State and Local Taxes

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The period covered by this survey saw a general increase in state taxes. Some new rules for the apportionment and allocation of income for purposes of the Bank and Corporation Tax Law became applicable as the Uniform Division of Income for Tax Purposes Act went into operation. The property tax field was, however, the most productive of case, constitutional and statutory developments.

This article does not purport to mention all the changes in the constitution and statutes or all cases decided during

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The authors extend their appreciation to Joe Russell, second-year student at Golden Gate College, School of Law, for assistance in the preparation of this article.

The views expressed in this article are those of the authors, and do not necessarily reflect those of the California Attorney General’s Office.
the period covered by the survey. Rather, it is an attempt
on a selective basis to call attention to what are believed to
be some of the more significant developments.

Property Tax

A standard so long established it almost reached back into
California antiquity has come to an end. No longer is the gen-
eral lien date for property taxes noon on the first Monday in
March. As a result of 1967 legislation, the lien date has
been changed to March 1 at 12:01 a.m. It will be remem-
bered the significance of the lien date is that generally speak-
ing the status of property at that time determines whether
and to whom it is taxable. Property value also generally is
determined as of the lien date.

During 1966 and 1967, some tests were laid down by court
decisions concerning the taxation of flight equipment of air-
lines as well as the taxation of seagoing vessels and possessory
interests. In Zantop Air Transport, Inc. v. County of San
Bernardino, a non-domiciliary air carrier was engaged in
the transportation of goods in interstate and intrastate com-
merce. Flight equipment partially utilized in the county was
assessed by a formula based on the time such equipment was
within the county. In computing the time the equipment was
in the jurisdiction, the assessor included ground time plus all
flight time to or from the state line in the case of interstate
flights, and ground time plus half the flight time on intrastate
flights between California counties. The court upheld this
formula against federal constitutional objections as well as
the objection that the California statutory and constitutional
provisions did not purport to tax property not permanently
situated in this state, reasoning that a portion of the flight
equipment was “situated” within the county by virtue of its
contacts therewith and that the method of apportionment uti-

2. Cal. Rev. & Tax. Code § 405. But see Slick Airways v. County of Los
Angeles, 140 Cal. App.2d 311, 295 P.2d 46 (1956) (property subject to appor-
tionment among states); and Cal. Rev. & Tax. Code § 2193.3 (establishing a
different lien date with respect to cotton).
3. 246 Cal. App.2d 433, 54 Cal. Rptr. 813 (1966). For another discus-
sion of Zantop, see Leahy, CONSTITU-
TIONAL LAW in this volume.
lized by the assessor was reasonable. The rule of the Zantop case was adopted by the legislature to remain in effect until July 1, 1968, pending further study of the problem of assessing flight equipment. 4

San Diego County lost two decisions with respect to the taxation of seagoing vessels. In Martinac v. County of San Diego 5 the court invalidated an ad valorem property tax assessed by San Diego County on the value of vessels that spent two-thirds of their port time in San Diego. The vessels had not been in Tacoma, their port of registry, since they were constructed. Nevertheless, the court in denying that the situs was in San Diego relied on the fact that it was not the federally registered home port of the vessels, that the vessels were at sea 265 days a year and that management decisions were made in Tacoma, the domicile of the owner. The case demonstrates the need for a careful re-examination of the so-called “home port” rule which precludes the imposition of an ad valorem personal property tax by any jurisdiction other than the home port. This seems far less acceptable than the apportionment rule applied by the United States Supreme Court to vessels plying inland waters. 6

In Alalunga Sports Fishers, Inc. v. County of San Diego 7 the court held that article XIII, section 4 of the California Constitution precluded the imposition of property taxes on certain sportfishing vessels. The constitution provides that all vessels of more than 50 tons burden registered at any port in this state and engaged in the transportation of freight or passengers shall be exempt from local taxation. The county contended that the vessels were not engaged in transportation of passengers since they did not have a scheduled fixed point of terminus and since they did not deposit the passengers at a place other than the point of departure. The court held that it was not necessary for the vessels to operate between fixed points or termini in order to be engaged in the trans-

5. 255 Cal. App.2d 213, 63 Cal. Rptr. 64 (1967).
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Portation of passengers. The court further held that a consideration of whether the vessels were subject to regulation by the Public Utilities Commission was irrelevant in determining the application of the constitutional exemption.

The court in McCaslin v. DeCamp held that an employee of an irrigation district had a taxable possessory interest in a family residence owned by the tax-exempt irrigation district for which the employee paid rent. The employee occupied the property at the district's sufferance and at the district's request in connection with his employment by the district. Nevertheless, the court held that since the employee's use and possession were exclusive of others, including his employer, this was a taxable possessory interest, particularly since the employee was required to pay rent.

The oft-discussed subject of property tax relief received some measure of legislative action, as outlined below, through provisions for the valuation of open space lands; a reduction in valuation of possessory interests consisting of oil and gas leaseholds in exempt property; a senior citizens tax assistance program; the extension of the veterans exemption; the exemption of fruit trees, nut trees and grapevines of growers while such trees and vines are personal property and in storage; and provisions for tax relief in the event of disaster.

