

Appeal of Louis E. and Echite M. Dana

Appellants, California residents since 1974, previously resided in Michigan, where appellant Louis E. Dana practiced law. Several of Mr. Dana's Michigan clients were involved in personal injury cases, which appellant handled under contingent fee contracts. When the appellants left Michigan, these cases were transferred to other Michigan attorneys under an arrangement whereby Mr. Dana was to **receive** a fixed ratio of the fees generated in each case. The cases were settled in 1975 and appellants received **\$1,906.52** as Mr. Dana's share of the fees. Appellants, cash basis taxpayers, reported this amount on their 1975 California income tax return. However, in August 1977, appellants filed a claim **for** refund/stating their belief that the fees reported were properly subject to state income tax in Michigan rather than in California. The claim for refund was denied and this appeal followed.

The question presented is whether the legal fees generated under the contingent fee contract executed in Michigan but received by appellants after they became **California** residents constitute taxable California income.

Where a change in residency occurs, as in the instant case, the computation of income taxable in California is governed by Revenue and Taxation Code section 17596, which provides:

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

The accrual treatment referred to above -applies even though the taxpayer may be on the cash receipts and disbursements accounting basis. (Cal. Admin. Code, tit. 18, reg. 17596.)

Appellants argue that the income accrued when the contingent fee contracts were executed because the only contingency at that time was the total amount of fees generated. Respondent maintains that that unknown factor precluded the accrual of any income from the fees in question until the settlement in 1975. For the reasons expressed below, we conclude that respondent's reasoning is correct.

Under an accrual method of accounting, income is **includible** in gross income when all the events have occurred

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which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy. (Cal. Admin. Code, tit. 18, reg. 17571(a).) But if there are substantial contingencies as to the taxpayer's right to receive, or uncertainty as to the amount he is to receive, an item of income does not accrue until the contingency or events have occurred and fixed the fact and amount of the sum involved. (Midwest Motor Express, Inc., 27 T.C. 167 (1956), **affd.**, 251 F.2d 405 (1958).)

It is apparent that pending litigation imposes a substantial condition on a taxpayer's right to receive income from that litigation. Here, there might not have been a settlement or any award at all to Mr. Dana's client, in which circumstances he would have had a share of nothing. Thus, under the law cited herein, appellants clearly did not accrue any income from the legal fees in question until 1975, when they were California residents. The amount received was then properly taxable in California in that year. (Rev. & Tax. Code, § 17041.)

We conclude that respondent's denial of appellants' claim for refund must be sustained.

