McGeorge Law Review

Volume 7 | Issue 1 Article 31

1-1-1976

Taxation

University of the Pacific; McGeorge School of Law

Taxation

Taxation; interspousal transfers

Revenue and Taxation Code §§13560, 15310 (repealed); §15310 (new); §§13403, 13551, 13554, 13694, 13801, 13805, 15301, 15303.5, 15421, 18045 (amended).
AB 343 (Kapiloff); STATS 1975, Ch 942
Support: State Bar of California; California Bankers Association

Prior to the enactment of Chapter 942, interspousal transfers of community property by inheritance or gift were not subject to taxation by the state. Chapter 942 amends Revenue and Taxation Code Sections 13551, 13801, 15301 and 15421 to provide for the taxation of the transferor's interest in community property which passes to the spouse. but only to the extent that the transferor's interest exceeds a clear market value of $60,000 (§§13801, 15421). By subjecting interspousal transfers of community as well as separate property to taxation, the advantages of transfers of community property over transfers of separate property have been eliminated. Prior to the enactment of Chapter 942, there existed a glaring inequity in the taxation scheme for property passing at the death of a spouse [Martin & Kinney, *California Inheritance Taxation of Inter-Spousal Transfers*, 2 COMMUNITY PROPERTY JOURNAL 6 (1975)]. For example, if an estate consisting entirely of community property passed to the surviving spouse, no inheritance tax was charged. For an estate of the same size, but consisting entirely of quasi-community property passing to the surviving spouse, a deduction could be taken, but the estate was still subject to inheritance tax [*Id.* at 6]. If the entire estate consisted of separate property of the deceased spouse and passed to the surviving spouse, an exemption could be taken, but the resulting tax on this estate was higher than the tax on the other types of estates [*Id.* at 7]. Because spouses must now pay taxes on transfers of community property, Revenue and Taxation Code Sections 13560 and 15310, which provided that community property which had been converted from separate property retained its quality as separate property and thus was subject to taxation upon any subsequent transfer, were no longer necessary and have been repealed.

Powers of appointment remain subject to taxation with a marital exclusion of one-half of the value of the property. Any interest in community property which the spouse takes in addition to the power of appointment itself is now subject to taxation.

Under Sections 13805 and 15310 of the Revenue and Taxation Code, 50 percent of the value of any separate property in an interspousal transfer remains exempt from taxation. Furthermore, while Section 15303.5 still provides that transfers of quasi-community property into community property are not subject to gift tax, the provision of this section which provided unequal treatment for husband and wife has been repealed.

One effect of Chapter 942 is to close a loophole left by 1965 legislation which allowed a tax-free transfer of quasi-community property to community property (§15303.5) and a tax-free transfer of such community property to separate property (§15301), a two-step transfer which if done directly in one step would be subject to taxation (§15301.5) [Martin & Miller, *Estate Planning and Equal Rights*, 40 CAL. S.B.J. 706, 711 (1965)]. Since transfers or transformations of community property to separate property are now subject to taxation, this tax avoidance will no longer be possible. The addition of Subdivision (b) of Section 13805 further constricts the ability to avoid taxation by expressly disallowing an exemption for separate property which has been converted from quasi-community or separate property.

The exemption from taxation allowed on interspousal transfers of community, quasi-community, and separate property has been raised from $5,000 to $60,000 by the amendment of Sections 13801 and 15421. In effect, this eliminates taxes on inheritances or gifts to the spouse of $120,000 or less. Previously, inheritances or gifts of community property were completely exempt and gifts and inheritances of separate property above $10,000 were taxable.

Finally, Chapter 942 has amended Revenue and Taxation Code Section 18045 to specify how the basis of certain community property held by the surviving spouse is to be determined for personal income tax purposes. In the case of decedents dying on or after January 1, 1976, if the decedent's half of the community property was transferred at his or her death to someone *other* than the surviving spouse, the basis of the share of the surviving spouse in such community property is the value of the property at the date of the decedent's death.

See Generally:

1) 5 WITKIN, SUMMARY OF CALIFORNIA LAW, *Taxation* §§217-260 (8th ed. 1974).

2) CONTINUING EDUCATION OF THE BAR, REVIEW OF SELECTED 1965 CODE LEGISLATION 241 (review of affected sections).
3) Martin & Miller, *Estate Planning and Equal Rights*, 40 CAL. S.B.J. 706 (1965).
4) Martin & Kinney, *California Inheritance Taxation of Inter-Spousal Transfers*, 2 COMMUNITY PROPERTY JOURNAL 6 (1975).