Tax relief for so-called open space land is provided for by article XXVIII of the California Constitution, adopted November 8, 1966. The article declares a policy to preserve open space lands for the production of food and fiber and to assure the use and enjoyment of natural resources and scenic beauty. It further declares that assessment practices must be so designed as to permit the continued availability of open space lands. The legislature is authorized to define open space lands and to provide that when such lands are subject to enforceable restriction, as specified by the legislature, to be used solely for recreation, for the enjoyment of

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scenic beauty, for the development of natural resources or for the production of food or fiber, such lands shall be valued for assessment purposes on such basis as the legislature shall determine to be consistent with such restriction and use. Assessors are to assess such open space lands only on the basis of such restriction and use.

A basic purpose of the constitutional and implementing statutory provisions is to permit the assessment of farm lands and recreational areas at a lower valuation than otherwise would be permissible, even though they are in potential subdivision areas, provided the owners agree to restrict the use of their land for a specified period of time. The reasoning is that if farm land and recreational areas are assessed at the value of subdivision property then the resulting high taxes will force the transformation of more and more farm land and recreational areas into subdivisions or other uses inconsistent with the preservation of open space.

The permanent implementation of article XXVIII is under study by the Joint Legislative Committee on Open Space Lands. In 1967 the legislature enacted interim legislation designed to apply during the period of study. This legislation provides that land which is subject to a "contract" under the Land Conservation Act of 1965, or to an "agreement" under that Act that is substantially as restrictive as a contract, or to a scenic easement deed, is to be valued according to the uses contemplated by the local government and legally available to the owner under the provision of the enforceable restrictions rather than on consideration of land sales data. The presence, however, of quarries, mines and minerals, including hydrocarbons, may be taken into consideration. These provisions are operative until the 61st day following the adjournment of the regular session of the 1970 legislature by which time it is contemplated that the permanent standards now under study will have been enacted.

Additional property tax relief is provided by the partial exemption of some possessory interests that concern certain leasehold estates in exempt property. These leases are for
the production of gas, petroleum and other hydrocarbon substances. The partial exemption is in the form of a provision that the value of such leases is to exclude the value of any royalties or other rights to share in production owned by any tax-exempt entity. These provisions apply only to leases entered into prior to July 26, 1963. The justification given by the legislature for this benefit is that prior to 1963 the royalties in question were excluded from the value of a leasehold by all assessors in the state, that the leases entered into prior to July 26, 1963 presumably were negotiated with the assumption that this practice would continue to prevail and that certain assessors have recently reversed that long-standing method, allegedly causing severe hardship.

Something new in the way of property tax relief has been added in the form of senior citizens property tax assistance on property taxes that are assessed for fiscal years ending on or after June 30, 1968. The amount of assistance is based on the claimant’s “household income.” Persons 65 or over who pay property taxes on their “homestead” and whose household income does not exceed $3,350, are entitled to receive “assistance,” which consists of a reimbursement of a percentage of such taxes. The percentage decreases as total “household income” increases, but may be as much as 95 percent of taxes paid on assessed values. The relief provisions are limited to taxes paid on the first $5,000 of assessed value. These provisions are to be administered by the Franchise Tax Board. The terms “homestead” and “household income” are defined in the statute.

The scope of property tax relief accorded veterans has been somewhat expanded through extension of the veterans’ tax exemption to qualifying veterans of the Vietnam conflict serving in that campaign since August 4, 1964. Although the exemption thus was broadened, provisions were enacted for auditing the claims for exemption granted so that only those entitled to the veterans’ exemption would receive re-

The legislature was authorized, through the addition of section 1 1/2b to article XIII of the constitution, to also expand the exemption for veterans who are blind in both eyes (visual acuity of 5/200 or less), by reason of a permanent service-connected disability incurred in the military or naval service of the United States. This constitutional provision is implemented by section 205.7 of the Revenue and Taxation Code.

Another act of tax relief was the exemption from property taxes of solvent credits and money kept on hand to be used in the ordinary and regular course of a trade, profession or business.

An exemption has been granted for fruit trees, nut trees and grapevines of a grower that are personal property, held in storage on the lien date for subsequent planting in orchard or vineyard form and that are planted by the grower during the assessment year. The exemption does not apply to plant nurseries.

Property tax relief after major disaster has been broadened by an amendment to section 2.8 of article XIII of the California Constitution, which permits the legislature to authorize local taxing agencies to reassess property in a disaster area when the property has been damaged or destroyed by a major misfortune or calamity and the damaged or destroyed property is located in an area or region that was subsequently proclaimed by the Governor to be in a state of disaster. The provision formerly limited such legislative action to situations where the property has been damaged or destroyed by fire, flood, earthquake or other act of God.

Case law also has contributed to possible property tax relief. The welfare exemption was given a broad construction in Stockton Civic Theatre v. Board of Supervisors. The California Supreme Court held that the activities of a nonprofit civic theatre dedicated to providing educational

benefits with regard to dramatic art, both to its actors and its audience, was “charitable” within the meaning of the welfare exemption. The court stated that the term “charitable purposes” used in the code section should be given the same meaning as in the constitution unless a clear legislative intent to the contrary appears. The court further stated that the activity of the civic theatre satisfied the requirement that, to be charitable, the activity must benefit the community as a whole or an unascertained and indefinite portion thereof. The holding is consistent with the very liberal and expansive interpretation that the appellate courts of this state have given to the welfare exemption.20

Other important developments in the property tax field concern changes in various steps a property taxpayer may be required or permitted to take in reporting property; in petitioning for a reduction in assessment; in proving there should be a reduction in assessment; in establishing a basis for challenging an assessment in court; and in some instances, in the payment of taxes.

