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State and Local Taxes

by *James E. Sabine** and *Ernest P. Goodman***

The year 1968 may have been more significant for constitutional changes that did not occur than for those that did. Proposition 9, the so-called "Watson Amendment," would have imposed severe limitations on the property tax as a source of revenue. According to its opponents, this measure, which was defeated, would have resulted in a drastic restriction on the borrowing power of the state and its political

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

subdivisions, and would have required an extensive shift to other taxes if the present level of expenditure were to be maintained.

But Proposition 1–A, affording a moderate amount of property Tax relief was adopted by the voters and became Article 13 section 1 d of the Constitution. It was implemented by Senate Bill 8.¹ The specific provisions of this bill will be discussed under the Property Tax and Personal Income Tax headings.

Legislative changes in other fields will be discussed under the headings relating to the particular taxes affected.

Property Tax

Tax Relief; Exemptions

Proposition 1–A. This constitutional measure implemented by statutory enactment afforded some degree of property tax relief through the use of revenues raised by state taxes. One feature of the provisions is the exemption of 15 percent of the assessed value of business inventories. Household furnishings and personal effects (not including vehicles, boats or aircraft) in excess of the \$100 constitutional exemption are exempt from property tax starting with the 1969–1970 fiscal year.

The most significant relief to the average citizen, however, is the homeowner's property tax exemption of \$750 in assessed value. The exemption applies to:

- (a) A single-family dwelling occupied by an owner as his principal place of residence on the lien date,
- (b) A multiple-dwelling unit occupied by an owner on the lien date as his principal place of residence and not containing more than two separate dwelling units, or
- (c) A condominium occupied by an owner as his principal place of residence on the lien date.

This exemption does *not* apply to property which is rented, vacant, or under construction, nor does it apply to an owner's

¹ Cal. Stats. 1968, ch. 1, First Ex. 255.1, and 471 to the Rev. & Tax. Sess, adding §§ 129, 218, 219, 224, Code.

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 vacation of secondary home. The statute also provides that the exemption does not apply to property for which an owner received an allowance for taxes, either in whole or in part, either directly or indirectly, for the property tax year from the state or any political subdivision thereof, except assistance received under The Senior Citizens Property Tax Assistance Law. Nor is the exemption available if the veterans' exemption is granted with respect to the same dwelling.

The State Board of Equalization is to prescribe all procedures and forms necessary to administer the homeowner's property tax exemption. Starting in 1969, persons wishing to receive this exemption must file an annual claim with the county assessor.

In lieu of the \$750 homeowner's property tax exemption, which starts with the 1969-70 fiscal year, qualified homeowners may receive a flat \$70 property tax relief payment for the 1968-69 fiscal year if the necessary claim has been filed with the county assessor.

Other Exemptions. Section 277 was added to the Revenue and Taxation Code to provide for the cancellation or refund of 90 percent of the tax, penalty or interest imposed on property, otherwise eligible for exemption, whose owners failed to file timely applications for the cemetery, college, exhibition, church, orphanage or welfare exemption.² Under this section, operative January 15, 1969, application for such cancellation or refund must be made by January 15 of the calendar year next succeeding the calendar year in which the exemption was not timely claimed.

The legislature continued to broaden the welfare exemption in the 1968 session.³ Under the 1968 legislation,⁴ property owned or leased by a nonprofit organization established for the purpose of leasing the property to the state, a county, a city and county, or a city will qualify for this exemption

2. Cal. Stats. 1968, ch. 1351.

3. The *Stockton Civic Theatre* case (66 Cal.2d 13, 56 Cal. Rptr. 658, 423 P.2d 810 (1967)) discussed in last year's survey serves as the focus for an ex-

tensive law review comment on the California welfare exemption (40 So. Calif. L.R. 844).