Taxation; income taxes—home sale deduction

Revenue and Taxation Code §§17154, 18091, 18093, 18094, 18098 (amended).
AB 263 (Bannai); STATS 1975, Ch 221
(Effective July 5, 1975)

Section 18091 of the Revenue and Taxation Code provides that a gain from the sale or exchange of a residence by a taxpayer of any age is recognized for personal income tax purposes only to the extent that it exceeds the cost of purchasing a new residence within a certain time period. This section has been amended by Chapter 221 to extend the allowable period for purchase of the new residence to 18 months prior to and 18 months following the sale of the old residence. Formerly the period was one year prior to and one year after the sale. Construction or reconstruction of a new residence is treated as a purchase of a new residence, but in such a case the allowable period for incurring construction costs as part of the purchase price has been changed from one year before and 18 months after the sale of the old residence to 18 months prior to and two years following the sale. One effect of this legislation is to bring California law into conformity with federal income tax provisions as amended by Section 207 of the Tax Reduction Act of 1975 [Pub. L. No. 94-12 (Feb. 18, 1975)].

A taxpayer over the age of 65 may also take advantage of Revenue and Taxation Code Section 17154, which provides that such a taxpayer who sells property used as his principal residence for five of the preceding eight years is entitled to exclude from gross income for purposes of personal income tax a portion of the gain on the sale or exchange of the property. This section lessens the tax burden on a taxpayer over 65 who does not purchase a new residence or purchases a new residence for less than the sale price of the old residence, but this exclusion is available only once during the taxpayer's lifetime (§17154(b)).

Prior to the enactment of Chapter 221, if the sale price after adjustment for expenses to assist in the sale was less than $20,000, the entire gain could be excluded. If the sale price was greater than $20,000, the formula for computing the amount of gain to be excluded was

$20,000 times the amount of gain, divided by the adjusted sale price. These provisions were previously in conformity with federal income tax law [INT. REV. CODE OF 1954, §121]. Section 17154 of the Revenue and Taxation Code has been amended to raise the $20,000 figure to $30,000. Therefore the entire gain realized from the sale of property sold for $30,000 or less may be excluded, while the excludable gain on the sale of property sold for more than $30,000 is now determined by multiplying $30,000 times the amount of gain, and dividing this amount by the adjusted sale price. The amendment of Section 17154 by Chapter 221 has taken the section out of conformity with federal income tax law [INT. REV. CODE OF 1954, §121].

See Generally:
1) INT. REV. CODE OF 1954, §§121, 1034.
2) R. BOCK, GUIDEBOOK TO CALIFORNIA TAXES 115 (26th ed. 1975).

Taxation; oil depletion allowance

Revenue and Taxation Code §§17686.5, 24835.5 (new); §§17686, 24832 (amended).
AB 177 (Lockyer); STATS 1975, Ch 75
(Effective May 14, 1975)

In the computation of personal or corporate income taxes a deduction is allowed for the depletion of oil and gas wells owned by the taxpayer, computed on either a cost or percentage depletion basis [18 CAL. ADMIN. CODE §§24831, 24835]. A cost depletion deduction may be taken each year until the accumulated deductions taken on the property equal its adjusted cost (original cost plus capital expenditures) [18 CAL. ADMIN. CODE §§24381, 24912]. Alternatively, under percentage depletion, 22 percent of gross income from the property, excluding rents and royalties paid by the taxpayer, may be deducted. The maximum annual deduction for corporations is 50 percent of net income and for individuals 50 percent of taxable income with the net or taxable income being computed without the allowance for depletion.

Prior to the enactment of Chapter 75, the taxpayer could continue to claim the full percentage depletion allowance as long as there was gross income from the property, regardless of whether the full adjusted cost of the well had been "depleted". Sections 17686 and 24832 of the Revenue and Taxation Code have been amended to limit percentage depletion deductions whenever the total accumulated depletion deductions allowed on any property exceed the adjusted cost of that property. In such instances an annual ceiling of $1.5 million is placed upon the depletion deduction. Furthermore, if 22 percent of gross income exceeds the maximum allowance of $1.5 million, 125 percent of such excess shall be deducted from this maximum allowance. Consequently, once the calculable depletion deduction reaches $7.5 million, no deduction may be taken.

