

Appeal of Georqianna Brewer

The issue for determination is whether respondent properly computed appellant's basis in stock which was sold in 1971.

Appellant's then-husband, Ernest M. May (hereinafter "decedent"), died testate on June 23, 1970, leaving an estate composed entirely of the spouses' community property.^{1/} Decedent's estate plan provided for the creation of two trusts. The corpus of one trust (hereinafter "first trust") consisted of appellant's one-half of the community property. She received all the income from this trust, together with a general power of appointment in the remainder, exercisable either during her life or at her death. The corpus of the second trust (hereinafter "second trust") consisted of decedent's one-half of the community property. According to the plan of distribution for the second trust, appellant was to receive a life estate plus a general power of appointment therein to the extent of \$5,000 or five percent of the corpus annually, whichever amount was greater. On appellant's death, the remainder of the second trust would be payable to the spouses' two children.

The California Report of Inheritance Tax Appraiser (hereinafter "report") dated October 27, 1971, indicated that the clear market value of the property which decedent transferred amounted to \$785,732. Of this amount, appellant received \$717,218, of which \$613,965 was excluded from taxation. (Rev. & Tax. Code, §§ 13551, 13554.^{2/}) That report valued the amount of the general power of appointment that was taxable to appellant (see Rev. & Tax. Code, § 13694) at \$103,253 and the remainder interests that were taxable to each child at \$34,257. Accordingly, \$171,767 (i.e., \$103,253 + \$34,257 + \$34,257) was subject to state inheritance tax. In addition to the inheritance tax paid on these amounts, "pick-up" tax was also paid. (Rev. & Tax. Code, § 13441.)

^{1/} The decedent's estate also included a relatively small joint tenancy account that the State Controller treated as community property for inheritance tax purposes.

^{2/} All statutory references are to the Revenue and Taxation Code, as then in effect.

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In her personal income tax return for 1971, appellant reported the sale of stock which was part of the first trust. In order to compute gain on this sale, appellant's return indicated that she used the fair market value of such stock as of decedent's death. Upon audit, however, respondent determined that the basis of this stock should be its adjusted cost. Respondent modified appellant's return accordingly and issued the proposed assessment in question. Appellant protested, and respondent's denial of that protest led to this appeal.

The pertinent statutory provisions are set out in Revenue and Taxation Code sections 18042 through 18045. Section 18042 states the general rule that the basis of property is its cost. Under section 18044, however, the basis of property acquired from a decedent is its fair market value as of the date of the decedent's death. For purposes of this rule, subdivision (e) of section 18045 (hereinafter referred to as "subdivision (e)") provides that a surviving spouse's share of the community property is deemed to have been acquired from a decedent, subject to the following proviso:

. . . if at least one-half of the whole of the community interest in such property was includable in determining the value of the decedent's gross estate under Chapter 3 of the California Inheritance Tax Law.

Appellant contends that subdivision (e) applies under the facts of this case to grant her share of the community property a stepped-up basis as of the date of decedent's death. Respondent determined that it does not **apply**, on the ground that the conditions of the proviso have not been satisfied. The issue thus redefined is whether at least one-half of the **spouses' community** property was "includable in determining the value of the decedent's gross estate" within the meaning of the proviso to subdivision (e).

Respondent argues that this question must be answered by reference to chapter 3 of **the** Inheritance Tax Law, since the term "gross estate" in subdivision (e) is qualified by the words "under Chapter 3. . . ." Specifically, its position is that only property made "subject to" the Inheritance Tax Law by the terms of chapter 3 can be considered includable in determining the value of the decedent's "gross estate under Chapter 3." Since the interests subject to the Inheritance Tax Law in this case amounted to less than one-half the value of the spouses'

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community property, respondent concludes that less than one-half of such property was includable in decedent's gross estate for purposes of subdivision (e).

Appellant objects to respondent's construction of subdivision (e). The term "gross estate," she maintains, embraces the decedent's entire interest in property, not only property "subject to" the **Inheritance Tax Law**.

We have consistently held that respondent's construction of subdivision (e) is correct. (Appeal of Estate of Philip Rosenberg, Deceased, etc., Cal. St. Bd. of Equal., Aug. 19, 1975; Appeal of Marion Malouf, Cal. St. Bd. of Equal., Aug. 19, 1975; see also, Appeal of Sarah C. Dorfman, Cal. St. Bd. of Equal., July 26, 1978; Appeal of Louis (L. M.) Halper Marital Trust, Cal. St. Bd. of Equal., April 6, 1977; Appeal of William F. and Dorothy M. Johnson, Cal. St. Bd. of Equal., Oct. 6, 1976.) Moreover, respondent's construction has recently been adopted by the appellate court. (Mel v. Franchise Tax Board, 119 Cal.App.3d 898 [174 Cal.Rptr. 269] (1981).) In Mel, the court stated that subdivision (e) "must be construed so as to equate the phrase 'includible in ... decedent's gross estate under Chapter 3' with 'subject to state inheritance tax under Chapter 3 of that law.'" Accordingly, the court continued, in order:

to obtain a stepped-up basis under former subdivision (e), a taxpayer must show that at least one-half of the whole of the community property held by the decedent and the taxpayer-- as the surviving spouse--was subject to state inheritance taxation under chapter 3 of the Revenue and Taxation Code.

(Mel v. Franchise Tax Board, *supra*, 119 Cal.App.3d at 907.)

As indicated above, the inheritance tax report indicates that only **\$171,767** of \$785,732 (i.e., the whole of the community property) was subject to state inheritance taxation upon decedent's death. Clearly, less than one-half of the whole of the community property held by decedent was subject to state inheritance tax. Therefore, respondent correctly determined that appellant is required to use adjusted cost as the basis of her **one-half** community interest in the stock sold.

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O R D E R

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

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Georgianna Brewer, formerly Georgianna May, against a proposed assessment of additional personal income tax in the amount of **\$10,787.18** for the year 1971, be and the same is hereby sustained.

Done at Sacramento, California, this 26th day of October , 1983, by the State Board of Equalization, with Board Members Mr. Bennett, Mr. Collis, Mr. Dronenburg, Mr. Nevins and Mr. Harvey present.

William M. Bennett , Chairman
Conway H. Collis , Member
Ernest J. Dronenburg, Jr. Member
Richard Nevins , Member
Walter Harvey* , Member

*For Kenneth Cory., per Government Code section 7.9