4. Cal. Stats. 1968, ch. 1428, adding section 231 to the Rev. & Tax. Code.

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when certain conditions are satisfied. Provision must be made for transfer of the property in fee to the public entity at the termination of the leasing period and the property must be used for purposes uniquely of governmental character such as city halls, fire stations, parks or playgrounds. Although the uniquely governmental character under the terms of the statute precludes property intended to produce income from sources such as rents and admissions, there is a grandfather clause allowing the application of the welfare exemption to certain types of income-producing property if the lease was entered into between the nonprofit corporation and the public entity on or before December 31, 1968. The list of real properties qualifying for this grandfather clause includes community recreation buildings, golf courses, airports, water, sewer and drainage facilities, music centers and their related facilities, and public parking incidental to and in connection with one of the buildings or structures enumerated in the statute.

The welfare exemption law has been amended to provide that the exemption may not exceed an amount of property reasonably necessary to accomplish the exempt purpose and to make clear that the exemption applies to certain housing for elderly or handicapped families financed by the federal government.⁵

*Smith-Rice Heavy Lifts, Inc. v County of Los Angeles*⁶ involved an effort to obtain a property tax exemption under Article XIII, section 4, of the California Constitution which accords an exemption to "All vessels of more than 50 tons burden registered at any port in this State and engaged in the transportation of freight or passengers. . . ." Exemption was sought for certain barges located in Los Angeles harbor. Large cranes were attached to the barges. The cranes primarily were engaged in dredging and construction work and in lifting and depositing items of personal property that were to be carried by other vessels. The court concluded that the

5. Cal. Stats. 1968, ch. 645 amending §§ 214 & 254.5 of the Rev. & Tax. Code.

6. 256 Cal. App.2d 190, 63 Cal. Rptr. 841 (1967).

barges did not qualify for the exemption as vessels “engaged in the transportation of freight.” The court also rejected an argument that the registration of the barges in San Francisco as a home port served to exempt them from taxation by the County of Los Angeles. The court construed statutes providing for taxation at the home port as inapplicable to vessels which had a permanent situs elsewhere. The court held that Article XIII, section 10 of the California Constitution which provides for taxation at the place where property is situated, authorized the property tax imposed by Los Angeles County.

Assessments

Procedure and Review. There have been several developments relating to the practices of assessors. A Joint Committee on Assessment Practices has been created to study and analyze property tax assessment practices of local assessors and the State Board of Equalization.⁷

Legislation which restricts the State Board of Equalization in the performance of its intercounty equalization function may prove ineffective. An opinion of the Attorney General⁸ concluded that section 1815.7 of the Revenue and Taxation Code, which was amended at the 1968 session of the legislature,⁹ was unconstitutional both before and after the 1968 amendment as applied to land which does not qualify as “open space” land under Article XXVIII of the California Constitution. Section 1815.7 purports to impose restrictions on the State Board of Equalization in performance of its duty, prescribed by the California Constitution,¹⁰ to equalize the assessment levels of the various counties of the state. The restrictions in section 1815.7 relate to the use of comparable sales as indicators of value as well as to the use of such sales in arriving at the value of the property by the capitalization-of-income approach.

In *State Board of Equalization v. Watson*,¹¹ the right of the

7. Cal. Stats. 1968, Res. ch. 251.

10. Art. XIII, section 9.

8. 51 Ops. Cal. Atty. Gen. 228 (1968).

11. 68 Cal.2d 307, 66 Cal. Rptr. 377, 437 P.2d 761 (1968).

9. Cal. Stats. 1968, ch. 1153.

State Board of Equalization to have access to the records of the county assessor was affirmed. An interim legislative committee, studying the problem of assessment of aircraft with a view to legislative changes, became concerned with apparent discrepancies between local assessment practices in San Mateo and Los Angeles Counties with respect to the assessment of the flight equipment of three airlines. The committee requested the State Board of Equalization to audit the personal property assessments of the airlines. The San Mateo County Assessor immediately made available the information requested by the State Board. The Los Angeles County Assessor, however, refused to allow the State Board to examine his records, claiming they were confidential. The court made reference to section 408 of the Revenue and Taxation Code as containing a command that “ ‘The assessor *shall* disclose information, furnish abstracts or permit access to *all* records in his office’ to certain named governmental agencies, including the State Board of Equalization.”¹² [Emphasis by the court.] The court went on to say:

By such amendments the Legislature manifested a clear intent to deny to local assessors their former power of withholding records from governmental agencies having an interest in inspecting them. That right of inspection is an essential part of the tax reform program, and must be scrupulously respected.¹³

The court also rejected other contentions of the assessor relating to the manner in which the request was initiated, as well as to the form and content of the request.