With respect to the reporting of property, section 8 of article XIII of the constitution, requiring each taxpayer to deliver a property statement to the assessor, has been repealed. This commendable action of removing the requirement from the constitution gives the legislature flexibility to deal with the subject and, at least to a slight extent, disencumbers the constitution.

The legislature has responded to its newly received flexibility by lifting the all-inclusive requirement for the filing of a written property statement except as to persons who own taxable tangible personal property having an aggregate cost of $30,000 or more, other than household furnishings and personal effects.1 Persons owning personal property having an aggregate cost of less than $30,000 and persons owning real property are required to file written property statements only if the assessor requests them to do so.

Another taxpayer procedural change concerns the filing date of petitions for reduction in assessment in counties of over four million people, at present Los Angeles County. The date has been changed to the period between the third Monday in July and September 15, rather than between the fourth Monday in September and the fourth Monday in November.\textsuperscript{2} For counties having a population of less than four million, the petitions must be filed between July 2 and August 26 instead of between the third Monday in July and September 15.\textsuperscript{3}

Petitions for reduction in assessment are considered by county boards of supervisors sitting as boards of equalization or, in counties where they have been created, by assessment appeals boards. These assessment appeals boards formerly were called county tax appeals boards. The name was changed by an amendment to section 9.5 of article XIII of the constitution. The amendment authorizes the board of supervisors of each county to create such a board. Prior to the amendment, such a board could be created by the board of supervisors only in counties that had over 400,000 population and then only with prior legislative approval. Under the amendment, legislative authorization is required for the creation of more than one board in a county, and the legislature still must prescribe the qualifications and composition of such boards as well as the procedure for their discontinuance. The legislature has implemented the amendment by providing that up to five appeals boards may be created in any county and that the board of supervisors may reduce the number or discontinue such boards.\textsuperscript{4}

In connection with hearings on petitions for reduction of assessments, section 1605 of the Revenue and Taxation Code has been amended to provide for a conclusive presumption that the average ratio of assessed value to full cash value of property is not more than 115 percent of the latest preliminary or final ratio as determined by the State Board of Equalization. Previously, a 15 percent deviation from the

\textsuperscript{2} Cal. Rev. & Tax. Code § 1760.
\textsuperscript{3} Cal. Rev. & Tax. Code § 1607.
\textsuperscript{4} Cal. Rev. & Tax. Code §§ 1621, 1626.
board ratio was prima facie evidence of an inequitable assessment. The applicant for a reduction in assessment on the local roll is required to establish the full cash value of the property by independent evidence, but the records of the assessor may be used as part of such evidence.

_El Tejon Cattle Co. v. County of San Diego_5 points out the importance of administrative procedures by illustrating the general rule that if a taxpayer wishes to preserve his right to contest his assessment in court, he must first exhaust his administrative remedies before the county board of supervisors, sitting as a board of equalization, or before a county assessment appeals board. The taxpayer claimed that it was unnecessary to have a hearing before the county board of equalization since the alleged overassessment was predicated on the taxpayer’s ownership of over 1000 more cows than the taxpayer actually owned. The trial court concluded that recourse to the board of equalization was not required, since the assessment covered nonexistent property. The court of appeal reversed, holding that recourse to the county board of equalization was required before a suit could be brought when a single assessment including numerous items of the same generic character is challenged as to the number, quantity or extent of the items.

With respect to property tax payments, a board of supervisors in a county with a population of four million or more may provide that all taxes on real and personal property on the secured roll shall be due on September 10, but may be paid in four equal installments, which will become delinquent on October 10, January 10, March 10 and May 10.6

Assessors received some guidelines both from the courts and the legislature with respect to assessment procedures. Involved were such subjects as whether property must be assessed at full cash value; what ratio must be maintained between assessed value and full cash value; the duty of assessors to give notice of change in assessed valuation; unauthorized discriminatory assessment practices; the separate assess-

ment of property of landlord and tenant; how personal property consigned for sale is to be assessed; and how certain commercial fishing and research documented vessels should be assessed. Changes were also made in the escape assessment and penalty provisions and in certain lien provisions.

A case that received considerable attention from the press as well as from assessors, taxpayers, legislators and tax lawyers was *County of Sacramento v. Hickman*, in which the California Supreme Court upheld the validity of fractional assessments for property tax purposes. The case arose because the assessor of Sacramento County announced that she would assess at 100 percent cash value, despite the requirement of section 401 of the Revenue and Taxation Code that assessors should assess at a publicly announced ratio of between 20 and 25 percent of cash value. In granting a writ of mandate to Sacramento County requiring compliance with section 401, the court rejected the assessor's contention that the California Constitution requires assessment at 100 percent of cash value, relying on the long-continued and consistent interpretation to the contrary by the courts, assessors and legislature.