Where husband and wife file separate returns the annual percentage depletion allowance limit is $750,000 minus 125 percent of any excess percentage depletion allowance over $750,000 (§17686(d)). Commonly owned or controlled corporations are treated as being one corporation; and any percentage depletion allowed is prorated among them (§24832(d)). The deduction for depletion remains subject to the special two and a half percent tax imposed on items of tax preference (§§17063, 23401).

Since a taxpayer or corporation must have a gross income from oil or gas wells in excess of $6.8 million in a single year to be able to claim percentage depletion in excess of $1.5 million, only the largest California companies will be affected by this chapter. The federal government recently enacted the Tax Reduction Act of 1975 [Pub. L. No. 94-12 (February 18, 1975)] which eliminated the percentage depletion allowance for all but independent oil producers and royalty owners in the calculation of federal income taxes [*Id.* §501], hence reflecting a move away from percentage depletion allowances for large oil companies.

See Generally:
1) 18 CAL. ADMIN. CODE §§24831-24837 (regulations concerning cost and percentage depletion).
2) R. BOCK, GUIDEBOOK TO CALIFORNIA TAXES 134 (26th ed. 1975).

Taxation; property taxation—exemption for goods in transit

Revenue and Taxation Code §§225, 225.1, 225.2 (new).
SB 389 (Marks); STATS 1975, Ch 1126

Personal property located in California as of March 1st of each year is subject to local ad valorem property taxation [CAL. REV. & TAX. CODE §§201-232, 751], although 50 percent of the assessed value of personal property which is classified as business inventory is exempt from taxation (§219). Chapter 1126 has added Section 225 to the Revenue and Taxation Code to provide a *total* tax exemption for personal property manufactured and produced outside of California which is temporarily in the state for shipment out of the United States, and for personal property manufactured or produced outside of the United States which is brought into California for shipment to another point outside the state for sale in the ordinary course of trade or business. No provision is made for personal property manufactured in another state which is temporarily in California before shipment to *another state*; and presumably this type of property is still subject to taxation. Section 225, as added to the Revenue and Taxation Code by Chapter 1126, further provides that this exemption from taxation is not lost if the property is broken in bulk, labeled or relabeled, packaged or repackaged. Finally, Section 225.2 has been added to provide that any property reconsigned to a final destination in California will be subject to escape assessment procedures.

See Generally:
1) 5 WITKIN, SUMMARY OF CALIFORNIA LAW, *Taxation* §136 (8th ed. 1974).

Taxation; imports in cargo containers

Revenue and Taxation Code §233 (new).
SB 659 (Marks); STATS 1975, Ch 748

Article I, Section 10 of the United States Constitution prohibits the states from imposing taxes on imports from foreign countries. Goods lose their character as imports and become subject to state taxation, however, when the importer either sells or uses them or removes them from their original package [Hooven & Allison Co. v. Evatt, 324 U.S. 652, 657 (1944)]. Under the original package doctrine, first announced in *Brown v. Maryland* [25 U.S. (12 Wheat.) 441 (1827)], the immunity lasts as long as the goods remain in their original packages [*Id.* at 442].

The applicability of the original package doctrine to large reuseable cargo containers known as "sea vans" has been frequently questioned, as it is unclear whether these containers are original packages or merely methods of transport [Singer v. County of Kings, 46 Cal. App. 3d 852, 862, 121 Cal. Rptr. 398, 404 (1975)]. In *Volkswagen Pacific Inc. v. City of Los Angeles* [7 Cal. 3d 48, 496 P.2d 1237, 101 Cal. Rptr. 869 (1972)] the California Supreme Court held that the opening of sea vans does not as a matter of law mean a loss of immunity [*Id.* at 55, 496 P.2d at 1242, 101 Cal. Rptr. at 874].

Chapter 748 adds Section 233 to the Revenue and Taxation Code to provide that opening the sea van will not necessarily result in a loss of immunity. The section then states that in certain circumstances the opening will definitely *not* render the goods subject to taxation. Immunity will not be lost if the opening was for the purpose of inspecting the goods, removing goods belonging to two or more importers for delivery to them, removing goods solely for storage, or removing the goods to divert them to separate outlets of the importer in interior states. As circumstances in which immunity is retained are not limited to the exceptions enumerated above (§233(c)), the problem of opening sea vans has not been definitively solved by this chapter.

See Generally:
1) 5 WITKIN, SUMMARY OF CALIFORNIA LAW, *Taxation* §§47-51 (8th ed. 1974).