*DeLucia v. County of Merced*¹⁴ held that factual determinations respecting valuation made by a local board of equalization are reviewable on certiorari. The court held that review is limited to evaluating the determinations for arbitrariness, abuse of discretion, or failure to follow the standards prescribed by the legislature. The court further held that a

^{12.} 68 Cal.2d at 312, 66 Cal. Rptr. at 379, 437 P.2d at 763.

^{13.} 68 Cal.2d at 312, 66 Cal. Rptr. at 379–380, 437 P.2d at 763–764.

^{14.} 257 Cal. App.2d 620, 65 Cal. Rptr. 177 (1968). For further discussion of this case, see Manual, ADMINISTRATIVE LAW, in this volume.

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taxpayer was not entitled to a trial *de novo* in the superior court to settle factual matters passed on by the local board of equalization.

An additional source of information concerning valuation has been made available to taxpayers by 1968 legislation. Section 619 of the Revenue and Taxation Code already required assessors either (1) to inform each assessee of real property on the local secured roll of the new assessed value of property whose full cash value has been increased or (2) to elect to inform every assessee of real property on the secured roll, or to inform every assessee on both the secured and unsecured rolls, of his property's assessed valuation. In addition to the foregoing, the 1968 amendment of section 1816 of the Revenue and Taxation Code¹⁵ now requires the State Board of Equalization to mail to taxpayers, whose property is appraised by the board in making surveys for the purpose of intercounty equalization, a notice of the market value of the property as appraised by the board. During the 30-day period following the mailing of such notice, the taxpayer may inspect, at the appropriate intercounty equalization division office of the board, any information and records relating to the appraisal of his property except information and records which also relate to the property or business affairs of another person.¹⁶

In *Tamco Development Co. v. Del Norte*,¹⁷ the assessor failed to give plaintiffs the notice of an increased assessment required by section 619 of the Revenue and Taxation Code. The property had been assessed as grazing land for the taxable year 1963–1964 at \$12,415, but after the filing of a subdivision map, the assessed value was raised to \$624,080 for the following year. Since the taxpayers had no notice of the increased assessment, they did not appear at the equalization hearings held by the board of supervisors between the first and third Mondays in July. The taxpayers did appear before the board of supervisors on December 8, 1964, and

15. Cal. Stats. 1968, ch. 1012.

16. Cal. Stats. 1968, ch. 1012, amending § 1820 of the Rev. & Tax. Code.

17. 260 Cal. App.2d 929, 67 Cal. Rptr. 590 (1968).

January 25, 1965, to protest the increased assessment, but the board declined to cancel either the increased assessment or the taxes resulting therefrom. The court held that the taxpayers were entitled to an immediate refund to the extent their tax payment exceeded the allowable tax, based on a 25 percent increase over the prior year's assessment, rather than referring the matter back to the local board of equalization. The board of supervisors was no longer empowered to sit as a board of equalization at the time of the judgment.

The statutory provisions involved in the *Tamco* case have now been amended. Provision has been made for a late local equalization procedure for an assessee on the local secured roll where the assessor failed to send a notice pursuant to section 619 of the Revenue and Taxation Code. Section 620 was expressly amended to apply to an assessee of real property on the secured roll whose property's full cash value has increased. The court in the *Tamco* case observed that prior to this amendment section 620 only applied to an assessee whose property was not on the prior year's secured roll.¹⁸

A provision has been added to the Revenue and Taxation Code¹⁹ providing that when a county board of equalization changes the value on a parcel of real property, there is a rebuttable presumption that the appraised value of the property for the succeeding two assessment years is the value so determined by the county board. If the assessor or the taxpayer wishes to rebut the presumption and the other party does not accede, the matter is automatically set for hearing by the board. Certain related procedural changes also are made by this legislation. Other statutory revisions relating to local equalization procedures require written findings of fact under certain circumstances and establish rules of evidence.²⁰

