition of personal property (other than property of a kind

which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year), for a price exceeding one thousand dollars, or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed thirty per centum of the selling price, the income may, under regulations prescribed by the commissioner be returned on the basis and in the manner prescribed by this section. As used in this section the term "initial payment" means the payments received in cash or property other than evidence of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

(c) If a taxpayer entitled to the benefits of subsection (a) of this section elects for any taxable year to report his net income on the installment basis, then in computing his income for the year of change or any subsequent year, amounts actually received during any such year on account of sales or other dispositions of property made in any prior year shall not be excluded.

(d) If an installment obligation is satisfied at other than its face value or distributed, transmitted, sold or otherwise disposed of, gain or loss shall result to the extent of the difference between the basis of the obligation and (1) in the case of satisfaction at other than face value or a sale or exchange—the amount realized, or (2) in case of a distribution, transmission, or disposition otherwise than by sale or exchange—the fair market value of the obligation at the time of such distribution, transmission or disposition. Any gain or loss so resulting shall be considered as resulting from the sale or exchange of the property in respect of which the installment obligation was received. The basis of the obligation shall be the excess of the face value of the obligation over an amount equal to the income which would be returnable were the obligation satisfied in full. This subsection shall not apply to the transmission at death of installment obligations if there is filed with the commissioner at such time as he may by regulation prescribe, a bond in such amount and with such sureties as he may deem necessary, conditioned upon the return as income, by the person receiving any payment on such obligations, of the same proportion of such payment as would be returnable as income by the decedent if he had lived and had received such payment.

SEC. 12. Imposition of Tax on Estates and Trusts.

(a) The taxes imposed by this act upon individuals shall apply to, and be imposed upon, the income of estates or of any kind of property held in trust (other than so-called Massachusetts trusts), including—

Imposition
of tax on
estates and
trusts

(1) Income accumulated in trust for the benefit of unborn or unascertained person or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a

Same.

guardian of an infant which is to be held or distributed as the court may direct;

(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) Income which, in the discretion of the fiduciary may be either distributed to the beneficiaries or accumulated.

(b) The tax shall be computed upon the net income of the estate or trust, shall be a charge against such estate or trust, and shall be paid by the fiduciary, except as provided in subsections (g) and (h) of this section.

For the purposes of this section the word "settlor" shall mean and include every creator of a trust and every decedent and where in this section the settlor is spoken of as a resident or a nonresident the same shall be taken to include a decedent who upon his or her death is a resident or a nonresident as the case may be.

The taxable income of the estate or trust shall include the following:

(1) The income from real property and tangible personal property located and from business transacted in this State.

(2) The income from intangible property with a situs in this State.

(3) The income from real property and tangible personal property located outside this State and the income from intangible property with a situs outside this State in the following cases:

(A) Where the beneficiary and the fiduciary and the settlor are all residents of this State.

(B) Where the beneficiary and the fiduciary are residents of this State regardless of the residence of the settlor.

(C) Where the beneficiary and the settlor are residents of this State regardless of the residence of the fiduciary.

(D) Where the beneficiary is a resident of this State regardless of the residence of the fiduciary and the settlor.

(E) Where the fiduciary is a resident of this State regardless of the residence of the beneficiary and the settlor.

(F) Where the settlor is a resident of this State regardless of the residence of the beneficiary and the fiduciary.

(G) Where the fiduciary and the settlor are residents of this State regardless of the residence of the beneficiary.

Where the taxability of income under this section depends on the residence of the fiduciary and there are two or more fiduciaries for the estate or trust, the income taxable under this section shall be apportioned according to the number of fiduciaries resident in this State, such apportionment being determined according to rules and regulations prescribed by the commissioner.

Where the taxability of income under this section depends on the residence of the beneficiary and there are two or more beneficiaries for the estate or trust, the income taxable under this section shall be apportioned according to the number of beneficiaries resident in this State, such apportionment being

determined according to rules and regulations prescribed by the commissioner.

(c) The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

(1) There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by subsection (1) of section 8), any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in subsection (1) of section 8 or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit;

(2) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, and the amount of the income collected by a guardian of an infant which is to be held or distributed as the court may direct, but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under paragraph (3) of this subsection in the same or any succeeding taxable year. In the case of the income of a beneficiary not a resident derived through such an estate or trust, such income shall be taxable only to the extent provided in subsection (f) of section 7 of this act.

(3) In the case of income received by estates of deceased persons during the period of administration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year, which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir or beneficiary. In such cases the income of the legatee, heir, or beneficiary not a resident shall be taxable only to the extent provided in subsection (f) of section 7 of this act.

Tax on
estates and
trusts.

(d) For the purpose of the tax herein imposed, the estate or trust shall be allowed the same personal exemption as is allowed to a single person under section 10 (a).

(e) If the taxable year of a beneficiary is different from that of the estate or trust, the amount which he is required, under subsection (c) (2) of this section, to include in computing his net income, shall be based upon the income of the

estate or trust for any taxable year of the estate or trust ending within his taxable year.

(f) A trust created by an employer as a part of a stock bonus, pension, or profit-sharing plan for the exclusive benefit of some or all of his employees, to which contributions are made by such employer, employee, or both, for the purpose of distributing to such employees the earnings and principal of the fund accumulated by the trust in accordance with such plan, shall not be taxable under this section, but the amount actually distributed or made available to any distributee shall be taxable to him in the taxable year in which so distributed or made available to the extent that it exceeds the amounts paid in by him.

(g) Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) In the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) In any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, then the income of such part of the trust shall be included in computing the net income of the grantor.

(h) Where any part of the income of a trust—

(1) Is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be held or accumulated for future distribution to the grantor; or

(2) May, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

(3) Is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in subsection (1) of section 8, relating to the so-called "charitable contribution" deduction); then such part of the income of the trust shall be included in computing the net income of the grantor.

(i) As used in this section the term "in the discretion of the grantor," means "in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question."

SEC. 13. Time and Place for Filing Returns

(a) Returns shall be under oath, in such form as the commissioner may from time to time prescribe, and shall be filed with the commissioner, at his main office or at any branch office which he may establish. The commissioner shall cause to be prepared blank forms for the said returns and shall cause them to be distributed throughout the State and to be furnished upon application, but failure to receive or secure

Time and
place for
filing
returns.

the form shall not relieve any taxpayer from the obligation of making any return herein required.

(b) Returns made on the basis of the calendar year shall be filed on or before the fifteenth day of April following the close of the calendar year. Returns made on the basis of a fiscal year shall be filed on or before the fifteenth day of the fourth month following the close of the fiscal year.

(c) The commissioner, under such rules and regulations as he shall prescribe, may grant a reasonable extension of time for filing the return and/or for payment of the tax, or any installment thereof, disclosed by the return, due or to become due within the period of the extension, whenever in his judgment good cause exists therefor, and he shall keep a record of every such extension. No such extension or extensions shall aggregate more than six months from the due date provided in subsection (b) of this section.

SEC. 14. Time, Place, and Method of Payment of Tax.

Time, place
and method
of payment
of tax

(a) The total amount of tax imposed under this act shall be paid on the fifteenth day of April following the close of the calendar year, or, if the return should be made on the basis of a fiscal year, then on the fifteenth day of the fourth month following the close of the fiscal year.

(b) The taxpayer may elect to pay the tax in three equal installments, in which case the first installment shall be paid on the date prescribed for the payment of the tax, the second installment shall be paid on the fifteenth day of the fourth month, and the third installment on the fifteenth day of the eighth month, after such date. If any installment is not paid on or before the date fixed for its payment, the whole amount of tax unpaid shall be paid upon notice and demand from the commissioner.

(c) The tax imposed under this act, or any installment thereof, may be paid, at the election of the taxpayer, prior to the date prescribed for its payment.

(d) The tax, and any additions thereto, imposed by this act, shall be paid to the commissioner at Sacramento, or to his authorized representatives at any branch office. Remittances may be in the form of uncertified check, payable to the State Treasurer, during such time and under such regulations as the commissioner may prescribe, but if a check so received is not paid by the bank on which it is drawn, the taxpayer by whom such check is tendered shall remain liable for the payment of the tax, and all additions thereto, the same as if such check had not been tendered.

SEC. 15. Interest and Additions to the Tax.

Interest and
additions to
the tax
Failure to
file return

(a) Failure to File Return.

(1) If any taxpayer fails to make and file a return required by this act, within the time prescribed by law or prescribed by the commissioner in pursuance of law, twenty-five per centum of the tax shall be added to the tax, except that when a return is filed after such time and it is shown that the failure to file the return was due to reasonable cause and not due to wilful

neglect no such addition shall be made to the tax. The amount so added to any tax shall be collected at the same time and in the same manner and as a part of the tax unless the tax has been paid before the discovery of the neglect, in which case the amount so added shall be collected in the same manner as the tax.

(2) If any taxpayer, upon notice and demand by the commissioner, fails or refuses to make and file a return required by this act, the commissioner is authorized to make an estimate of the net income and to compute and levy the amount of tax due under this act from any available information, and in such case fifty per centum of the tax shall be added to the tax as a part of the tax and collected in the same manner as the tax.

Interest on
deficiencies

(b) Interest on Deficiencies.—Interest upon the amount determined as a deficiency shall be assessed at the same time as the deficiency, shall be paid upon notice and demand from the commissioner, and shall be collected as a part of the tax, at the rate of six per centum per annum from the date prescribed for the payment of the tax (or, if the tax is paid in installments, from the date prescribed for the payment of the first installment) to the date the deficiency is assessed.

Additions in
case of
deficiency

(c) Additions to the Tax in Case of Deficiency:

(1) Negligence.—If any part of any deficiency is due to negligence, or intentional disregard of rules and regulations but without intent to defraud, five per centum of the total amount of the deficiency (in addition to such deficiency) shall be assessed, collected, and paid in the same manner as if it were a deficiency, except that the provisions of section 19, relating to the prorating of a deficiency, and of subsection (b) of this section, relating to interest on deficiencies, shall not be applicable.

(2) Fraud.—If any part of any deficiency is due to fraud with intent to evade tax, then fifty per centum of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, and shall be paid upon notice and demand from the commissioner.

Additions in
case of
nonpayment.

(d) Additions to Tax in Case of Nonpayment:

(1) General Rule.—Where the amount determined by the taxpayer as the tax imposed by this act, or any installment thereof, or any part of such amount or installment, is not paid on or before the date prescribed for its payment, there shall be collected as a part of the tax, interest upon such unpaid amount at the rate of one per centum a month from the date prescribed for its payment until it is paid.

(2) If Extension Granted.—Where an extension of time for payment of the amount so determined as the tax by the taxpayer, or any installment thereof, has been granted, and the amount the time for payment of which has been extended, and the interest thereon determined under paragraph (4) of this subsection, is not paid in full prior to the expiration of the period of the extension, then, in lieu of the interest provided

in paragraph (1) of this subsection, interest at the rate of one per centum a month shall be collected on such unpaid amount from the date of the expiration of the period of the extension until it is paid.

(3) Deficiency.—Where a deficiency, or any interest or additional amounts assessed in connection therewith under subsections (b) and (c) of this section, or any addition to the tax in case of delinquency provided for in subsections (a) (1) and (2) of this section is not paid in full within ten days from the date of notice and demand from the commissioner, there shall be collected as part of the tax, interest upon the unpaid amount at the rate of one per centum a month from the date of such notice and demand until it is paid. If any part of a deficiency prorated to any unpaid installment under section 19 is not paid in full on or before the date prescribed for the payment of such installment, there shall be collected as part of the tax, interest upon the unpaid amount at the rate of one per centum a month from such date until it is paid.

(4) Interest on Extension.—If the time for payment of the amount determined as the tax by the taxpayer, or any installment thereof, is extended under the provisions of section 13 (c), there shall be collected as a part of such amount, interest thereon at the rate of six per centum per annum from the date upon which such payment should have been made if no extension had been granted to the date of expiration of the period of extension, or to the date the tax is paid, whichever is earlier.

(5) Fiduciaries.—For any period an estate is held by a fiduciary appointed by order of any court of competent jurisdiction or by will, there shall be collected interest at the rate of six per centum per annum in lieu of the interest provided in subsections (d) (1), (2) and (3) of this section.

SEC. 16. Accounting Periods:

Accounting
periods

(a) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 2 (i) or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

(b) If a taxpayer, with the approval of the commissioner, changes the basis of computing net income from fiscal year to calendar year a separate return shall be made for the period between the close of the last fiscal year for which return was made and the following December 31. If the change is from calendar year to the fiscal year, a separate return shall

be made for the period between the close of the last calendar year for which return was made and the date designated as the close of the fiscal year. If the change is from one fiscal year to another fiscal year a separate return shall be made for the period between the close of the former fiscal year and the date designated as the close of the new fiscal year.

(1) Where a separate return is made under subsection (b) of this section on account of a change in the accounting period, and in all other cases where a separate return is required or permitted, by regulations prescribed by the commissioner, to be made for a fractional part of a year, then the income shall be computed on the basis of the period for which separate return is made.