Related to the principle that property may be assessed at less than its full cash value is the 1967 amendment to section 401 that permits the assessor for the fiscal years 1967-68 to 1970-71, inclusive, to announce a ratio of assessed value to full cash value the same as the ratio employed by the county, as found by the State Board of Equalization, for the preceding fiscal year, if such ratio was between 20 and 25 percent, or to move closer to a 25 percent ratio. As part of the plan to bring all counties closer to the same ratio, the statutory amendment prevents an assessor from announcing a ratio farther away from 25 percent than the ratio of the preceding year.

Consistent with the decision in the *Hickman* case, another 1967 amendment calls for the assessed value of property, rather than the full cash value, to be shown on the local

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property tax assessment roll. Additionally, assessors are now required to inform each assessees of real property on the local secured roll whose property's full cash value has increased, of the assessed value of that property. However, the assessor may instead elect either to inform every assessees of real property on the secured roll, or to inform every assessees on both the secured and unsecured rolls, of their property's assessed valuation.

Gaumer v. County of Tehama illustrates the importance of compliance with assessment procedures. The question arose because of a failure to send notice of an increase of over 25 percent in assessed value pursuant to the provisions of section 619 of the Revenue and Taxation Code. The court of appeal held the failure to give such notice invalidated the 86 percent increase in taxes. In that regard, the court pointed out that a 1963 amendment of section 619 had eliminated a provision that the failure to give notice would not invalidate the assessment or taxes levied. The court concluded that by deletion of this provision, the legislature intended the sending of a notice to be a “sine qua non” upon which the validity of the assessment and tax based thereon depended.

The successful challenge of assessment procedures, however, may not always result in tax recovery for the taxpayer. In Jones Lumber Co. v. Del Norte County, the taxpayer challenged the propriety of a discounting procedure employed by the assessor in valuing timber. The taxpayer claimed that the procedure discriminated in favor of a larger company. The taxpayer won the battle but lost the war, since the court held that although the particular discounting procedure was invalid, the Jones Lumber Company had failed to prove that it had paid more than its fair share of taxes. The discounting procedure used by the assessor involved discounting a base figure depending on acreage. The timber of the largest lumber company in the county was assessed at 48 percent of this


http://digitalcommons.law.ggu.edu/callaw/vol1967/iss1/19
base figure, while that of Jones Lumber Company was assessed at 82½ percent. The court of appeal, in holding invalid this discounting procedure, stated that the discount formula necessarily disclosed a discriminatory method of assessment since the assessor applied a discount only after having fixed a market value for the timber and land involved.

The classification of property as real or personal was considered in *County of Ventura v. Channel Islands State Bank*,¹³ where it was held that a bank sign and a night depository installed by a bank in a leased building were properly classified as improvements to realty, because of the permanence of the method of annexation. The court further held that these improvements could properly be assessed as the real property of the bank, even though no request for separate assessment was filed pursuant to section 2188.2 of the Revenue and Taxation Code.¹⁴

Personal property consigned for sale to any person within this state from any place outside the county in which it is situated is to be assessed either to the consignee or to the consignor or to both, in the county where the property is situated.¹⁵

Procedures also have been enacted for the assessment of certain documented vessels engaged exclusively in commercial fishing or oceanographic research, with a port of documentation in California, at one percent of full cash value.¹⁶

The escape assessment and penalty provisions have been extensively revised.¹⁷ The statute of limitations for the assessment of escaped property was revised to provide for a 6-year

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¹⁴. Cf. *Valley Fair Fashions, Inc. v. Valley Fair*, 245 Cal. App.2d 614, 54 Cal. Rptr. 306 (1966), which held that the assessor could not be required to assess the property of landlord and tenant separately in the absence of compliance with the requirements of § 2188.2 of the Revenue and Taxation Code. § 2188.2 was held to be applicable only if the improvements were in fact owned by someone other than the owner of the land and if a statement of separate ownership is filed.


limitation with respect to assessments to which the penalty provided for in section 504 of the Revenue and Taxation Code applies, and for a 4-year limitation with respect to other assessments. The law also was amended to reduce the amount of penal assessments to 25 percent of the additional assessed value. The law relating to escaped property was extended in certain cases to the amount of a veteran’s exemption allowed if the veteran knowingly submitted erroneous information.

Guidelines for establishing liens on certain taxed property also have been revised. A tax based on an assessment of a possessory interest, or on an assessment of improvements that have been separately assessed because the improvements are owned by a person other than the owner of the land on which the improvements are located, now becomes a lien on such possessory interest or such improvements. There has been a repeal of the provision that the tax based on an assessment of a possessory interest automatically becomes a lien on the owner’s other real property in the county. Also repealed is the provision that the tax on goods in transit is a lien on all the property of the owner of the goods. As a substitute for the repealed provision, the tax collector is authorized to record, in any county, a lien on all the taxpayer’s property in the county if a tax becomes delinquent on an unsecured possessory interest, on improvements that are not owned by the owner of the real property on which they are located, on unsecured property, or on goods in transit. The duration of such liens and the period within which they may be extended has been increased from three to ten years.