Specific Assessment and Valuation Problems. Proposition 2, adopted at the November 5, 1968 election adds section 1.60

18. Cal. Stats. 1968, ch. 481, amending § 620 of the Rev. & Tax. Code.

19. Cal. Stats. 1968, ch. 1156, adding § 1616 to the Rev. & Tax. Code.

20. Cal. Stats. 1968, ch. 1211, amending §§ 1605.5 and 1609 of the Rev. & Tax. Code and Cal. Stats. 1968, ch. 1213 adding § 1609.2.

through 1.69 to Article XIII of the California Constitution to provide for formula assessment of lands (including water rights) owned by public agencies such as cities, counties, or districts, where the lands are located outside the boundaries of the public agency and were taxable when acquired.

The constitutional measure further provides that any replacement or substitution of a taxable improvement after March 1954 will be assessed while owned and possessed by the governmental owner at no more than the highest value ever assessed upon the replaced improvement.

Unredeemed pledged goods in the possession of a pawnbroker, but not owned by him to hold and dispose of as his property, are not to be assessed to him.¹ The adoption of this statutory provision will serve to promote uniformity as there had been divergence among assessors as to the tax treatment to be accorded to pledged goods.

Another new statute provides that under specified circumstances the assessor shall separately assess the land and improvements subject to a lease and the land and improvements not subject to the lease where a portion of a parcel of land is leased and the lessee is obligated to pay, or reimburse the lessor for, the property taxes on the leased premises. The statute permits the assessor, with certain limitations, to assess the leased premises to either the lessee or the lessor.²

In *Millbrook Farm v. Watson*,³ a taxpayer was unsuccessful in its attempt to compel the assessor to assess plaintiff's contiguous property located in two sections as nine separate parcels instead of two parcels. The court referred to the absence of any legislative provisions respecting the minimum assessable unit of real property. It also made reference to the presumption of the regularity of governmental action. In rejecting an "equal protection" argument, the court concluded that there had been no purposeful discrimination by the assessor with respect to the size of the parcels assessed.

Other additions to the Revenue and Taxation Code were

1. Cal. Stats. 1968, ch. 420, adding section 989 to the Rev. & Tax. Code.

2. Cal. Stats. 1968, ch. 1282, adding § 2188.4 to the Rev. & Tax. Code.

3. 264 Cal. App. 2d —, 70 Cal. Rptr. 745 (1968).

made by adding sections 1150 through 1156 which provide the procedure for determining the value of certificated aircraft operated by an air carrier.⁴ Certificated aircraft are defined as aircraft operated under a certificate or permit from the United States Civil Aeronautics Board or the California Public Utilities Commission.

This legislation provides for an allocation formula to be used in determining the extent to which such aircraft are normally present in the state. The time the aircraft is in this state, both in the air and on the ground, as compared with total time, is determined for a representative period. This element is then given 75 percent of the weight under the formula. The remaining 25 percent is attributed to the result of comparing arrivals and departures within the state with total arrivals and departures.

Section 1153 of the Revenue and Taxation Code further provides that, after consulting with the assessors of counties in which the aircraft of a carrier normally make physical contact, the State Board of Equalization shall designate for each assessment year the representative period to be used by the assessors in assessing aircraft of the carrier. Section 1154 provides that the formula is also to be applied to a category of aircraft designated as air taxis. The provisions respecting allocating flight time within the state formerly found in section 987 (now repealed) are set forth in section 1155.

One industry which clearly obtained property tax relief was the motion picture industry. Legislation was enacted to overturn the holding of the California Supreme Court in *Michael Todd Co. v. Los Angeles County*,⁵ which held that in valuing a motion picture film it was appropriate to consider the production or replacement cost. Section 988 has now been added to the Revenue and Taxation Code to provide that the cash value of motion pictures, including the negatives and prints, is the cash value of only the tangible materials upon which such motion pictures are recorded.⁶

4. Cal. Stats. 1968, ch. 1306.

6. Cal. Stats. 1968, ch 927.

5. 57 Cal.2d 684, 21 Cal. Rptr. 604,
371 P.2d 340 (1962).