(2) If a separate return is made under subsection (b) of this section, on account of a change in the accounting period, the net income, computed on the basis of the period for which separate return is made, shall be placed on an annual basis by multiplying the amount thereof by twelve and dividing by the number of months included in the period for which the separate return is made. The tax shall be such part of the tax computed on such annual basis as the number of months in such period is of twelve months.

(c) In the case of a return made for a fractional part of a year, except a return made under subsection (b), on account of a change in the accounting period, the personal exemption and the credit for dependents shall be reduced respectively to amounts which bear the same ratio to the full credits provided as the number of months in the period for which return is made bears to twelve months.

(d) The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the methods of accounting permitted under subsection (a) of this section, any such amounts are to be properly accounted for as of a different period. In the case of the death of the taxpayer there shall be included in computing net income for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly includable in respect of such period or a prior period.

(e) The deductions and credits provided for in this act shall be taken for the taxable year in which "paid or accrued" or paid or incurred, dependent upon the method of accounting upon the basis of which the net income is computed, unless in order clearly to reflect the income the deductions or credits should be taken as of a different period. In the case of the death of a taxpayer there shall be allowed as deductions and credits for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly allowable in respect of such period or a prior period.

Supplement-
ary returns.

SEC. 17. Supplementary Returns. If the commissioner shall be of the opinion that any taxpayer has failed to file a

return, or to include in a return filed, either intentionally or through error, items of taxable income, he may require from such taxpayer a return, or a supplementary return, under oath, in such form as he shall prescribe, of all the items of income which the taxpayer received during the year for which the return is made, whether or not taxable under the provisions of this act. Every taxpayer required by the Federal government to file a supplementary return shall file a supplementary return with the commissioner. If from a supplementary return, or otherwise, the commissioner finds that any items of income, taxable under this act, have been omitted from the original return he may require the items so omitted to be disclosed to him, under oath of the taxpayer, and to be added to the original return. Such supplementary return and the correction of the original return shall not relieve the taxpayer from any of the penalties to which he may be liable under any provision of this act. The commissioner may proceed under the provisions of section 19 of this act whether or not he requires a return or a supplementary return under this section.

SEC. 18. Jeopardy Assessments.

Jeopardy
assessments

(a) If the commissioner finds that a taxpayer designs quickly to depart from this State or to remove his property therefrom, or to conceal himself or his property therein, or to do any other act tending to prejudice or to render wholly or partly ineffectual proceedings to collect the tax for the taxable year then last past or the taxable year then current unless such proceedings be brought without delay, the commissioner shall declare the taxable period for such taxpayer immediately terminated and shall cause notice of such finding and declaration to be given the taxpayer, together with a demand for immediate payment of the tax for the taxable period so declared terminated and of the tax for the preceding taxable year or so much of such tax as is unpaid, whether or not the time otherwise allowed by law for filing the return and paying the tax has expired; and such taxes shall thereupon become immediately due and payable. In any proceeding in court brought to enforce payment of taxes made due and payable by virtue of the provisions of this section the finding of the commissioner, made as herein provided, whether made after notice to the taxpayer or not, shall be for all purposes presumptive evidence of the taxpayer's design.

(b) If the commissioner believes that the assessment or collection of a deficiency will be jeopardized by delay, he shall immediately assess such deficiency (together with all interest, additional amounts, or additions to the tax provided for by this act) and the amount so assessed shall be due and payable upon notice and demand from the commissioner.

(c) If any taxpayer fails to file a return, or files a false or fraudulent return with intent to evade tax, for any taxable year, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

(d) The commissioner is hereby authorized to prescribe such rules and regulations as may be necessary to properly carry out the provisions of this section.

Assessment
of deficiency
tax.

SEC. 19. Assessment of Deficiency Tax. Protest. Appeal. As soon as practicable after the return is filed, the commissioner shall examine it and shall determine the correct amount of the tax. If the commissioner determines that the tax disclosed by the original return is less than the tax disclosed by his examination he shall mail notice to the taxpayer at his last known address of the deficiency proposed to be assessed. The notice shall set forth the details and computation of such deficiency.

Protest

Within sixty days after mailing of said notice the taxpayer may file with the commissioner a written protest against the levy of the proposed deficiency, specifying therein the grounds upon which the protest is based. The protest must be under oath.

If no such protest is so filed the amount of the deficiency shall be final upon the expiration of said sixty-day period. If a protest is so filed it shall be the duty of the commissioner to reconsider the computation and levy of the deficiency complained of, and, if the taxpayer has so requested in his protest, it shall be the duty of the commissioner to grant said taxpayer, or his authorized representatives, an oral hearing.

Appeal

The commissioner's action upon the protest shall be final upon the expiration of thirty days from the date when he mails notice of his action to the taxpayer, unless within that thirty day period the taxpayer appeals in writing from the action of the commissioner to the State board. The appeal must be addressed and mailed to the State Board of Equalization at Sacramento, California, and a copy of the appeal addressed and mailed at the same time to the commissioner at Sacramento, California. Said board shall hear and determine the same and thereafter shall forthwith notify the taxpayer and the commissioner of its determination, and the reasons therefor. Such determination shall be final, unless, within sixty days from the time of such determination, the commissioner shall apply to the Supreme Court of the State for a writ of certiorari or review for the purpose of having the lawfulness of the decision of said board inquired into and determined.

Notice and
demand

When a deficiency has been determined and the tax has become final under the provisions of this section, the commissioner shall mail notice and demand to the taxpayer for the payment thereof, and such tax shall be due and payable at the expiration of ten days from the date of such notice and demand, unless the taxpayer has elected to pay the tax in installments, in which case the deficiency shall be prorated to the three installments. Except as provided in section 18 (relating to jeopardy assessments), that part of the deficiency so prorated to any installment the date for payment of which has not arrived, shall be collected at the same time as, and as part of,

such installment. That part of the deficiency so prorated to any installment the date for payment of which has arrived shall be due and payable at the expiration of ten days from the date of such notice.

A certificate by the commissioner or of said board, as the case may be, of the mailing of the notices specified in this section shall be prima facie evidence of the computation and levy of the deficiency in tax and of the giving of said notices.

Except in the case of a fraudulent return, every notice of a proposed deficiency tax shall be mailed to the taxpayer within three years after the return was filed and no deficiency shall be assessed or collected with respect to the year for which such return was filed unless such notice is mailed within such period. For the purposes of this paragraph a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day.

Any amount of tax in excess of that disclosed by the return, due to a mathematical error, notice of which has been mailed to the taxpayer, shall not be considered a deficiency assessment within the meaning of this section. The taxpayer shall have no right of protest or appeal as herein provided, based on such notice, nor shall such assessment or collection be prohibited by any of the provisions of this section.

SEC. 20. Refund of Tax, Interest on Refunds, Appeal.

Refund of
tax.

If in the opinion of the commissioner, or State board, as the case may be, a tax has been computed in a manner contrary to law or has been erroneously computed by reason of a clerical mistake on the part of the commissioner or said board, or, if any tax, penalty or interest has been paid more than once, or has been erroneously or illegally collected, or has been erroneously or illegally computed, such fact shall be set forth in the records of the commissioner, and the amount collected in excess of what was legally due shall be credited on any taxes then due from the taxpayer under this act, and the balance refunded to the taxpayer; but no such credit or refund shall be allowed or made after three years from the time the return was filed by the taxpayer or within two years from the time the tax was paid, whichever period expires the later, unless before the expiration of such period a claim therefor is filed by the taxpayer. If no return is filed by the taxpayer, then no credit or refund shall be allowed or made after two years from the time the tax was paid unless before the expiration of such period a claim therefor is filed by the taxpayer. Every claim for refund must be in writing under oath and must state the specific grounds upon which the claim is founded.

If the commissioner disallows any claim for refund he shall notify the taxpayer accordingly. Within thirty days after the mailing of such notice, or if the commissioner does not act upon any claim for a refund within six months after the time the claim was filed, then within thirty days after the expiration of said six months, the commissioner's action upon the claim shall be final, unless within such thirty day period

the taxpayer appeals in writing from the action of the commissioner to the State board. The appeal must be addressed to the State Board of Equalization at Sacramento, California, and a copy of the appeal addressed and mailed at the same time to the commissioner at Sacramento, California. Said board shall hear and determine the same and thereafter shall forthwith notify the taxpayer and the commissioner of its determination. Such determination shall be final, unless, within sixty days from the time of such determination, the commissioner shall apply to the Supreme Court of the State for a writ of certiorari or review for the purpose of having the lawfulness of the decision of said board inquired into and determined.

Interest

Interest shall be allowed and paid upon any overpayment of any tax, if the overpayment was not made because of an error or mistake on the part of the taxpayer, at the rate of six per centum per annum as follows:

(1) In the case of a credit, from the date of the overpayment to the date of the allowance of the credit. Any interest allowed on any credit shall first be credited on any taxes due from the taxpayer under this act.

(2) In the case of a refund, from the date of the overpayment to a date preceding the date of the refund warrant by not more than thirty days, such date to be determined by the commissioner.

Recovery
of refunds
or credits.

Any refund or any portion thereof which is erroneously made, and any credit or any portion thereof which is erroneously allowed, may be recovered, together with interest at the rate of six per centum per annum from the date the refund was made or the credit allowed, in an action brought by the commissioner in a court of competent jurisdiction in the county of Sacramento in the name of the people of the State of California, and such action shall be tried in the county of Sacramento unless the court with the consent of the prosecutor, order a change of place of trial. The Franchise Tax Counsel or the Attorney General must prosecute such action, and the provisions of the Code of Civil Procedure, relating to service of summons, pleadings, proofs, trials, and appeals are applicable to the proceedings herein provided for.

In the event that a tax has been illegally levied against a taxpayer, the commissioner shall set forth on his records the reasons therefor and thereafter shall authorize the cancellation of such tax.

Action to
recover tax.

SEC. 21. Action to Recover Tax.

Any taxpayer claiming that the tax computed and levied against him is void in whole or in part may pay the tax under protest and bring an action against the State Treasurer for the recovery of the whole or any part of the amount paid. The protest must be in writing under oath and must state in detail the grounds upon which the claim is founded. Such action must be filed within ninety days after the notice and demand for the payment of the tax under section 19 hereof;

provided, however, no action shall be filed for the recovery of a deficiency assessment unless the taxpayer has made protest to the commissioner of the computation and levy complained of under the provisions of such section; and provided further, that no action shall be brought to recover any deficiency assessment, or any part thereof, if the taxpayer has at any time appealed to the State board from the action of the commissioner in overruling the taxpayer's protest to the commissioner's proposal of the said deficiency assessment.

When a refund claim has been filed under the provisions of section 20 hereof, and the same has been denied or no action has been taken thereon by the commissioner within six months from the filing thereof, the taxpayer may bring an action against the State Treasurer on the grounds set forth in such claim for the recovery of the whole or any part of the amount claimed as an overpayment, but such action must be brought within ninety days from the date of the commissioner's denial of such claim or within ninety days from the expiration of the said six months if no action has been taken by the commissioner; provided, that no action shall be filed if the taxpayer has appealed to the State board from the action of the commissioner with respect to any refund claim.

In any judgment of any court rendered for any overpayment in respect of any tax imposed by this act, interest shall be allowed at the rate of six per centum per annum upon the amount of the overpayment, from the date of the payment or collection thereof to the date of allowance of credit on account of such judgment or to a date preceding the date of the refund warrant by not more than thirty days, such date to be determined by the commissioner. Interest

Whenever under the provisions of this section an action is commenced against the State Treasurer, a copy of the complaint and the summons must be served upon the Treasurer or his deputy and the commissioner. At the time the Treasurer demurs or answers, he may demand that the action be tried in the superior court of the county of Sacramento, which demand must be granted. The Franchise Tax Counsel or the Attorney General of the State of California must defend the action. A failure to begin such action within the time herein specified shall be a bar against the recovery of such taxes. Service of papers

Within sixty days after the determination of the State board of any appeal from the action of the commissioner the appellant may apply to the Supreme Court of the State for a writ of certiorari or review for the purpose of having the lawfulness of the decision or order of the State board inquired into and determined. Such writ shall be made returnable not later than thirty days after the date of the issuance thereof, and shall direct the State board to certify its record in the case to the court. On the return day, the cause shall be heard by the Supreme Court, unless for a good reason the same be continued. The State board and each party to the proceeding before such board shall appear in the review proceeding. Review.

The provisions of the Code of Civil Procedure of this State relating to the writs of review shall apply to proceedings instituted in the Supreme Court under the provisions of this section.

Partnership
not taxable

SEC. 22. Partnership Not Taxable.

(a) An individual carrying on business in partnership shall be liable for income tax only in his individual capacity and shall include in his gross income the distributive share of the net income of the partnership received by him or distributable to him during the taxable year.