As we have seen in the foregoing material, guidelines for taxpayers and assessors were extensively revised. Also decided was the right of the State Board of Equalization to examine certain taxpayer records in the performance of its intercounty equalization function. In *California Portland Cement Co. v. State Board of Equalization,* the taxpayer moved to quash a subpoena duces tecum by which the board was seeking to obtain certain information it needed in con-

19. 67 Cal.2d 588, 63 Cal. Rptr. 5, 432 P.2d 700 (1967).
connection with its intercounty equalization survey of Kern County. The taxpayer refused to furnish information with respect to sales of products manufactured in its Mojave plant, its cost of operation of the plant, and its profits from the products of the plant.

The court rejected the taxpayer’s argument that the data with respect to its cement plant was not relevant in the valuation of its property. The court observed that the board was attempting to value not just the land on which the cement mill was located, but rather to value as a unit the company’s entire Mojave plant, consisting of a single parcel of land on which a quarry and mill were located, together with the improvements and the personal property located there. Since the capitalization-of-income method of valuation was being used, the court stated that the information sought by the board was relevant because it would enable the board to make accurate income studies. The court noted that the quarry and cement mill appeared to be operated as a unit with each contributing to the profitability of the other.

**Local License Taxes**

Something new on the local license tax scene is the Documentary Stamp Act.\(^20\) This act came about when the federal government gave up its documentary stamp tax. Counties have been authorized by the act to impose a tax with respect to certain real property transfers at the rate of 55 cents for each $500 of consideration or value of property transferred in excess of $100, exclusive of the amount of any liens remaining on the property at the time of the sale. Cities have been authorized to impose a similar tax at one-half that rate, with credit against the county tax for the city tax. The statute provides that the United States or any agency or instrumentality thereof, or any state or political subdivision thereof, shall not be liable for the tax with respect to any deed, instrument, or writing to which it is a party, but the tax may be collected by assessment from any other party liable therefor. Exemp-

tions also are provided with respect to instruments in writing given to secure a debt; conveyances to make effective plans of reorganization or adjustment confirmed under the Federal Bankruptcy Act or approved in certain equity receivership proceedings, or whereby a mere change in identity, form or place of organization is effected; to certain conveyances under the orders of the Securities and Exchange Commission; and to certain transfers of partnership property.

Under the act, adhesive stamps to be affixed to documents will be furnished to county recorders by the State Board of Equalization and will be sold by the county recorders. Claims for refund will be governed by the provisions of the law relating to property tax refunds. Authorization of this tax is correlated with the expiration of the provisions for the federal documentary stamp tax that terminated at the end of 1967 and, if the federal government again imposes such a tax, the statutory provisions authorizing a county or city to impose the real property transfer tax will be inoperative on and after the first day of the fiscal year that follows the imposition of the federal tax.\(^1\)

The courts, as well as the legislature, have been heard from with respect to local license taxes. In *Willingham Bus Lines, Inc. v. Municipal Court*,\(^2\) the California Supreme Court declined to issue a writ of prohibition against the municipal court to restrain it from a criminal action against a bus line operating without a city license. The bus line contended that the city license tax on apportioned gross receipts of charter vehicles for hire, based on the intracity portion of the revenue, invaded a field preempted by the state and violated equal protection of the laws. The court, in rejecting these arguments, concluded that the state may have occupied the regulatory field in establishing a comprehensive system for licensing and controlling charter carriers, but it did not preempt the power to tax. The court further held that since the tax was not based on the number of


\(^2\) 66 Cal.2d 893, 59 Cal. Rptr. 618, 428 P.2d 602 (1967). For an analysis critical of the approach taken by the supreme court, see Leahy, *Constitutional Law*, in this volume.
buses used, it did not constitute a tax for the use of the streets. Finally, the court concluded that although some other types of businesses were taxed upon bases other than gross receipts, there was no violation of the equal protection of the laws.

City of Los Angeles v. Moore Business Forms put in issue the propriety of the apportionment measured by gross sales used by the City of Los Angeles in the application of its business license tax on the privilege of doing business in Los Angeles. The court upheld the tax computation that attributed to the City of Los Angeles gross receipts from sales within the city, and 12½ percent of sales made outside the city by sales personnel working out of the taxpayer’s Los Angeles offices. The controversy related to out-of-city sales. The court held that the activities of the Los Angeles office in the solicitation of the sales outside the city and the processing of orders by the Los Angeles offices of the taxpayer constituted a sufficient basis to sustain the allocation of 12½ percent of such sales to Los Angeles.

Bank and Corporation Tax Law

There became operative in 1967 the most extensive changes in the methods of determining the amount of net income attributable to California since the enactment of the bank and corporation franchise tax in 1929. The changes were brought about by the adoption of the Uniform Division of Income for Tax Purposes Act. The Act applies to both the bank and corporation franchise tax and the corporation income tax for income years beginning after December 31, 1966.


Any taxpayer that has income from business activity that is taxable both within and without the state is required to allocate and apportion its net income as provided in the Act. 6 For this purpose a taxpayer is regarded as taxable in another state if, in that state, the taxpayer is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax; or, if that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether the other state does in fact subject the taxpayer to the tax. 7

The Act distinguishes between business income, which is to be apportioned by formula, and nonbusiness income, which generally is to be allocated specifically to the situs of the property that produces the income or to the commercial domicile of the recipient. The Act defines “business income” to mean income arising from transactions and activity in the regular course of the taxpayer’s trade or business and to include income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer’s regular trade or business operations. 8 Income not falling within this definition is nonbusiness income. 9 The Act further provides that business income is to be apportioned to California by means of a three-factor formula of property, payroll, and sales. 10 While this is stated as the general rule, the provision is not inflexible, for the Act states, in effect, that if this method does not fairly represent the extent of the taxpayer’s business activity in this state, the taxpayer may petition for, or the Franchise Tax Board may require, the use of other methods to accomplish an equitable apportionment of the taxpayer’s income. 11

Although the same three factors of property, payroll and sales were used in the formula generally employed before the adoption of the Act, a number of changes have been made by the Act in the composition of the individual factors.