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In *Los Angeles Dodgers, Inc. v. County of Los Angeles*,⁷ the court upheld the assessor's valuation of the land on which Dodger Stadium is located at approximately \$14,000,000, although experts for the taxpayer testified the land was worth between two and four million dollars. The appraisal by Los Angeles County for the fiscal year 1963-64 was based on sales of land, some of which was industrially zoned. For the period 1964-65, 55 land sales were considered by the county. An adjustment was made for zoning which reduced the value by 20 percent. The Dodgers contended that the land from which the sales data were obtained was not comparable to the stadium land. The court of appeal, relying on the trial judge's implied acceptance of comparability, rejected this contention. The 1964-65 appraisal produced a higher value per acre—\$80,000 as against \$42,000—but limited the application of this value to 167 usable acres of the total 235.68. Thus, although in the second appraisal by the county the value per acre was almost doubled, the total valuation on the second appraisal was almost identical to that of the first.

In *Red Bluff Developers v. County of Tehama*,⁸ the court of appeal ordered a refund of property taxes assessed against the reserved mineral rights in land when it was shown that the assessor computed his assessment so that the resulting tax would cover his bookkeeping costs. The court pointed out that an assessor, in arriving at the full cash value of the mineral rights, should consider factors such as the price a willing purchaser would pay or, in the absence of an actual market, replacement cost and income. The court held that the assessor had a duty to assess the reserved mineral rights; but that his method was improper in failing to apply prescribed standards for ascertaining the full cash value of the right.

Possessory Interests. Possessory interests have received some attention from both the legislature and the courts. The State Board of Equalization is prohibited from prescribing rules and regulations with respect to the assessment and

⁷ 260 Cal. App.2d 697, 67 Cal. Rptr. 341 (1968).

⁸ 258 Cal. App.2d 668, 66 Cal. Rptr. 229 (1968).

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equalization of possessory interests until the lien date in 1970. The board is directed to develop comprehensive rules as to all types of possessory interests by February 28, 1970.⁹ The declared purpose of this amendment is to obtain uniform treatment as to the taxability and valuation of all possessory interests.

In *Mattson, et al. v. County of Contra Costa*,¹⁰ it was held that a taxable possessory interest was created in connection with the operation of refreshment services at the clubhouse of a municipal golf course. By written agreement with the city of Concord, plaintiff taxpayers were described as concessionaires and given the exclusive right to serve food and beverages at the clubhouse for 5 years. The "concessionaires" were to pay the city 5 percent of the gross receipts, less sales taxes. The city reserved the right to terminate when the method of operation and quality of the service failed to measure up to the requirements of the agreement or the needs of the public. The agreement provided for the time of operation, for reasonable prices and for restricted advertising of particular food or beverages. In actual operation, the kitchen and storeroom were in the exclusive possession of the plaintiff concessionaires. The dining area was open to the public. Vending machines were installed by the "concessionaires" without special permission. They also furnished the dining room with chairs and tables. The "concessionaires" had almost complete control of hiring and firing of employees and were required to provide workmen's compensation for such employees. The court weighed all the above factors and concluded that the plaintiffs, by virtue of the exclusiveness of their rights, together with the degree of control they exercised, had more than a mere license. Rather, the court concluded they had the possession and valuable use of land and improvements sufficient to amount to a possessory interest within the meaning of section 107 of the Revenue and Taxation Code. The court held this result would follow even if the city were obliged to reimburse the concessionaires for the tax.

⁹ Cal. Stats. 1968, ch. 771, amending § 15606 of the Gov. Code.

¹⁰ 258 Cal. App.2d 205, 65 Cal. Rptr. 646 (1968).