(b) The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual.

(c) Every partnership shall make a return for each taxable year, stating specifically the items of gross income and the deductions allowed by this act, and shall include in the return the names and addresses of the individuals, whether residents or nonresidents, who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.

(d) If the taxable year of a partner is different from that of the partnership, the distributive share of the net income of the partnership to be included in computing the net income of the partner for his taxable year shall be based upon the net income of the partnership for any taxable year of the partnership ending within the taxable year of the partner.

Information
at source

SEC. 23. Information at Source.

(a) Every individual, partnership, corporation, joint stock company or association, insurance company, business trust, or so-called Massachusetts trust, being a resident or having a place of business in this State, in whatever capacity acting, including lessees or mortgagors of real or personal property, fiduciaries, employers and all officers and employees of this State or any political subdivision of this State, having the control, receipt, custody, disposal or payment of interest (other than interest coupons payable to bearer), rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments or other fixed or determinable annual or periodical gains, profits and income amounting to \$1,000 or over, paid or payable during any year to any taxpayer, shall make complete return thereof under oath, to the commissioner, under such regulations and in such form and manner and to such extent as may be prescribed by him.

(b) Such returns may be required, regardless of amounts, (1) in the case of payments of interest upon bonds, mortgages, deeds of trust, or other similar obligations of corporations, and (2) in the case of collections of items (not payable in the United States) of interest upon the bonds of foreign countries and interest upon the bonds of and dividends from foreign corporations by persons undertaking as a matter of business

or for profit the collection of foreign payments of such interest or dividends by means of coupons, checks, or bills of exchange.

(c) When necessary to make effective the provisions of this section the name and address of the recipient of income shall be furnished upon demand of the person paying the income.

(d) The provisions of this section shall not apply to the payment of interest obligations not taxable under this act.

(e) The commissioner, whenever he deems it necessary to insure compliance with the provisions of this act, may under rules and regulations prescribed by him, require any individual, partnership, corporation, joint stock company or association or insurance company, including lessees or mortgagors and employees of the State or of any political subdivision of the State having control, receipt, custody, disposal or payment of interest (other than interest coupons payable to bearer), rent, salaries, wages, premiums, annuities, compensation, remunerations, emoluments or other fixed or determinable annual or periodical gains, profits and income paid or payable to any taxpayer, to deduct and withhold the tax due from such taxpayer and make return thereof and pay the tax to the commissioner.

Sec. 24. Allocation of Income and Deductions.—In any case of two or more organizations, trades or businesses (whether or not incorporated, whether or not organized in the State of California, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the commissioner is authorized to distribute, apportion or allocate gross income or deductions between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary (1) in order to prevent evasion of taxes of any taxpayer taxable hereunder, or (2) clearly to reflect the income of any of such organizations, trades, or businesses where the income of any taxpayer taxable hereunder is affected thereby in such manner as to permit evasion of taxes.

Allocation
of income
and deduc-
tions

Sec. 25. Credit for Taxes Paid Other States by Resident or Nonresident Taxpayers.

Credit for
taxes paid
other States
Resident
taxpayers.

(a) Whenever a resident taxpayer of this State has become liable to income tax to another State or country upon his net income, or any part thereof, for the taxable year, derived from sources without this State, and subject to taxation under this act, the amount of income tax payable by him under this act shall be credited with the amount of income tax so paid by him to such other State or country, but such credit shall not exceed such proportion of the tax payable under this act as the income subject to tax in such other State or country bears to the taxpayer's entire income upon which the tax is imposed by this act.

(b) Whenever a nonresident taxpayer taxable under this act has become liable to income tax to the State or country where he resides upon his net income for the taxable year, derived from sources within this State and subject to taxation

Nonresident
taxpayers

under this act, the amount of income tax payable by him under this act shall be credited with such proportion of the tax so payable by him to the State or country where he resides as his income subject to taxation under this act bears to his entire income upon which the tax so payable to such other State or country was imposed; provided, that such credit shall be allowed only if the laws of said State or country grant a substantially similar credit to residents of this State subject to income tax under such laws, or impose a tax upon the personal incomes of its residents derived from sources in this State and exempt from taxation the personal incomes of residents of this State. No credit shall be allowed against the amount of the tax on any income taxable under this act which is exempt from taxation under the laws of such other State.

(c) The credits provided in this section shall be allowed only on presentation to the commissioner of satisfactory proof that the taxpayer is entitled to same.

Tax upon
settlement
of fiduciary's
account.

SEC. 26. Tax Upon Settlement of Fiduciary's Account.

(a) No final account of a fiduciary shall be allowed by the probate court unless such account shows and the judge of said court finds, that all taxes imposed by the provisions of this act upon said fiduciary, which have become payable, have been paid, and that all taxes which may become due are secured by bond, deposit or otherwise. The certificate of the commissioner and the receipt for the amount of the tax therein certified shall be conclusive as to the payment of the tax, to the extent of said certificate.

(b) For the purpose of facilitating the settlement and distribution of estates held by fiduciaries, the commissioner may on behalf of the State agree upon the amount of taxes at any time due or to become due from such fiduciaries under the provisions of this act, and payment in accordance with such agreement shall be full satisfaction of the taxes to which the agreement relates.

(c) Upon notice to the commissioner that any person is acting in a fiduciary capacity, such fiduciary shall assume the powers, rights, duties, and privileges of the taxpayers in respect of any tax imposed by this act (except as otherwise specifically provided and except that the tax shall be collected from the estate of the taxpayers), until notice is given that the fiduciary capacity has terminated. Notice under this section shall be given in accordance with rules and regulations prescribed by the commissioner.

Contract to
assume tax
illegal

SEC. 27. Contract to Assume Tax Illegal.—It shall be unlawful for any person to agree or contract directly or indirectly to pay or assume or bear the burden of any tax payable by any taxpayer under the provisions of this act. Any such contract or agreement shall be null and void and shall not be enforced or given effect by any court.

Enforcement
of tax.

SEC. 28. Enforcement of Tax.—In any case in which any tax or any portion or installment thereof, interest or penalty imposed under this act is not paid when due, the commissioner

shall file in the office of the county clerk of Sacramento County, or any other county, a certificate specifying the amount of the tax, penalty and interest due, the name and last known address of the taxpayer liable for the same, that the commissioner has complied with all the provisions of this act in relation to the computation and levy of the tax and a request that judgment be entered against the taxpayer in the amount of the tax, penalty and interest set forth in the certificate. The county clerk immediately upon the filing of such certificate shall enter a judgment for the people of State of California against the taxpayer in the amount of the tax, penalty and interest set forth in the certificate. The judgment may be filed by the county clerk in a loose-leaf book entitled "Personal Income Tax Judgments."

An abstract of such judgment or a copy thereof shall be recorded with the county recorder of any county and from the time of such recording, the amount of the taxes, penalty and interest therein set forth shall constitute a lien upon all property of the taxpayer in such county, owned by him or which he may afterwards and before the lien expires acquire, which lien shall have the force, effect and priority of a judgment lien. Execution shall issue upon such a judgment upon request of the commissioner in the same manner as execution may issue upon other judgments, and sales shall be held under such execution as prescribed in the Code of Civil Procedure. In all proceedings under this section the commissioner shall be authorized to act on behalf of the people of the State of California.

The commissioner may, at any time, bring an action in a court of competent jurisdiction, in the name of the people of the State of California, to recover the amount of any taxes, penalties, and interest due under this act. The Franchise Tax Counsel or the Attorney General of this State must prosecute such action and such action shall be tried in the county of Sacramento unless the court with the consent of the prosecutor, order a change of place of trial. In such action a writ of attachment may be issued, and no bond or affidavit previous to the issuing of said attachment is required. In such action a certificate by the commissioner showing the delinquency shall be prima facie evidence of the levy of the tax, of the delinquency and of compliance by the commissioner and the State board with all the provisions of this act in relation to the computation and levy of the tax.

It is expressly provided that the foregoing remedies of the State shall be cumulative and that no action taken by the commissioner shall be or be construed to be an election on the part of the State or any of its officers to pursue any remedy hereunder to the exclusion of any other remedy for which provision is made in this act.

Sec. 29. Tax a Debt—Every tax imposed by this act, and all increases, interest and penalties thereon, shall become, from the time it is due and payable, a personal debt,

Tax lien.

Action to recover tax.

Tax a debt.

person or persons liable to pay the same, to the State of California.

Penal
provisions

SEC. 30. Penal Provisions --Any person who, with or without fraudulent intent, fails to pay any tax or to make, render, sign or verify any return, or to supply any information, within the time required by or under the provisions of this act, shall be liable to a penalty of not more than \$1,000, to be recovered by the Franchise Tax Counsel or the Attorney General, in the name of the people, by action in any court of competent jurisdiction.

Any person or any officer or employee of any corporation, or member or employee of any partnership, who, with or without intent to evade any requirement of this act or any lawful requirement of the commissioner thereunder, shall fail to pay any tax or to make, sign or verify any return or to supply any information required by or under the provisions of this act, or who, with like intent, shall make, render, sign or verify any false or fraudulent return or statement, or shall supply any false or fraudulent information, shall be liable to a penalty of not more than \$1,000, to be recovered by the Franchise Tax Counsel or the Attorney General in the name of the people, by action in any court of competent jurisdiction, and shall also be guilty of a misdemeanor and shall, upon conviction, be fined not to exceed \$1,000 or be imprisoned not to exceed one year, or both, at the discretion of the court.

The prosecutor shall have the power, with the consent of the commissioner to compromise any penalty for which he is authorized to bring action under this section. The penalties provided by this section shall be additional to all other penalties in this act provided.

The certificate of the commissioner to the effect that a tax has not been paid, that a return has not been filed, or that information has not been supplied as required by the provisions of this act, shall be prima facie evidence that such tax has not been paid, that such return has not been filed or that such information has not been supplied.

Disposition
of proceeds

SEC. 31. Disposition of Proceeds.

(a) All moneys and remittances received by the commissioner in pursuance of the provisions of this act shall be transmitted promptly to the State Treasurer, and copies of the schedules covering such transmittals shall be furnished at the same time to the State Controller.

(b) All moneys and remittances so received and so transmitted shall be deposited, after clearance of remittances, in the State treasury and credited to the "Personal income tax fund."

(c) For expenditure by the commissioner in carrying out the provisions of this act there is hereby appropriated a sum of money equal to one hundred thousand dollars and three per cent, or so much thereof as may be necessary, of all other moneys deposited in the personal income tax fund; said one hundred thousand dollars being payable out of moneys in the

general fund not otherwise appropriated, the remainder of the moneys hereby appropriated being payable out of the personal income tax fund; provided, that, out of said three per cent of said other moneys deposited in the personal income tax fund on or before June 30, 1937, the sum of one hundred thousand dollars shall be returned into the general fund. For expenditure by the Controller in carrying out the provisions of this act there is hereby appropriated out of the personal income tax fund the sum of five thousand dollars or so much thereof as may be necessary, for expenditure by the State Treasurer in carrying out the provisions of this act there is hereby appropriated out of the personal income tax fund the sum of ten thousand dollars or so much thereof as may be necessary, and for expenditure by the Department of Finance in auditing the revenues and expenditures resulting from the provisions of this act there is hereby appropriated out of the personal income tax fund the sum of ten thousand dollars or so much thereof as may be necessary. The balance of the moneys in the personal income tax fund shall, upon order of the State Controller, be drawn therefrom for the purpose of making refunds hereunder or be transferred to the general fund of the State.

Sec. 32. Commissioner to Administer This Act.

(a) The commissioner shall administer and enforce the tax herein imposed, for which purpose he may divide the State into a reasonable number of districts, in each of which a branch office or offices may be maintained during all or such part of the time as may be necessary. In the establishment of such districts and offices due consideration shall be given by the commissioner to the matter of economy of administration and service to the taxpayers.

Commissioner to administer act.

(b) The commissioner, for the purpose of ascertaining the correctness of any return or for the purpose of making an estimate of the taxable income of any taxpayer, shall have power to examine or cause to be examined by any agent or representative designated by him for that purpose, any books, papers, records or memoranda, bearing upon the matters required to be included in the return, and may require the attendance of the taxpayer or of any other person having knowledge in the premises, and may take testimony and require proof material for his information, with power to administer oath to such person or persons.

(c) The commissioner may appoint and remove, in the manner provided by law, such officers, agents, branch office income tax deputies, and other employees as he may deem necessary, such persons to have such duties and powers as the commissioner may from time to time prescribe. Any temporary appointments of branch office income tax deputies and other branch office employees shall be made from eligible residents of the district in which such branch office or offices are located. The salaries of the personnel required by the commissioner shall be such as he may prescribe, in the manner provided by

Assistants

law, and the commissioner and such personnel shall be allowed reasonable and necessary traveling and other expenses incurred in the performance of their duties. The commissioner may require such of the officers, agents, deputies and other employees as he may designate, to give bond for the faithful performance of their duties in such sum and with such sureties as he may determine, and all premiums on such bonds shall be paid by the commissioner out of moneys appropriated for the administration of this act.