The property factor is a fraction in which the numerator is the average value of real and tangible personal property owned or rented and used in California during the income year and the denominator is the average value of all the taxpayer’s real and tangible property owned or rented and used during the income year. Two important changes have been made in the property factor. Rented property previously was not included but now is included in the property factor. Further, the value previously used for property was depreciated cost or “adjusted basis.” Now original cost is used. Thus, the original cost of even fully depreciated property is included. For purposes of the property factor, rented property is valued at eight times the net annual rental. Only property used in the business is included.

The payroll factor is a fraction in which the numerator is the total compensation paid in California during the income year and the denominator is the total compensation paid everywhere during the income year. Prior to the Act, for purposes of the payroll factor, compensation for services was attributed to the state where the services were performed. The Act provides that compensation is deemed paid in California if the individual’s service is performed entirely within this state or the individual’s service performed outside is incidental to the individual’s service within the state. The same result is also obtained if the employee performs some of his service within the state and his base of operations is located here or, if there is no base of operations, the place from which the service is directed or controlled is in this state. Compensation also is attributed to California if the employee performs some service within the state, the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, and the employee’s residence is in California.

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The sales factor is a fraction in which the numerator is the total of sales attributable to California during the income year and the denominator is the total of all sales during the income year. Important changes in the sales factor have been made. Prior to the Act, sales were attributed to the state where the activities of employees responsible for the sales took place. If there were no sales activities, the sales were attributed to the state from which the property was shipped. The rule emphasized employee activity. The Act now divides sales into sales of tangible personal property and all other sales. It provides that sales of tangible personal property are to be attributed to the state of destination provided the taxpayer is subject to tax in that state. The emphasis now, therefore, is on destination. If, however, the taxpayer is not subject to tax in the state of destination, or if the purchaser is the United States Government, the sales are attributed to the state from which the tangible personal property is shipped. With respect to sales other than sales of tangible personal property, the Act provides that the sales are to be attributed to the state in which the income-producing activity is performed, and if the income-producing activity is performed in two or more states, then the sales are to be attributed to the state in which the greatest proportion of the activity is performed, the proportion to be determined on the basis of cost of performance.

With respect to nonbusiness income, specific rules are prescribed for the treatment of income from property not an integral part of the taxpayer's regular trade or business operations. Income from the rental, sale, or other disposition of real property is allocated to the state where the real property is located, as are gains and losses from such property. With certain exceptions and qualifications, net rents and royalties from tangible personal property are allocated to the state in which the property is utilized, and utilization in California is deemed to be that percentage of the total time that the

property is physically located here. Capital gains and losses from the sale of tangible personal property are allocated to the state of the situs or to the state of the taxpayer's commercial domicile if the taxpayer is not taxable in the state of situs.

Capital gains and losses from the sale of intangible personal property, as well as dividend and interest income, are allocated to the state of the commercial domicile of the taxpayer. Gains or losses from the sale of patents and copyrights are also allocated to the state of the taxpayer's commercial domicile. Royalties from patents and copyrights, however, are allocated to the state where the patents or copyrights are utilized, unless the taxpayer is not taxable in that state, in which event the income is again allocated to the state of commercial domicile.

An additional piece of important legislation was the enactment of section 25106 of the Revenue and Taxation Code to provide that if, under the allocation of income provisions, the tax of a corporation is or has been determined with reference to the income and apportionment factors of another corporation with which it is doing or has done a unitary business, all dividends paid by one to another of such corporations, to the extent such dividends are paid out of such income of the unitary business, shall be eliminated from the income of the recipient and shall not be taken into account under section 24344, the interest deduction section.

Also of interest are several provisions of the Bank and Corporation Tax Law, which have been amended to conform substantially with the 1954 Internal Revenue Code provisions, including those dealing with bad debt deductions, stock redemptions and distributions, and corporate liquidations. Section 24455 has been amended to conform to federal law by providing that a distribution in cancellation or redemption of

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stock may be equivalent to a dividend. Redemption of stock, through use of related corporations, is considered equivalent to a taxable dividend if it comes within the scope of section 24455. Section 24504 has been conformed to federal law to allow a stepped-up basis on assets acquired in liquidation of a subsidiary, even though the stock in the subsidiary was acquired from another subsidiary.