(d) The commissioner and such officers, as he may designate, shall have the power to administer an oath to any person or to take the acknowledgment of any person in respect of any return or report required by this act or the rules and regulations of the commissioner.

SEC. 33. Secrecy Required of Officials, Penalty for Violation.

Secrecy re-
quired of
officials,
penalty for
violation

(a) Except in accordance with proper judicial order or as otherwise provided by law, it shall be unlawful for the commissioner, any deputy, agent, clerk or other officer or employee, to divulge or make known in any manner the amount of income or any particulars set forth or disclosed in any report or return required under this act. Nothing herein shall be construed to prohibit the publication of statistics, so classified as to prevent the identification of particular reports or returns and the items thereof, or the inspection by the Attorney General or other legal representatives of the State, of the report or return of any taxpayer who shall bring action to set aside or review the tax based thereon, or against whom an action or proceeding has been instituted to recover any tax or any penalty imposed by this act. Reports and returns shall be preserved for four years and thereafter until the commissioner orders them to be destroyed.

(b) Any offense against subdivision (a) of this section shall be a misdemeanor.

(c) Notwithstanding the provisions of this section, the commissioner may permit the Commissioner of Internal Revenue of the United States, or the proper officer of any State imposing an income tax upon the incomes of individuals, or the authorized representative of either such officer, to inspect the income tax returns of any individual, or may furnish to such officer or his authorized representative an abstract of the return of income of any taxpayer or supply him with information concerning any item of income contained in any return, or disclosed by the report of any investigation of the income or return of income of any taxpayer; but such permission shall be granted or such information furnished to such officer or his representative, only if the statutes of the United States or of such other State, as the case may be, grant substantially similar privileges to the proper officer of this State charged with the administration of this act.

Personal
holding
companies.

SEC. 34. Personal Holding Companies. For the purpose of this act a personal holding company whether or not organ-

ized under the laws of this State shall not be recognized as a legal entity separate and distinct from the shareholders thereof. Any such company having more than one shareholder shall be deemed a partnership.

SEC. 35. Unconstitutionality or Invalidity. If any clause, sentence, paragraph, or part of this act shall, for any reason, be adjudged by any court of competent jurisdiction to be invalid, such judgment shall not affect, impair, or invalidate the remainder of this act, but shall be confined in its operation to the clause, sentence, paragraph or part thereof directly involved in the controversy in which such judgment shall have been rendered. No caption of any section or set of sections shall in any way affect the interpretation of this act or any part thereof.

SEC. 36. Taking Effect of the Act.

This act, inasmuch as it provides for a tax levy for the usual current expenses of the State, shall, under the provisions of section 1 of Article IV of the Constitution, take effect immediately, and shall apply to the net income of persons taxable hereunder received or accrued on and after January 1, 1935.

CHAPTER 330.

An act to license, regulate and control the manufacture, transportation, sale, purchase, possession and disposition of alcoholic beverages; to levy an excise tax on the sale of alcoholic beverages; to provide for the licensing of the manufacture, distribution and sale of alcoholic beverages; to prescribe penalties for the violation of this act; to make an appropriation for the enforcement of this act; to take effect immediately.

[Approved by the Governor June 13, 1935. In effect immediately.]

The people of the State of California do enact as follows:

SECTION 1. This act is known and may be cited as the "Alcoholic Beverage Control Act."

SEC. 2. The following words, terms and phrases when used in this act have the meanings ascribed to them in this section, except where the context clearly indicates a different meaning:

(a) "Alcohol" means ethyl alcohol, hydrated oxide of ethyl, or spirits of wine, from whatever source or by whatever process produced.

(b) "Alcoholic beverage" means and includes alcohol, spirits, liquor, wine, beer and every liquid or solid containing alcohol, spirits, wine or beer, and which contains one-half of one per cent or more of alcohol by volume and which is fit for beverage purposes either alone or when diluted, mixed or combined with other substances.

STATUTES OF CALIFORNIA

1937

—
CONSTITUTION OF 1879 AS AMENDED

MEASURES SUBMITTED TO VOTE
OF ELECTORS 1936

GENERAL LAWS, AMENDMENTS TO
CODES, RESOLUTIONS AND
CONSTITUTIONAL
AMENDMENTS

PASSED AT THE

EXTRA SESSION OF THE FIFTY-FIRST
LEGISLATURE, 1936

AND THE

REGULAR SESSION OF THE FIFTY-SECOND
LEGISLATURE, 1937



CALIFORNIA STATE PRINTING OFFICE
GEORGE H. MOORE, STATE PRINTER
SACRAMENTO, 1937

CI-50017

the possession of the property taken upon such search warrant to the owner thereof.

SEC. 8. The violation of any of the provisions of this act shall constitute a misdemeanor. Penalty

SEC. 9. If any section, subsection, sentence, clause or phrase of this act is for any reason held to be unconstitutional such decision shall not affect the validity of the remaining portions of this act. The Legislature hereby declares that it would have passed this act, each section, subsection, sentence, clause or phrase thereof, irrespective of the fact that any one or more of the sections, subsections, sentences, clauses or phrases be declared unconstitutional. Constitutionality.

CHAPTER 668.

An act to amend sections 2, 3, 4, 7, 8, 9, 10, 12, 15, 18, 19, 20, 21, 23, 25, 26, 27, 32, 33 and 34 of "The Personal Income Tax Act of 1935," relating to the taxation of income of individuals, estates and trusts. Stats 1935,
p 1090,
amended

[Approved by the Governor July 1. In effect August 27, 1937.]

The people of the State of California do enact as follows:

SECTION 1. Section 2 of the act cited in the title hereof is hereby amended to read as follows: Stats 1935,
p 1090

Sec. 2. Definitions. For the purposes of this act and unless otherwise required by the context— Definitions

(a) The word "commissioner" as used in this act and the word "commissioner" as used in the "Revenue Act of 1936," when any part of that act is incorporated herein by reference, mean the Bank and Corporation Franchise Tax Commissioner.

(d) The word "fiduciary" means a guardian, trustee, ciary, estate, or trust subject to the tax imposed by this act.

(c) The word "individual" means a natural person.

(d) The word "fiduciary" means a guardian, trustee, executor, administrator, receiver, conservator, or any person, whether individual or corporate, acting in any fiduciary capacity for any person, estate or trust.

(e) The word "person" includes individuals, fiduciaries, partnerships and corporations.

(f) The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this act, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

(g) The word "corporation" includes joint-stock companies or associations, insurance companies, business trusts or so-called "Massachusetts trusts."

(h) The words "taxable year" mean the calendar year or the fiscal year, upon the basis of which the net income is computed under this act; if no fiscal year has been established they mean the calendar year.

"Taxable year" includes, in the case of a return made for a fractional part of a year under the provisions of this act or under regulations prescribed by the commissioner, the period for which such return is made.

(i) The words "fiscal year" mean an accounting period of twelve months ending on the last day of any month other than December.

(j) The words "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under this act.

Presumption
of residence

(k) Every natural person who is in the State of California for other than a temporary or transitory purpose is a resident and every natural person domiciled within this State is a resident unless he is a resident within the meaning of that term as herein defined of some other State, Territory or country. Every natural person who spends in the aggregate more than nine months of the taxable year within the State or maintains a permanent place of abode within this State shall be presumed to be a resident. The presumption may be overcome by satisfactory evidence that such person is in the State for a temporary or transitory purpose. Any natural person who is or shall become a resident of this State shall continue to be a resident even though temporarily absent from the State. Every natural person other than a resident is a non-resident.

(l) The words "foreign country" mean any jurisdiction other than one embraced within the United States. The words "United States," when used in a geographical sense, include the States, the Territories of Alaska and Hawaii, the District of Columbia and the possessions of the United States.

(m) The words "Revenue Act of 1936" mean the act of Congress of the United States, approved June 22, 1936, and known and cited as the "Revenue Act of 1936."

(n) The words "trade or business" include the performance of the functions of a public office.

(o) The words "State board" mean the State Board of Equalization.

Stats. 1935,
p 1091.

Sec. 2. Section 3 of said act is hereby amended to read as follows:

Who shall
file returns

Sec. 3. Who Shall File Returns. (a) Every person taxable under this act shall make a return to the commissioner, stating specifically the items of his gross income and the deductions and credits allowed by this act, if having a net income for the taxable year of—

(1) \$1,000 or over, if single, or if married and not living with husband or wife;

(2) \$2,500 or over, if married and living with husband or wife; or

(3) If having a gross income of \$5,000 or over, regardless of the amount of net income.

(b) If a husband and wife living together have an aggregate net income for the taxable year of \$2,500 or over, or an aggregate gross income for such year of \$5,000 or over—

(1) Each shall make such a return, or

(2) The income of each shall be included in a single joint return, in which case the tax shall be computed on the aggregate income.

(c) If the taxpayer is unable to make his own return, the return shall be made by a duly authorized agent or by the guardian or other person charged with the care of the person or property of such taxpayer.

(d) Every resident or nonresident who is taxable upon income of an estate or trust shall include such income in his gross income.

SEC. 3. Section 4 of said act is hereby amended to read as follows: Stats 1935.
p. 1092.

Sec. 4. Fiduciary Returns. (a) Every fiduciary (except a receiver appointed by authority of law in possession of part only of the property of an individual) shall make a return for any of the following individuals, estates or trusts, taxable hereunder, for which he acts, stating specifically the items of gross income thereof and the deductions and credits allowed under this act— Fiduciary
returns

(1) Every individual having a net income for the taxable year of \$1,000 or over, if single, or if married and not living with husband or wife;

(2) Every individual having a net income for the taxable year of \$2,500 or over, if married and living with husband or wife;

(3) Every individual having a gross income for the taxable year of \$5,000 or over, regardless of the amount of his net income;

(4) Every estate or trust the net income of which for the taxable year is \$1,000 or over;

(5) Every estate or trust the gross income of which for the taxable year is \$5,000 or over, regardless of the amount of the net income.

(b) Under such rules and regulations as the commissioner may prescribe, a return filed by one of two or more joint fiduciaries shall be sufficient compliance with the above requirement. Such fiduciary shall state under oath (1) that he has sufficient knowledge of the affairs of the individual, estate, or trust, for which the return is made, to enable him to make the return, and (2) that the return is, to the best of his knowledge and belief, true and correct.

(c) Any fiduciary required to make a return under this act shall be subject to all the provisions of this act which apply to individuals.

Stats 1935,
p 1094

SEC. 4. Section 7 of said act is hereby amended to read as follows:

Gross
income.

Sec. 7. Gross Income. (a) Gross income includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever, and includes any salary, wages or compensation of any officer or employee of this State, or any political subdivision, district or municipality thereof.

Exemptions.

(b) The following items shall not be included in gross income and shall be exempt from taxation under this act:

(1) Amounts received under a life insurance contract paid by reason of the death of the insured, whether in a single sum or otherwise (but if such amounts are held by the insurer under an agreement to pay interest thereon, the interest payments shall be included in gross income);

(2) Amounts received (other than amounts paid by reason of the death of the insured and interest payments on such amounts and other than amounts received as annuities) under a life insurance or endowment contract, but if such amounts (when added to amounts received before the taxable year under such contract) exceed the aggregate premiums or consideration paid (whether or not paid during the taxable year) then the excess shall be included in gross income. Amounts received as an annuity under an annuity or endowment contract shall be included in gross income; except that there shall be excluded from gross income the excess of the amount received in the taxable year over an amount equal to 3 per centum of the aggregate premiums or consideration paid for such annuity (whether or not paid during such year), until the aggregate amount excluded from gross income under this act in respect of such annuity increased by the amount which would have been excluded from gross income in respect of such annuity had this act been in effect continuously from and after the date at which payments under such annuity were first received equals the aggregate premiums or consideration paid for such annuity. In the case of a transfer for a valuable consideration, by assignment or otherwise, of a life insurance, endowment, or annuity contract, or any interest therein, only the actual value of such consideration and the amount of the premiums and other sums subsequently paid by the transferee shall be exempt from taxation under paragraph (1) or this paragraph;

(3) The value of property acquired by gift, bequest, devise, or inheritance (but the income from such property shall be included in gross income);

(4) Amounts received, through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received whether by suit or agreement on account of such injuries or sickness;

(5) The rental value of a dwelling house and appurtenances thereof furnished to a minister of the gospel as part of his compensation;

(6) 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.

(c) Whenever in the opinion of the commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the commissioner may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

(d) In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in sections 111, 112 and 113 of the Revenue Act of 1936 which sections and the sections referred to therein are hereby referred to and incorporated with the same force and effect as though fully set forth herein; provided, however, that the words "with the approval of the secretary" in said sections shall be deemed omitted.

(e) In the case of sales or exchanges of capital assets, the gain or loss shall be taken into account in computing net income in the manner provided in section 117 of the Revenue Act of 1936 which section and the sections of the Revenue Act of 1936 referred to therein are hereby referred to and incorporated with the same force and effect as though fully set forth herein.

(f) In the case of taxpayers other than residents the gross income includes only the gross income from sources within this State. Gross income from sources within and without this State shall be allocated and apportioned under rules and regulations to be prescribed by the commissioner.

Income of nonresidents from stocks, bonds, notes, or other intangible personal property shall not be considered income from sources within this State unless the property has acquired a business situs in this State, except that if a nonresident buys or sells such property in this State or places orders with brokers in this State to buy or sell such property so regularly, systematically, and continuously as to constitute doing business in this State, the profit or gain derived from such activity is income from sources within this State irrespective of the situs of the property.

Income of nonresident beneficiaries from estates or trusts is income from sources within this State only if distributed or distributable out of income of the estate or trust derived from sources within this State.

Dividends.

(g) (1) The term "dividend" when used in this act means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913, or out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

(2) For the purposes of this act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the adjusted basis of the stock provided in subsection (d) of this section.

(3) Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under subsection (d) of this section, and shall be recognized only to the extent provided in subsection (d) of this section. Despite the provisions of subsection (e) of this section, 100 per centum of the gain so recognized shall be taken into account in computing net income, except in the case of amounts distributed in complete liquidation of a corporation. For the purpose of the preceding sentence, "complete liquidation" includes any one of a series of distributions made by a corporation in complete cancellation or redemption of all of its stock in accordance with a bona fide plan of liquidation and under which the transfer of the property under the liquidation is to be completed within a time specified in the plan, not exceeding two years from the close of the taxable year during which is made the first of the series of distributions under the plan. In the case of amounts distributed (whether before or after the effective date of this amendment) in partial liquidation (other than a distribution within the provisions of subsection (8) of this section of stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits. In the case of amounts distributed (whether before January 1, 1934, or on or after such date) in partial liquidation (other than a distribution within the provisions of subdivision (8) of this subsection or stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within

the meaning of subdivision (2) of this subsection for the purpose of determining the taxability of subsequent distributions by the corporation. Dividends.

(4) If any distribution (not in partial or complete liquidation) made by a corporation to its shareholders is not out of increase in value of property accrued before March 1, 1913, and is not a dividend, then the amount of such distribution shall be applied against and reduce the adjusted basis of the stock provided in subsection (d) of this section, and if in excess of such basis, such excess shall be taxable in the same manner as a gain from the sale or exchange of property.

(5) Any distribution made by a corporation, which was classified as a personal service corporation under the provisions of the Federal Revenue Act of 1918 or the Federal Revenue Act of 1921, out of its earnings or profits which were taxable in accordance with the provisions of section 218 of the Federal Revenue Act of 1918 or section 218 of the Federal Revenue Act of 1921, shall be exempt from tax to the distributees

(6) (a) A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution of the United States.

(b) Whenever a distribution by a corporation is, at the election of any of the shareholders (whether exercised before or after the declaration thereof), payable either (1) in its stock or in rights to acquire its stock, of a class which if distributed without election would be exempt from tax under paragraph (a), or (2) in money or any other property (including its stock or rights to acquire its stock, of a class which if distributed without election would not be exempt from tax under paragraph (a)), then the distribution shall constitute a taxable dividend in the hands of all shareholders, regardless of the medium in which paid.

(7) If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

(8) The distribution heretofore or hereafter made to a distributee by or on behalf of a corporation of its stock or securities or stock or securities in another corporation shall not be considered a distribution of earnings or profits of any corporation—

(a) If no gain to such distributee from the receipts of such stock or securities was recognized under the provisions of the Federal Revenue Act of 1936 or prior Federal Revenue Acts in effect at the time of the distribution, or

(b) If the distribution was not subject to tax in the hands of such distributee under the Federal Revenue Act of 1936 or prior Federal Revenue Acts in effect at the time of the distribution because it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution of the United States or because exempted to him under section 115(f) of the Federal Revenue Act of 1934, or a corresponding provision of a prior Federal Revenue Act.

As used in this subsection, the term "stock or securities" includes rights to acquire stock or securities.

(9) As used in this subsection the term "amount distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock

(10) If the whole or any part of a dividend is paid to a shareholder in any medium other than money the property received other than money shall be included in gross income at its fair market value at the time as of which it becomes income to the shareholder.

Stats 1935,
p 1097.

Sec. 5. Section 8 of said act is hereby amended to read as follows:

Deductions
from gross
income

Sec. 8. Deductions from Gross Income. In computing net income there shall be allowed as deductions:

(a) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

In the case of any taxpayer the deductions permitted by this subsection shall not be allowed if, and to the extent that they are connected with the production of income not taxable under this act, and proper apportionment and allocation of such deductions with respect to taxable and nontaxable income shall be determined under rules and regulations to be prescribed by the commissioner.

(b) All interest paid or accrued within the taxable year on indebtedness of the taxpayer; provided, however, in the case of any taxpayer the deduction permitted by this subdivision shall not be allowed if, and to the extent that such deduction is connected with income not taxable under this act; and provided further, no such deduction shall be allowed or taken for interest paid or accrued within the taxable year on indebtedness incurred or continued to purchase or carry obligations, the interest upon which is wholly exempt from taxes imposed by this act. The proper apportionment and

allocation of such deductions with respect to taxable and nontaxable income shall be determined under rules and regulations to be prescribed by the commissioner.

(c) Taxes or licenses paid or accrued during the taxable year, other than taxes paid or accrued to the State under this act, and other than taxes on or according to or measured by income or profits paid or accrued within the taxable year imposed by the authority of (1) the Government of the United States or any foreign country, (2) any State, Territory, county, city and county, school district, municipality or other taxing subdivision of any State or Territory, and other than estate, inheritance, legacy, succession and gift taxes, and other than taxes assessed against local benefits of a kind tending to increase the value of the property assessed, but this shall not exclude the allowance as a deduction of so much of said taxes assessed against local benefits as is properly allocable to maintenance or interest charges. Taxes or licenses paid or accrued to this State or its political subdivisions which are deductible under the provisions of this subsection shall be deductible by nonresidents even though not connected with income from sources within this State.

(d) Losses sustained during the taxable year and not compensated for by insurance or otherwise: ^{Losses}

- (1) If incurred in trade or business; or
- (2) If incurred in any transaction entered into for profit, though not connected with the trade or business; or
- (3) Of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft.

The basis for determining the amount of deduction for losses sustained, to be allowed under this subsection shall be the adjusted basis provided in section 7 of this act for determining the loss from the sale or other disposition of property.

(e) Losses from wagering transactions shall be allowed only to the extent of the gains from such transactions.

(f) Debts ascertained to be worthless and charged off within the taxable year (or in the discretion of the commissioner a reasonable addition to a reserve for bad debts) and when satisfied that a debt is recoverable only in part, the commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction.

(g) In the case of any loss claimed to have been sustained from any sale or other disposition of shares of stock or securities where it appears that, within a period beginning thirty days before the date of such sale or disposition and ending thirty days after such date, the taxpayer has acquired (by purchase or by an exchange upon which the entire amount of gain or loss was recognized by law) or has entered into a contract or option so to acquire, substantially identical stock or securities, then no deduction for the loss shall be allowed. If the amount of stock or securities acquired (or covered by the contract or option to acquire) is less than the amount of stock

or securities sold or otherwise disposed of, then the particular shares of stock or securities the loss from the sale or other disposition of which is not deductible shall be determined under rules and regulations prescribed by the commissioner.

If the amount of stock or securities acquired (or covered by the contract or option to acquire) is not less than the amount of stock or securities sold or otherwise disposed of, then the particular shares of stock or securities the acquisition of which (or the contract or option to acquire which) resulted in the nondeductibility of the loss shall be determined under the rules and regulations prescribed by the commissioner.

(h) Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in subsection (d) of section 117 of the Revenue Act of 1936 which subsection is hereby referred to and incorporated with the same force and effect as though fully set forth herein.

Obsolescence, etc.

(i) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

(j) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the commissioner. In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, then such prior estimate (but not the basis for depletion) shall be revised and the allowance under this subsection for subsequent taxable years shall be based upon such revised estimate. In the case of leases the deductions shall be equitably apportioned between the lessor and the lessee. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each. The percentage of depletion allowable under this subsection shall be computed in accordance with the provisions of subdivisions (3) and (4) of subsection (b) of section 114

of the Revenue Act of 1936 which subdivisions and the sections of said revenue act referred to therein are hereby referred to and incorporated with the same force and effect as though fully set forth herein.

(k) The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114 of the Revenue Act of 1936 which section and all sections of said revenue act referred to therein are hereby referred to and incorporated with the same force and effect as though fully set forth herein; provided, however, that the words "with the approval of the secretary" shall be deemed omitted.

(l) In the case of an individual, contributions or gifts made ^{Gifts.} within the taxable year to or for the use of:

(1) The United States, any State, Territory or any political subdivision thereof, or the District of Columbia, for exclusively public purposes;

(2) A corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation;

(3) The special fund for vocational rehabilitation authorized by section 12 of the World War Veterans' Act, 1924;

(4) Posts or organizations of war veterans, or auxiliary units or societies of any such posts or organizations, if such posts, organizations, units, or societies are organized in the United States or any of its possessions, and if no part of their net earnings inures to the benefit of any private shareholder or individual; or

(5) A fraternal society, order, or association; operating under the lodge system, but only if such contributions or gifts are to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals.

The deductions under this subsection shall be allowed to an ^{Limitation} amount which in all the above cases combined does not exceed fifteen per centum of the taxpayer's net income as computed without the benefit of this subsection. Such contributions or gifts shall be allowed as deductions only if verified under rules and regulations prescribed by the commissioner.

In the case of an individual if in the taxable year and in each of the ten preceding taxable years the amount of the contributions or gifts described in this subsection plus the amount of income, war profits, or excess profits taxes paid during such year in respect of preceding taxable years, exceeds ninety per centum of the taxpayer's net income for each such year, as computed without the benefit of this sub-

section then the fifteen per centum limit imposed herein shall not be applicable.

In the case of a taxpayer other than a resident the deductions under this subsection shall be allowed only as to contributions or gifts to corporations or associations incorporated by or organized under the laws of this State or to the vocational rehabilitation fund above mentioned or to this State or any political subdivision thereof for exclusively public purposes.

(m) An employer establishing or maintaining a pension trust to provide for the payment of reasonable pensions to his employees (if such trust is exempt from tax under subsection (f) of section 12, relating to trusts created for the exclusive benefit of employees) shall be allowed as a deduction (in addition to the contributions to such trust during the taxable year to cover the pension liability accruing during the year, allowed as a deduction under subsection (a) of this section) a reasonable amount transferred or paid into such trust during the taxable year in excess of such contributions, but only if such amount (1) has not theretofore been allowable as a deduction, and (2) is apportioned in equal parts over a period of ten consecutive years beginning with the year in which the transfer or payment is made.

(n) In the case of a taxpayer other than a resident the deductions allowed by this section shall unless otherwise provided in this section be allowed only if and to the extent that they are connected with the income arising from sources within this State and taxable under this act to a nonresident taxpayer, and the proper apportionment and allocation of the deductions with respect to sources of income within and without the State shall be determined under rules and regulations to be prescribed by the commissioner.

Stats. 1935,
p. 1101.

Items not
deductible

SEC. 6. Section 9 of said act is hereby amended to read as follows:

Sec. 9. Items Not Deductible.

(a) In computing net income no deduction shall in any case be allowed in respect of—

- (1) Personal, living, or family expenses;
- (2) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate;
- (3) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made;
- (4) Premiums paid on any life insurance policy covering the life of any officer or employee, or of any person financially interested in any trade or business carried on by the taxpayer, when the taxpayer is directly or indirectly a beneficiary under such policy;
- (5) Any amount otherwise allowable as a deduction which is allocable to one or more classes of income (whether or not any amount of income of that class or classes is received or accrued) wholly exempt from the taxes imposed by this act; or

(6) Loss from sales or exchanges of property, directly or indirectly, (A) between members of a family, or (B) except in the case of distributions in liquidation, between an individual and a corporation in which such individual owns, directly or indirectly, more than fifty per cent in value of the outstanding stock. For the purpose of this paragraph—(C) an individual shall be considered as owning the stock owned, directly or indirectly, by his family; and (D) the family of an individual shall include only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants.

(b) Amounts paid under the laws of any State, Territory, District of Columbia, possession of the United States, or foreign country as income to the holder of a life or terminable interest acquired by gift, bequest, or inheritance shall not be reduced or diminished by any deduction for shrinkage (by whatever name called) in the value of such interest due to the lapse of time, nor by any deduction allowed by this act (except the deductions provided for in subsections (i) and (j) of section 8) for the purpose of computing the net income of an estate or trust but not allowed under the laws of such State, Territory, District of Columbia, possession of the United States, or foreign country for the purpose of computing the income to which such holder is entitled.