There were two other amendments to the Bank and Corporation Tax Law of some significance. First, trusts or plans which meet the requirements of the Federal Self-Employed Individuals Tax Retirement Bill of 1962 have been exempted.11 Secondly, the provision allowing, as an alternative to the usual deduction for depreciation, the amortization of the cost of air-pollution control equipment over a period of 60 months has been expanded to include the cost of water-pollution control equipment and to give the taxpayer the choice of amortizing the cost of such control equipment over the 60 month period or making a direct write-off of the cost in a single year.12

Two cases of interest affecting the bank and corporation franchise tax also have been decided. In RKO Teleradio Pictures, Inc. v. Franchise Tax Board,13 two major issues were presented. The court of appeal held it was proper to apply a single allocation formula to RKO's income derived from its activity of producing and distributing its own pictures and its activity of distributing pictures produced by others. The taxpayer wished to use two formulas, contending that a separate formula should be used with respect to revenues derived from distributing pictures RKO had not produced. This argument was rejected, since the same personnel and facilities were used for distribution of all films without regard to who produced them. Unity of ownership,
operation, and use therefore were established. The taxpayer was thus determined to be conducting a single unitary business, which required application of the single formula.

Secondly, the court of appeal rejected RKO's contention that the automatic extension of the period for making state assessments when the taxpayer gave a waiver of time limitations to the federal government only extended the state's time to make assessments related to federal audit adjustments. The court held that the state's time to make adjustments on grounds unrelated to federal audit adjustments was also extended by the federal waiver.

South Coast Co. v. Franchise Tax Board\(^4\) involved an unsuccessful attempt on the part of a taxpayer to switch the year of realization of an item of income in the sum of $137,284.21 from 1953, when it was accrued on the taxpayer's accounting records, to 1956. The taxpayer, in performing under a government contract, had an absolute right to labor escalation income in 1953 and had taken a corresponding deduction for labor expense. In 1956, the taxpayer settled its claims against the government for various items, including the labor escalation claim, for $210,000. The court held that the taxpayer's right to receive at least $137,284.21 was sufficiently fixed in 1953 by virtue of the terms of the contract so that it was then taxable.

**Personal Income Tax**

In the discretion of the Franchise Tax Board, dealers in property are now allowed to use the reserve method for computing bad debts on contracts sold to financial institutions with the seller's guarantee as to collection.\(^5\) It is generally required that a suspense account be used when this method is employed. Restrictions are specified on the use of the reserve method and suspense account.

Amounts received with respect to the services of a child now are included in the gross income of the child and not

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of the parent. 16 All expenditures attributable to such income are treated as paid or incurred by the child. 17

Trusts or plans for owner-employees and the self-employed have been exempted from the personal income tax if such trusts or plans meet the requirements of federal law, but contributions to such trusts or plans are not deductible. 18

Sales and Use Tax

An important sales tax case, Shell Oil Co. v. State Board of Equalization, 19 involving interstate and foreign commerce, was brought to a conclusion by the United States Supreme Court's dismissal of the appeal. The taxpayer contended that the sales of bunker fuel used in propelling vessels in interstate or foreign commerce were exempt from sales tax. It asserted that the export clause of the federal constitution precluded the sales tax from being applied with respect to fuel used by vessels engaged in foreign commerce. It argued on two grounds: the fuel itself was an export, or alternatively, the tax was so closely related to the exportation of goods that it would constitute a burden on the process of exportation. As to vessels engaged in interstate commerce, the taxpayer contended that the tax was barred by the commerce clause because it constituted a burden on interstate commerce. Finally, the taxpayer contended that by virtue of federal statutory provisions, the field had been preempted by the federal government, thus precluding state taxation. The California Supreme Court rejected all these arguments. The United States Supreme Court dismissed an appeal as not presenting a substantial federal question.

In a legislative development, vending machine operators, for purposes of the sales or use tax, are to be treated as the consumers of tangible personal property which sells at retail

19. 386 U.S. 211, 17 L.Ed.2d 870, 87 S.Ct. 973 (1967). The opinion of the California Supreme Court is reported in 64 Cal. 2d 713, 51 Cal. Rptr. 524, 414 P.2d 820 (1966) and commented on in 40 So. CALIF. L. REV. 528 (1967) and 51 MINN. L. REV. 151 (1966).
for ten cents or less and is actually sold through a vending machine.\textsuperscript{20}

Two classifications of rental property are affected by other new tax legislation. The Sales and Use Tax Law has been amended to provide that if property purchased under a resale certificate is loaned for the temporary accommodation of a customer, who is awaiting delivery of property purchased or leased from the lender, the measure of the tax is the fair rental value of the property for the duration of the loan.\textsuperscript{1} Additionally, a person who leases property out of state and pays tax on the rentals is not allowed to credit such out-of-state tax against the California tax when he brings the property into this state and pays tax based upon rentals here.\textsuperscript{2}

With respect to exemptions, the definitions of “sale” and “purchase” in the Sales and Use Tax Law have been amended to exclude therefrom a lease of mobile transportation equipment for use in for-hire transportation of property in interstate or foreign commerce.\textsuperscript{3} Sales of vessels or aircraft by a retailer who is not regularly engaged in selling such property are also exempted from sales tax.\textsuperscript{4} The use tax, however, may apply to the use of a vessel or aircraft so acquired.\textsuperscript{5}

The provisions regarding petitions for redetermination have been amended to provide that the petition shall be in writing and shall state the specific grounds upon which the petition is founded. The petition may be amended to state additional grounds at any time prior to the date on which the State Board of Equalization issues its order or decision upon the petition for redetermination.\textsuperscript{6} Before this amendment, the taxpayer had the right to petition but the requirements of the petition were not specified.