(c) The obligor of a covenant bond shall not be allowed a deduction for the payment of the tax imposed by this act, or any other tax pursuant to the tax-free covenant clause, nor shall such tax be included in the gross income of the obligee.

SEC. 7. Section 10 of said act is hereby amended to read as follows: Stats 1935,
p 1102

Sec. 10. Credits Against Net Income.

There shall be allowed for the purpose of the tax herein imposed: Credits
against net
income

(a) Personal Exemptions.—In the case of a single person, a personal exemption of \$1,000; or in case of the head of a family or a married person living with husband or wife, or in case of a person contributing to the support of a former husband or wife, by order of a court of competent jurisdiction, a personal exemption of \$2,500. A husband and wife living together shall receive but one personal exemption. The amount of such personal exemption shall be \$2,500. If such husband and wife make separate returns, the personal exemption may be taken by either or divided between them;

(b) Credit for Dependents.—\$400 for each person (other than husband or wife) dependent upon and receiving his chief support from the taxpayer if such dependent person is under eighteen years of age or is incapable of self-support because mentally or physically defective; Credit for
dependents

(c) Credit of Estates or Trusts.—In the case of an estate or trust an exemption of \$1,000; Credit of
estates or
trusts

(d) Change of Status.—If the status of the taxpayer, in so far as it affects the personal exemption or credit for dependents changes during the taxable year, the personal Change of
status

exemption and credit shall be apportioned, under such rules and regulations as are prescribed by the commissioner, in accordance with the number of months before and after such change. For the purpose of such apportionment a fractional part of a month shall be disregarded unless it amounts to more than half a month in which case it shall be considered as a month.

Stats 1935,
p 1103.

Tax on
income of
estates and
trusts.

SEC. 8. Section 12 of said act is hereby amended to read as follows:

Sec. 12. Tax on Income of Estates and Trusts.

(a) The taxes imposed by this act upon individuals shall apply to, and be imposed upon, the income of estates or of any kind of property held in trust (other than so-called Massachusetts trusts), including—

(1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(b) For the purposes of this section the word "settlor" shall mean and include every creator of a trust and every decedent and where in this section the settlor is spoken of as a resident or a nonresident the same shall be taken to include a decedent who upon his or her death is a resident or a nonresident as the case may be.

(c) Except as otherwise provided in subsections (d), (g) and (h) of this section, the income of an estate or trust shall be taxable to the estate or trust. The tax shall apply to the entire net income if, in the case of an estate, the decedent was a resident, regardless of the residence of the fiduciary or beneficiary, and in case of both estates and trusts, if the fiduciary or beneficiary is a resident, regardless of the residence of the settlor.

Where the taxability of income under this subsection depends on the residence of the fiduciary and there are two or more fiduciaries for the estate or trust, the income taxable under this subsection shall be apportioned according to the number of fiduciaries resident in this State, such apportionment being determined according to rules and regulations prescribed by the commissioner.

Where the taxability of income under this subsection depends on the residence of the beneficiary and there are two or more beneficiaries for the estate or trust, the income taxable under this subsection shall be apportioned according to the number and interest of beneficiaries resident in this State,

such apportionment being determined according to rules and regulations prescribed by the commissioner. Same.

Taxes on income of an estate or trust which is taxable to the estate or trust shall be a charge upon the estate or trust and shall be paid by the fiduciary.

If, for any reason, the taxes imposed on income of an estate or trust which is taxable to the estate or trust because the fiduciary or beneficiary is a resident of this State are unpaid when due and remain unpaid when such income is distributable to the beneficiaries, or in case such income is distributable to the beneficiaries before the taxes are due, if such taxes are unpaid when due, such income shall be taxable to the beneficiaries when distributable to them except that in the case of non-resident beneficiaries such income shall be taxable only to the extent provided in subsection (f) of section 7 of this act.

(d) The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

(1) There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by subsection (1) of section 8), any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in subsection (1) of section 8 or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit;

(2) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, and the amount of the income collected by a guardian of an infant which is to be held or distributed as the court may direct, but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. For the purpose of this paragraph amounts currently distributable to beneficiaries are distributable out of income of the estate or trust for the taxable year if there is income of the estate or trust for the taxable year out of which such distributions may be made and if, under the terms of the will or trust instrument, the distributions may be made out of such income, regardless of the fact that the will or trust instrument provides that the distributions may be made out of the corpus of the estate or trust. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under paragraph (3) of this subsection in the same or any succeeding taxable year. In the case of the income of a beneficiary, not a resident, derived through such an estate or trust, such income will be taxable only to the extent provided in subsection (f) of section 7 of this act.

Same

(3) In the case of income received by estates of deceased persons during the period of administration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year, which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir or beneficiary. In such cases the income of the legatee, heir, or beneficiary, not a resident, shall be taxable only to the extent provided in subsection (f) of section 7 of this act.

(e) If the taxable year of a beneficiary is different from that of the estate or trust, the amount which he is required, under subsection (d) (2) of this section, to include in computing his net income, shall be based upon the income of the estate or trust for any taxable year of the estate or trust ending within his taxable year.

(f) A trust created by an employer as a part of a stock bonus, pension, or profit-sharing plan for the exclusive benefit of some or all of his employees, to which contributions are made by such employer, employee, or both, for the purpose of distributing to such employees the earnings and principal of the fund accumulated by the trust in accordance with such plan, shall not be taxable under this section, but the amount actually distributed or made available to any distributee shall be taxable to him in the taxable year in which so distributed or made available to the extent that it exceeds the amounts paid in by him.

(g) Where at any time the power to revert in the grantor title to any part of the corpus of the trust is vested—

(1) In the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) In any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, then the income of such part of the trust shall be included in computing the net income of the grantor if the grantor is a resident. If the grantor is a nonresident, such income shall be included in computing his income only to the extent derived from sources within this State; the balance of such income shall be taxable either to the trust or to the beneficiaries in accordance with the provisions of subsections (c) and (d) of this section.

(h) Where any part of the income of a trust—

(1) Is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be held or accumulated for future distribution to the grantor; or

(2) May, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

(3) Is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in subsection (1) of section 8, relating to the so-called "charitable contribution" deduction); then such part of the income of the trust shall be included in computing the net income of the grantor if the grantor is a resident. If the grantor is a nonresident, such income shall be included in computing his income only to the extent derived from sources within this State; the balance of such income shall be taxable either to the trust or to the beneficiaries in accordance with the provisions of subsections (c) and (d) of this section.

(i) As used in subsections (g) and (h) of this section the term "in the discretion of the grantor," means "in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question."

SEC. 9. Section 15 of said act is hereby amended to read as follows:

Stats 1935,
p. 1107.

Sec. 15. Interest and Additions to the Tax.

(a) Failure to File Return.

Interest and
additions to
the tax
Failure to
file return

(1) If any taxpayer fails to make and file a return required by this act on or before the due date of the return or the due date as extended by the commissioner, then, unless it is shown that such failure is due to reasonable cause and not due to wilful neglect, five per cent of the tax shall be added to the tax for each thirty days or fraction thereof elapsing between the due date of the return and the date on which filed, but the total addition shall not exceed twenty-five per cent of the tax. The amount so added to the tax shall be due and payable upon notice and demand from the commissioner.

(2) If any taxpayer, upon notice and demand by the commissioner, fails or refuses to make and file a return required by this act, the commissioner is authorized to make an estimate of the net income and to compute and levy the amount of the tax due under this act from any available information, and in such case twenty-five per cent of the tax (in addition to the amounts added under the provisions of paragraph (1) of this subsection) shall be added to the tax and shall be due and payable upon notice and demand from the commissioner.

(b) Additions to the Tax in Case of Deficiencies

Additions in
case of
deficiency

(1) Neglect.—If any part of any deficiency is due to negligence, or intentional disregard of rules and regulations but without intent to defraud, five per cent of the total amount of the deficiency (in addition to such deficiency and other addi-

tions provided in this section) shall be assessed, collected, and paid in the same manner as if it were a deficiency.

(2) **Fraud.**—If any part of any deficiency is due to fraud with intent to evade tax, then fifty per cent of the total amount of the deficiency (in addition to such deficiency and other additions provided in this section) shall be assessed, collected and paid in the same manner as if it were a deficiency.

Interest.

(c) **Interest.**

(1) **General Rule.**—If the tax imposed by this act (whether determined by the commissioner or the taxpayer) or any installment or portion thereof is not paid on or before the date prescribed for its payment, there shall be collected as a part of the tax interest upon such unpaid amount at the rate of six per cent per year from the date prescribed for its payment until it is paid.

(2) **Interest in Case of an Extension.**—If the time for the payment of the tax or any installment thereof is extended under the provisions of section 13 of this act, there shall be collected as part of such tax interest thereon at the rate of six per cent a year from the date upon which such payment should have been made if no extension had been granted until the date the tax is paid.

(3) **Interest on Deficiencies.**—Interest upon the amount determined as a deficiency shall be assessed and paid at the same time as the deficiency at the rate of six per cent per year from the date prescribed for the payment of the tax (or, if the tax is paid in installments, from the date prescribed for the payment of the first installment) to the date the deficiency is assessed.

(4) **Interest Where Taxes Not Paid Within Ten Days of Notice and Demand.**—Where a deficiency, or any interest or additional amounts assessed in connection therewith under subsections (a)(1) and (b) and (c)(3) of this section, or any addition to the tax in case of delinquency provided for in subsections (a) (1) and (2) of this section, is not paid in full within ten days from the date of notice and demand from the commissioner, there shall be collected as a part of the tax, interest upon the unpaid amount at the rate of six per cent a year from the date of such notice and demand until it is paid. If any part of such amount prorated to any unpaid installment is not paid in full on or before the date prescribed for the payment of such installment, there shall be collected as a part of the tax, interest upon the unpaid amount at the rate of six per cent a year from such date until it is paid.

Stats. 1936,
p. 1111.

SEC. 10. Section 18 of said act is hereby amended to read as follows:

Jeopardy
assessments

Sec. 18. **Jeopardy Assessments.**

(a) If the commissioner finds that a taxpayer designs quickly to depart from this State or to remove his property therefrom, or to conceal himself or his property therein, or to do any other act tending to prejudice or to render wholly or partly ineffectual proceedings to collect the tax for the taxable

year then last past or the taxable year then current unless such proceedings be brought without delay, the commissioner shall declare the taxable period for such taxpayer immediately terminated and shall cause notice of such finding and declaration to be given the taxpayer, together with a demand for immediate payment of the tax for the taxable period so declared terminated and of the tax for the preceding taxable year or so much of such tax as is unpaid, whether or not the time otherwise allowed by law for filing the return and paying the tax has expired; and such taxes shall thereupon become immediately due and payable. In any proceeding in court brought to enforce payment of taxes made due and payable by virtue of the provisions of this section the finding of the commissioner, made as herein provided, whether made after notice to the taxpayer or not, shall be for all purposes presumptive evidence of the taxpayer's design.

(b) If the commissioner believes that the assessment or collection of a deficiency will be jeopardized by delay, he shall immediately assess such deficiency (together with all interest, additional amounts, or additions to the tax provided for by this act) and the amount so assessed shall be due and payable upon notice and demand from the commissioner.

(c) If any taxpayer fails to file a return, or files a false or fraudulent return with intent to evade tax, for any taxable year, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

(d) Upon the adjudication of bankruptcy of any taxpayer in any bankruptcy proceeding or the appointment of a receiver for any taxpayer in any receivership proceeding before any court of the United States or of any State or Territory or of the District of Columbia, any deficiency (together with all interest, additional amounts, or additions to the tax provided for by law) determined by the commissioner in respect of a tax imposed by this act upon such taxpayer may be immediately assessed. In such cases the trustee in bankruptcy or receiver shall give notice in writing to the commissioner of the adjudication of bankruptcy or the appointment of the receiver, and the running of the statute of limitations on the making of assessments shall be suspended for the period from the date of adjudication in bankruptcy or the appointment of the receiver to a date 30 days after the date upon which the notice from the trustee or receiver is received by the commissioner; but the suspension under this sentence shall in no case be for a period in excess of two years. Claims for the deficiency and such interest, additional amounts and additions to the tax may be presented, for adjudication in accordance with law, to the court before which the bankruptcy or receivership proceeding is pending, despite the pendency of proceedings for the redetermination of the deficiency in pursuance of a petition to the State board; but no petition for any such

redetermination shall be filed with the State board after the adjudication of bankruptcy or the appointment of the receiver. Any portion of the claim allowed in such bankruptcy or receivership proceeding which is unpaid shall be paid by the taxpayer upon notice and demand from the commissioner after termination of such proceeding and may be collected in the manner provided in this act for the collection of delinquent taxes at any time within six years after termination of such proceeding.

(e) The commissioner is hereby authorized to prescribe such rules and regulations as may be necessary to properly carry out the provisions of this section.

Stats 1935,
p. 1112

SEC. 11. Section 19 of said act is hereby amended to read as follows:

Assessment
of deficiency
tax

SEC. 19. Assessment of Deficiency Tax. Protest. Appeal. As soon as practicable after the return is filed, the commissioner shall examine it and shall determine the correct amount of the tax. If the commissioner determines that the tax disclosed by the original return is less than the tax disclosed by his examination he shall mail notice to the taxpayer at his last known address of the deficiency proposed to be assessed. The notice shall set forth the details and computation of such deficiency.

Protest

Within sixty days after mailing of said notice the taxpayer may file with the commissioner a written protest against the levy of the proposed deficiency, specifying therein the grounds upon which the protest is based. The protest must be under oath.

If no such protest is so filed the amount of the deficiency shall be final upon the expiration of said sixty-day period. If a protest is so filed it shall be the duty of the commissioner to reconsider the computation and levy of the deficiency complained of, and, if the taxpayer has so requested in his protest, it shall be the duty of the commissioner to grant said taxpayer, or his authorized representatives, an oral hearing.

Appeal

The commissioner's action upon the protest shall be final upon the expiration of thirty days from the date when he mails notice of his action to the taxpayer, unless within that thirty-day period the taxpayer appeals in writing from the action of the commissioner to the State board. The appeal must be addressed and mailed to the State Board of Equalization at Sacramento, California, and a copy of the appeal addressed and mailed at the same time to the commissioner at Sacramento, California. Said board shall hear and determine the same and thereafter shall forthwith notify the taxpayer and the commissioner of its determination, and the reasons therefor. Such determination shall be final upon the expiration of sixty days from the time of such determination unless within such sixty-day period the determination is modified in which event it shall become final upon the expiration of sixty days from the time it is modified.

When a deficiency has been determined and the tax has become final under the provisions of this section, the commissioner shall mail notice and demand to the taxpayer for the payment thereof, and such tax shall be due and payable at the expiration of ten days from the date of such notice and demand, unless the taxpayer has elected to pay the tax in installments, in which case the deficiency shall be prorated to the three installments. Except as provided in section 18 (relating to jeopardy assessments), that part of the deficiency so prorated to any installment, the date for payment of which has not arrived, shall be collected at the same time as, and as part of, such installment. That part of the deficiency so prorated to any installment the date for payment of which has arrived shall be due and payable at the expiration of ten days from the date of such notice.

Notice and demand.

A certificate by the commissioner or of said board, as the case may be, of the mailing of the notices specified in this section shall be prima facie evidence of the computation and levy of the deficiency in tax and of the giving of said notices.

Except in the case of a fraudulent return, every notice of a proposed deficiency tax shall be mailed to the taxpayer within three years after the return was filed and no deficiency shall be assessed or collected with respect to the year for which such return was filed unless such notice is mailed within such period. For the purposes of this paragraph a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day.

Where before the expiration of the time prescribed in this section for the assessment of the tax, both the commissioner and the taxpayer have consented in writing to its assessment after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

Extension of assessment period

Any amount of tax in excess of that disclosed by the return, due to a mathematical error, notice of which has been mailed to the taxpayer, shall not be considered a deficiency assessment within the meaning of this section. The taxpayer shall have no right of protest or appeal as herein provided, based on such notice, nor shall such assessment or collection be prohibited by any of the provisions of this section.

Sec. 12. Section 20 of said act is hereby amended to read as follows:

Stats 1935, p 1113.

Sec. 20. Refund of Tax, Interest on Refunds, Appeal. If, in the opinion of the commissioner, or State board, as the case may be, a tax has been computed in a manner contrary to law or has been erroneously computed by reason of a clerical mistake on the part of the commissioner or said board, or, if any tax, penalty or interest has been paid more than once, or has been erroneously or illegally collected, or has been erroneously or illegally computed, such fact shall be set forth

Refund of tax.

in the records of the commissioner, and the amount collected in excess of what was legally due shall be credited on any taxes then due from the taxpayer under this act, and the balance refunded to the taxpayer. If any tax, penalty or interest has been paid more than once, or has been erroneously or illegally collected, or has been erroneously or illegally computed, the commissioner shall certify to the State Board of Control the amount collected in excess of what was legally due, from whom it was collected, or by whom paid, and if approved by that board, the same shall be credited on any taxes then due from the taxpayer under this act and the balance shall be refunded to the taxpayer.

No such credit or refund shall be allowed or made after three years from the time the return was filed by the taxpayer or after two years from the time the tax was paid, whichever period expires the later, unless before the expiration of such period a claim therefor is filed by the taxpayer. If no return is filed by the taxpayer, then no credit or refund shall be allowed or made after two years from the time the tax was paid unless before the expiration of such period a claim therefor is filed by the taxpayer. Every claim for refund must be in writing under oath and must state the specific grounds upon which the claim is founded.

If the commissioner disallows any claim for refund he shall notify the taxpayer accordingly. Within thirty days after the mailing of such notice, or in case the commissioner fails to act upon any refund claim within six months after the claim was filed, then within thirty days after the expiration of said six months the commissioner's action upon the claim shall be final, unless within such thirty-day period the taxpayer appeals in writing from the action of the commissioner to the State board; provided, however, that the six months' period for acting on refund claims may be extended with the consent of the taxpayer in which event the thirty-day period for appealing to the State board shall commence running when the claim for refund is acted upon or when the extension expires if no action has been taken prior thereto. The appeal must be addressed to the State Board of Equalization at Sacramento, California, and a copy of the appeal addressed and mailed at the same time to the commissioner at Sacramento, California. Said board shall hear and determine the same and thereafter shall forthwith notify the taxpayer and the commissioner of its determination. Such determination shall be final upon the expiration of sixty days from the time of such determination unless within such sixty-day period the determination is modified in which event it shall become final upon the expiration of sixty days from the time it is modified.

Interest.

Interest shall be allowed and paid upon any overpayment of any tax, if the overpayment was not made because of an error or mistake on the part of the taxpayer, at the rate of six per centum per annum as follows:

(1) In the case of a credit, from the date of the overpayment to the date of the allowance of the credit. Any interest allowed on any credit shall first be credited on any taxes due from the taxpayer under this act.

(2) In the case of a refund, from the date of the overpayment to a date preceding the date of the refund warrant by not more than thirty days, such date to be determined by the commissioner.

Any refund or any portion thereof which is erroneously made, and any credit or any portion thereof which is erroneously allowed, may be recovered, together with interest at the rate of six per cent per annum from the date the refund was made or the credit allowed, in an action brought by the commissioner in a court of competent jurisdiction in the county of Sacramento in the name of the people of the State of California, and such action shall be tried in the county of Sacramento unless the court with the consent of the prosecutor, order a change of place of trial. The Franchise Tax Counsel or the Attorney General must prosecute such action, and the provisions of the Code of Civil Procedure, relating to service of summons, pleadings, proofs, trials, and appeals are applicable to the proceedings herein provided for.

Recovery of
refunds or
credits

In the event that a tax has been illegally levied against a taxpayer, the commissioner shall set forth on his records the reasons therefor and thereafter shall authorize the cancellation of such tax.

SEC. 13. Section 21 of said act is hereby amended to read as follows:

Stats 1935,
p 1114.

Sec. 21. Action to Recover Tax.

Action to
recover tax

Any taxpayer claiming that the tax computed and levied against him is void in whole or in part may bring an action against the State Treasurer for the recovery of the whole or any part of the amount paid. Such action must be filed within ninety days after the notice and demand for the payment of the tax under section 19 hereof; provided, however, no action shall be filed for the recovery of a deficiency assessment unless the taxpayer has made protest to the commissioner of the computation and levy complained of under the provisions of such section; and provided further, that no action shall be brought to recover any deficiency assessment, or any part thereof, if the taxpayer has at any time appealed to the State board from the action of the commissioner in overruling the taxpayer's protest to the commissioner's proposal of the said deficiency assessment.

When a refund claim has been filed under the provisions of section 20 hereof, and the same has been denied or no action has been taken thereon by the commissioner within six months from the filing thereof, the taxpayer may bring an action against the State Treasurer on the grounds set forth in such claim for the recovery of the whole or any part of the amount claimed as an overpayment, but such action must be brought within ninety days from the date of the commissioner's

denial of such claim or within ninety days from the expiration of the said six months if no action has been taken by the commissioner; provided, that no action shall be filed if the taxpayer has appealed to the State board from the action of the commissioner with respect to any refund claim; and provided further, that the six months period provided for acting on refund claims may be extended with the consent of the taxpayer in which event the ninety-day period for instituting action to recover the amount claimed as an overpayment shall commence running when the claim for refund is acted upon or when the extension expires if no action has been taken prior thereto.

Interest

In any judgment of any court rendered for any overpayment in respect of any tax imposed by this act, interest shall be allowed at the rate of six per centum per annum upon the amount of the overpayment, from the date of the payment or collection thereof to the date of allowance of credit on account of such judgment or to a date preceding the date of the refund warrant by not more than thirty days, such date to be determined by the commissioner.

Service of
papers

Whenever under the provisions of this section an action is commenced against the State Treasurer, a copy of the complaint and the summons must be served upon the Treasurer or his deputy and the commissioner. At the time the Treasurer demurs or answers, he may demand that the action be tried in the superior court of the county of Sacramento, which demand must be granted. The Franchise Tax Counsel or the Attorney General of the State of California must defend the action. A failure to begin such action within the time herein specified shall be a bar against the recovery of such taxes.

Stats 1935,
p 1116

SEC. 14. Section 23 of said act is hereby amended to read as follows:

Information
and with-
holding at
source

Sec. 23. Information at Source.

(a) Every individual, partnership, corporation, joint stock company or association, insurance company, business trust, or so-called Massachusetts trust, being a resident or having a place of business in this State, in whatever capacity acting, including lessees or mortgagors of real or personal property, fiduciaries, employers and all officers and employees of this State or any political subdivision of this State, having the control, receipt, custody, disposal or payment of interest (other than interest coupons payable to bearer), dividends, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments or other fixed or determinable annual or periodical gains, profits and income amounting to \$1,000 or over, paid or payable during any year to any taxpayer, shall make complete return thereof under oath, to the commissioner, under such regulations and in such form and manner and to such extent as may be prescribed by him.

(b) Such returns may be required, regardless of amounts, (1) in the case of payments of interest upon bonds, mortgages, deeds of trust, or other similar obligations of corporations,

(2) in the case of dividends paid by corporations, and
 (3) in the case of collections of items (not payable in the United States) of interest upon the bonds of foreign countries and interest upon the bonds of and dividends from foreign corporations by persons undertaking as a matter of business or for profit the collection of foreign payments of such interest or dividends by means of coupons, checks, or bills of exchange.

(c) When necessary to make effective the provisions of this section the name and address of the recipient of income shall be furnished upon demand of the person paying the income.

(d) The provisions of this section shall not apply to the payment of interest obligations not taxable under this act.

(e) The commissioner, whenever he deems it necessary to insure compliance with the provisions of this act, may under rules and regulations prescribed by him, require any individual, partnership, corporation, joint stock company or association or insurance company, including lessees or mortgagors and employees of the State or of any political subdivision of the State having control, receipt, custody, disposal or payment of interest (other than interest coupons payable to bearer), rent, salaries, wages, premiums, annuities, compensation, remunerations, emoluments or other fixed or determinable annual or periodical gains, profits and income paid or payable to any taxpayer, to deduct and withhold the tax due from such taxpayer and make return thereof and pay the tax to the commissioner. Upon the giving of notice by the commissioner to the fiduciary of an estate or trust that the taxes due under this act from the grantor or beneficiary of an estate or trust or income of the estate or trust, which is taxable to the grantor or beneficiary under the provisions of subsections (c), (d), (g) or (h) of section 12, have not been paid, the fiduciary shall withhold the amount of such taxes from any payments or distribution due or to become due from the estate or trust to the grantor or beneficiary and transmit the amount so withheld to the commissioner. The notice herein required to be given may be served upon the fiduciary personally, or by mail; if by mail, service shall be made in the manner prescribed by section 1013 of the Code of Civil Procedure and addressed to the fiduciary at his address as the same appears in the records of the commissioner. Any person failing or refusing to deduct and withhold the tax due from any taxpayer as required by the commissioner pursuant to this subsection shall be personally liable for such tax.

SEC. 15. Section 25 of said act is hereby amended to read as follows: Stats 1035,
p 1117

Sec. 25. Credit for Taxes Paid Other States or Countries.

(a) Subject to the following conditions, residents of this State shall be allowed a credit against the taxes imposed by this act for net income taxes imposed by and paid to another State or country on income taxable under this act: Credit for
taxes paid
other States
or countries
Resident
taxpayers

(1) The credit shall be allowed only for taxes paid to such other State or country on income derived from sources within

such State or country which is taxable under the laws of such State or country irrespective of the residence or domicile of the recipient;

(2) The credit shall not be allowed if such other State or country allows residents of this State a credit against the taxes imposed by such State or country for taxes paid or payable under this act;

(3) The credit shall not exceed such proportion of the tax payable under this act as the income subject to tax in such other State or country and also taxable under this act bears to the taxpayer's entire income upon which the tax is imposed by this act.