\textsuperscript{20} Cal. Rev. & Tax. Code § 6359.4.
\textsuperscript{1} Cal. Rev. & Tax. Code §§ 6094, 6244.
\textsuperscript{2} Cal. Rev. & Tax. Code § 6406.
\textsuperscript{3} Cal. Rev. & Tax. Code §§ 6006(g)(4), 6010(e)(4).
\textsuperscript{4} Cal. Rev. & Tax. Code § 6283.
\textsuperscript{5} See In re Los Angeles Lumber Products Co., 45 F.Supp. 77 (D.C. [1942]).
\textsuperscript{6} Cal. Rev. & Tax. Code § 6561.5. Similar provisions have been enacted for the motor vehicle fuel license tax ($7710.5), the use fuel tax ($8851.5), the motor vehicle transportation license tax ($9926.5), cigarette tax ($30261.5), and alcoholic beverage tax ($32301.5–06, 32312).

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Insurance Tax

The home or principal office property tax deduction of insurance companies, from the gross premium insurance tax, has been modified by an amendment of section 14-4/5 of article XIII of the California Constitution. The amendment limits the deduction by a formula based on a consideration of the percent of the office building occupied by the insurance company. The new space limitation, however, does not apply to the real property occupied by a "domestic" insurer on January 1, 1970, as its home or principal office or to the real property upon which the "domestic" insurer commences construction of such office prior to January 1, 1970. A “domestic” insurer means one organized and licensed under California law prior to January 1, 1967.

The term “insurer” has been redefined so that reciprocal or inter-insurance exchanges, together with their corporate or other attorneys in fact, are considered as a single unit for purposes of taxes relating to their insurance operations.7

Inheritance and Gift Taxes

An inheritance tax case of interest is that of Estate of Clarke.8 The court held that the controller was not bound by a determination of a probate court establishing a trust and approving the claim of the executrix. The case is of significance with respect to the effect to be given an in rem judgment to which the taxing agency was not a party. The California Supreme Court expressly declined to overrule Estate of Radovich,9 which held that the controller was bound by an in rem judgment in an heirship proceeding to which the controller was not a party. Instead, the court distinguished the Radovich case by applying an exception recognized by the federal courts where the in rem proceeding is collusive or ex parte, does not adversely affect the economic interest of a

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party or potential party to the proceeding and is obtained for the sole purpose of defeating a tax. The court concluded that since each of the aforementioned elements relating to the exception was present in *Clarke*, the controller should be afforded a hearing as to the validity of the trust and creditors' claims that adversely affected the amount of inheritance tax.

**Tax Rate Increases**

1967 saw a general increase in state tax rates. As part of the increase, the franchise and income tax on corporations (excepting financial corporations) was increased from 5½ percent to 7 percent. The maximum rate of tax on banks and financial corporations also was raised from 9½ percent to 11 percent. Financial corporations, however, now are allowed, as part of the offset against the franchise tax, amounts paid for motor vehicle registration fees. The rate of tax on financial corporations after the allowance of offset cannot be less than 7 percent of the corporation's net income for the preceding income year.

The general increase in taxes in 1967 extended to the sales and use tax and certain other taxes administered by the State Board of Equalization. The state sales and use tax rate was increased from 3 to 4 percent, thereby raising the combined state and local sales and use tax rate to 5 percent. The state sales and use tax rate will go down to 3½ percent on July 1, 1968, unless before that time legislation is enacted for property tax relief. The increase in rate is negatived to some extent by a provision exempting gross receipts from the sale or use of material and fixtures from 25 percent of the state sales and use tax (an amount equal to the increase) if the sale or use is obligated under an engineering construction project contract or a building construction contract entered

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14. Sales tax (increased to 4%), § 6051; use tax (increased to 4%), § 6201; alcoholic beverage tax (tax on distilled spirits of proof strength or less increased to $2 per wine gallon), § 32201; cigarette tax (increased to 10 cents per pack), § 30101.
into for a fixed price prior to August 1, 1967. Tangible personal property is not considered obligated under a contract when any contracting party has a right to terminate the contract upon notice.

Personal income taxes have been increased generally by narrowing the lowest tax bracket to which the one percent rate applies from $2,500 or less of taxable income to $2,000 or less. Other tax brackets are narrowed from $2,500 to $1,500, and a top tax rate of 10 percent on taxable income of over $14,000 is provided, instead of a top rate of 7 percent on taxable income in excess of $15,000. The tax for the head of a household is increased by a lesser amount.

Deductions for personal income tax exemptions have been changed to credits for personal exemptions. Thus, there has been eliminated the allowance of deductions or personal exemptions of $600 for dependents and blind persons, $1,500 for single taxpayers, and $3,000 for married individuals and heads of households. There have been substituted tax credits of $8, $25 and $50 respectively. Also eliminated were the $1,000 deductions for estates and $100 for trusts; instead, credits of $10 and $1 respectively, are allowed.

The increase in state taxes also carried over to inheritance and gift taxes by an increase in rates and a reduction in the amount of exemptions. Class C and Class D transferees and donees have been combined for purposes of the inheritance and gift tax. The annual gift tax exemption has been reduced from $4,000 to $3,000, and exemptions for Class C transferees and donees also have been reduced.