Nonresident
taxpayers

(b) Subject to the following conditions, nonresidents of this State shall be allowed a credit against the taxes imposed by this act for net income taxes imposed by and paid to the State or country of residence on income taxable under this act:

(1) The credit shall be allowed only if the State or country of residence either does not tax income of residents of this State derived from sources within such State or country or allows residents of this State a credit against the taxes imposed by such State or country on such income for taxes paid or payable thereon under this act;

(2) The credit shall not be allowed for taxes paid to a State or country which allows its residents a credit against the taxes imposed by such State or country for income taxes paid or payable under this act, irrespective of whether its residents are allowed a credit against the taxes imposed by this act for income taxes paid to such State or country;

(3) Credit shall be allowed only for such proportion of the taxes paid to the State or country of residence as the income taxable under this act and also subject to tax in the State or country of residence bears to the entire income upon which the taxes paid to the State or country of residence are imposed;

(4) The credit shall not exceed such proportion of the tax payable under this act as the income subject to tax in the State or country of residence and also taxable under this act bears to the entire income taxable under this act.

Estates or
trusts.

(c) For the purposes of this section an estate or trust shall be considered a resident of the State or country which taxes the income of the estate or trust irrespective of whether the income is derived from sources within such State or country. If an estate or trust is a resident of this State and also a resident of another State or country, it shall, notwithstanding the limitations contained in subsections (a) and (b) of this section, be allowed a credit, subject to the following conditions, against the taxes imposed by this act for net income taxes imposed by and paid to such other State or country:

(1) Credit shall be allowed only for such proportion of the taxes paid to such other State or country as the income taxable under this act and also subject to tax in such other State or country bears to the entire income upon which the taxes paid to such other State or country are imposed;

(2) The credit shall not exceed such proportion of the tax payable under this act as the income subject to tax in such other State or country and also taxable under this act bears to the entire income taxable under this act.

(d) A resident beneficiary of an estate or trust who is taxable on the income of the estate or trust pursuant to the provisions of subsection (c) of section 12 shall, subject to the following conditions, be allowed a credit against the taxes imposed by this act on such income for net income taxes paid by the estate or trust to another State or country on such income:

(1) Credit shall be allowed only for such proportion of the tax paid to such other State or country by the estate or trust as the income of the estate or trust which is taxable to the beneficiary under this act and also taxed to the estate or trust in such other State or country bears to the entire income of the estate or trust upon which the taxes paid to such other State or country were imposed;

(2) The credit shall not exceed such proportion of the tax payable under this act as the income of the estate or trust which is taxable to the beneficiary under this act and also taxed to the estate or trust in such other State or country bears to the beneficiary's entire income upon which the tax is imposed by this act.

(e) If any taxes paid to another State or country for which a taxpayer has been allowed a credit under this act are at any time credited or refunded to the taxpayer, such fact shall immediately be reported by the taxpayer to the commissioner. A tax equal to the credit allowed for such taxes so credited or refunded shall be due and payable from the taxpayer upon notice and demand from the commissioner. Interest shall be added to and collected as a part of such tax at the rate of six per cent per annum from the date the credit was allowed under this act to the date of the notice and demand. If such tax and the interest thereon is not paid within ten days from the date of notice and demand, there shall be collected as a part of the tax interest upon the unpaid amount at the rate of six per cent per annum from the date of such notice and demand until it is paid.

The credit against the taxes imposed by this act on any taxpayer or any class or classes of taxpayers for net income taxes paid to another State or country shall not be allowed if the allowance of such credit will result in an invalid or illegal discrimination against another taxpayer or another class or classes of taxpayers.

SEC. 16. Section 26 of said act is hereby amended to read as follows:

Sec. 26. Tax Upon Settlement of Fiduciary's Account.

(a) No final account of a fiduciary shall be allowed by the probate court unless the fiduciary obtains from the commissioner and files with the court a certificate to the effect that all taxes imposed by this act upon the person, estate or trust for whom the fiduciary acts which have become payable, have

been paid, and that all taxes which may become due are secured by bond, deposit or otherwise. Within thirty days after receiving a request for a certificate, the commissioner shall either issue the certificate or notify the person requesting the certificate of the amount of tax that must be paid or the amount of bond, deposit or other security that must be furnished as a condition of issuing the certificate. The certificate of the commissioner shall not relieve the person, estate or trust for whom the fiduciary acts of liability for any taxes due and unpaid at the time the certificate is issued or which may become due from said person, estate or trust under this act after the issuance of the certificate nor shall it relieve the fiduciary of the liability imposed by subsection (b) of this section.

(b) Every fiduciary who pays, in whole or in part, any claim, other than claims for taxes, expenses of administration, funeral expenses, expenses of last illness, and family allowance, against the person, estate or trust for whom or for which he acts, or who makes any distribution of the assets of such person, estate or trust, before he satisfies and pays taxes, including all increases, interest and penalties, except penalties due from a decedent, imposed by this act on the person, estate or trust for whom or for which he acts, or which constitute a claim against such person, estate or trust, or which are a lien or charge on or against the assets of such person, estate or trust, shall be personally liable therefor to the extent of such payments and distributions.

In the case of income received or accrued during the lifetime of a decedent, or by his estate during the period of administration, or by a trust, notices proposing to assess the tax shall be mailed, and any proceeding in court without assessment for the collection of the tax shall be begun, within eighteen months after written request therefor (filed after the return is made) by the fiduciary of the estate or trust or by any other person liable for the tax or any portion thereof.

(c) Upon notice to the commissioner that any person is acting in a fiduciary capacity, such fiduciary shall assume the powers, rights, duties, and privileges of the taxpayers in respect of any tax imposed by this act (except as otherwise specifically provided), until notice is given that the fiduciary capacity has terminated. Notice under this section shall be given in accordance with rules and regulations prescribed by the commissioner.

Stats 1935,
p. 1118.

Lien on
trust
property

SEC. 17. Section 27 of said act is hereby amended to read as follows:

Sec. 27. Lien of Tax Imposed Upon Income of Grantors; Assessment and Collection of Tax from Persons Secondarily Liable Therefor.

(a) Upon recording an abstract of judgment, or a copy thereof, with the county recorder of any county for any taxes due from the grantor of a trust on income of the trust, which is

taxable to the grantor under the provisions of subsections (g) or (h) of section 12, and upon giving notice of such recording to the fiduciary of the trust or in case there is more than one fiduciary to any one of such fiduciaries, the amount of such taxes shall constitute a lien upon all property of the trust in such county owned by it or which it may afterwards and before the lien expires acquire, which lien shall have the force, effect and priority of a judgment lien. The notice herein required to be given may be served upon the fiduciary personally, or by mail; if by mail, service shall be made in the manner prescribed by section 1013 of the Code of Civil Procedure and addressed to the fiduciary at his address as the same appears in the records of the commissioner.

(b) The taxes imposed by this act upon any taxpayer for which any person other than the taxpayer is liable may be assessed against such person in the same manner as is provided in section 19 for the assessment of deficiencies and may be assessed at any time within which deficiency assessments may be made against the taxpayer. The provisions of section 28 and other provisions of this act respecting the collection of taxes shall apply to the collection of such taxes from such person to the same extent and with the same force and effect as though such person were the taxpayer.

Assessment,
etc., against
person
secondarily
liable.

Sec. 18. Section 32 of said act is hereby amended to read as follows:

Stats 1935,
p. 1121.

Sec. 32. Commissioner to Administer this Act.

Commis-
sioner to
administer
act

(a) The commissioner shall administer and enforce the tax herein imposed, for which purpose he may divide the State into a reasonable number of districts, in each of which a branch office or offices may be maintained during all or such part of the time as may be necessary. In the establishment of such districts and offices due consideration shall be given by the commissioner to the matter of economy of administration and service to the taxpayers.

(b) The commissioner, for the purpose of ascertaining the correctness of any return or for the purpose of making an estimate of the taxable income of any taxpayer, shall have power to examine or cause to be examined by any agent or representative designated by him for that purpose, any books, papers, records or memoranda, bearing upon the matters required to be included in the return, and may require the attendance of the taxpayer or of any other person having knowledge in the premises, and may take testimony and require proof material for his information, with power to administer oath to such person or persons.

(c) The commissioner may appoint and remove, in the manner provided by law, such officers, agents, branch office income tax deputies, and other employees as he may deem necessary, such persons to have such duties and powers as the commissioner may from time to time prescribe. The commissioner may appoint one or more deputies or assistants to conduct hearings, prescribe regulations or to perform any other duties

Assistants

imposed by this act or other laws of the State upon the commissioner. Any temporary appointments of branch office income tax deputies and other branch office employees shall be made from eligible residents of the district in which such branch office or offices are located. The salaries of the personnel required by the commissioner shall be such as he may prescribe, in the manner provided by law, and the commissioner and such personnel shall be allowed reasonable and necessary traveling and other expenses incurred in the performance of their duties. The commissioner may require such of the officers, agents, deputies and other employees as he may designate, to give bond for the faithful performance of their duties in such sum and with such sureties as he may determine, and all premiums on such bonds shall be paid by the commissioner out of moneys appropriated for the administration of this act.

(d) The commissioner and such officers, as he may designate, shall have the power to administer an oath to any person or to take the acknowledgment of any person in respect of any return or report required by this act or the rules and regulations of the commissioner.

Stats 1036,
p 1122

Information
confidential

Sec. 19. Section 33 of said act is hereby amended to read as follows:

Sec. 33. Secrecy Required of Officials, Penalty for Violation. (a) Except in accordance with proper judicial order in cases or actions instituted for the enforcement of the provisions of this act or for the prosecution of violations of this act and except as otherwise herein provided, it shall be unlawful for the commissioner, any deputy, agent, clerk or other officer or employee, to divulge or make known in any manner the amount of income or any particulars set forth or disclosed in any report or return required under this act; provided, however, that such information may upon request of a committee appointed by either the Assembly or the Senate be furnished to such committee. Nothing herein shall be construed to prohibit the publication of statistics, so classified as to prevent the identification of particular reports or returns and the items thereof, or the inspection by the Attorney General or other legal representatives of the State, of the report or return of any taxpayer who shall bring action to set aside or review the tax based thereon, or against whom an action or proceeding has been instituted to recover any tax or any penalty imposed by this act. Reports and returns shall be preserved for four years and thereafter until the commissioner orders them to be destroyed.

Penalty

(b) Any offense against subdivision (a) of this section shall be a misdemeanor.

Inspection
by Federal
Government,
etc

(c) Notwithstanding the provisions of this section, the commissioner may permit the Commissioner of Internal Revenue of the United States, or the proper officer of any State imposing an income tax upon the incomes of individuals, or the authorized representative of either such officer, to inspect the

income tax returns of any individual, or may furnish to such officer or his authorized representative an abstract of the return of income of any taxpayer or supply him with information concerning any item of income contained in any return, or disclosed by the report of any investigation of the income or return of income of any taxpayer; but such permission shall be granted or such information furnished to such officer or his representative, only if the statutes of the United States or of such other State, as the case may be, grant substantially similar privileges to the proper officer of this State charged with the administration of this act.

SEC. 20. Section 34 of said act is hereby amended to read as follows: Stats 1935,
p 1122

Sec. 34. Application of Regulations. The commissioner may prescribe the extent, if any, to which any ruling or regulation relating to this act shall be applied without retroactive effect. Application
of regula-
tions

SEC. 21. The provisions of this act effecting changes in the computation of taxes imposed by The Personal Income Tax Act of 1935 shall be applied only in the computation of the taxes for taxable years ending on or after December 31, 1937. The remaining provisions of this act shall become effective on the effective date of this act. Application
of act

CHAPTER 669.

An act relating to the sale, disposition of, and control through licensing and otherwise, of prophylactics.

[Approved by the Governor July 1, 1937. In effect August 27, 1937.]

The people of the State of California do enact as follows:

SECTION 1. As used in this act:

(a) Pharmacy means and includes each and all of the following: Any person, firm, partnership or corporation operating a retail drug store, a pharmacy or drug department complying with the pharmacy law requirements and having a permit to operate, issued by the board. Definitions

(b) Wholesaler means and includes each and all of the following: Any person, firm, partnership, or corporation operating as a wholesale druggist, manufacturer or surgical supply house, recognized by the board, through the granting of a license to sell prophylactics for purposes of resale.

(c) Retailer means and includes each and all of the following: Any person, firm, partnership, or corporation operating a pharmacy recognized by the board through the granting of a license to sell prophylactics for use in the prevention of venereal disease.

(d) Physician means and includes each and all of the following: Any person licensed within the State to practice