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In *Los Angeles Dodgers, Inc. v. County of Los Angeles*,¹¹ it was held that the Dodgers had a taxable possessory interest in 40 acres of land to which the city held title and which the Dodgers had agreed to develop for recreational purposes. The Dodgers, who agreed to spend \$500,000 on the property for such purposes, made improvements on the property, amounting to \$300,000 for grading, and paid the city a further \$200,000 in satisfaction of this obligation. No recreational facilities were built, however. The city retained title for 20 years to insure payment of \$60,000 annually for the upkeep of the property after which the property would be conveyed free and clear to the Dodgers. The court held that the city, which had declared the property to be surplus was not "possessing and using" the property and that the Dodgers had the beneficial use thereof. Since the Dodgers had fulfilled their part of the bargain by paying \$500,000, they needed only to make annual payments of \$60,000 for 20 years to get the property. Accordingly, the court concluded they had the equitable and beneficial ownership of the property and that the possessory interest was subject to tax.

Penalties

The subject of penalties received attention in *L. B. Foster Co. v. County of Los Angeles*.¹² The court upheld the imposition by the assessor of a penalty equal to 100 percent of the escaped assessment based on a finding by the assessor that the taxpayer misrepresented and underreported inventories. The trial court had granted the taxpayer a summary judgment relieving it of the penalties imposed on an escape assessment on the ground that sections 501, 503 and 504 of the Revenue and Taxation Code, pursuant to which the escape assessment and penalties were imposed, were unconstitutional. Section 504 provided that a penal assessment shall not exceed 10 times the value of the property with respect to which the penalty is assessed. The taxpayer contended that this provision, by allowing the assessor to determine whether the statute

11. 256 Cal. App.2d 918, 64 Cal. Rptr. 465 (1967).

12. 265 Cal. App.2d —, 71 Cal. Rptr. 16 (1968).

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was violated and the amount of penalty to be imposed, was an unconstitutional delegation of judicial power to a non-judicial officer in violation of the principles of separation of powers and due process. The court pointed out that the determination of the assessor as to whether the statute was violated did not involve an exercise of discretion. The court, in upholding the validity of the delegation to the assessor to determine the amount of penalty, analogized it to the power given to the assessor to estimate the value of property if the taxpayer neglects to submit a statement under oath. The constitutionality of the latter type of provision previously had been upheld by the California Supreme Court.¹³ The court further held that constitutional provisions calling for equal assessment cannot be construed as forbidding an extra charge against a taxpayer for violating the law. Finally, the court pointed out the taxpayer was entitled to have the local board of equalization review a penal assessment made pursuant to section 503.

There were statutory amendments in 1968 regarding escaped assessments and the penalty for failure to file a personal property statement.¹⁴

Bank and Corporation Taxes

Tax laws are being used increasingly to accomplish social objectives. Thus, to encourage the employment of disadvantaged persons, tax incentives have been provided to employers for both personal income tax and bank and corporation tax purposes.¹⁵

California statutes, 1968, chapter 1357 added sections 17202.2 and 17202.3 to the Personal Income Tax Law, sections 24343.5 and 24343.6 to the Bank and Corporation Tax Law; and sections 12803.2, 12803.3 and 12803.4 to the Government Code. Sections 17202.2 and 24343.5 provide

¹³. *Orena v. Sherman*, 61 Cal. 101 (1882).

¹⁴. Cal. Stats. 1968, ch. 1131, amending §§ 441, 463, 531, and adding § 531.2 to the Rev. & Tax. Code.

¹⁵. Cal. Stats. 1968, ch. 1357, adding §§ 17202.2, 17202.3, 24343.5, and 24343.6 to the Rev. & Tax. Code.

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that a qualifying employer is one who was in business on January 1, 1967, or is a newly formed subsidiary of such an employer. Sections 17202.3 and 24343.6 provide an additional expense deduction for a qualifying employer of an amount equal to 50 percent of the training costs and compensation of a certified disadvantaged person. This special deduction is limited to an 18-month period for each such person employed or trained. The person must have been employed by the qualifying employer for not less than 6 months and must be a California resident. This special deduction is not allowed for any period when the employer receives any payment or credit from state or federal agencies because of the employment of such persons.

Section 12803.2 provides that the number of trainees certified shall not exceed 2,500 in any fiscal year or such lesser number as will not cause a revenue loss of more than \$300,000 to the state in any fiscal year under the deductions provided by sections 17202.3 and 24343.6. A disadvantaged person or certified trainee must be certified to a qualifying employer for employment under section 12803.2 in the following preference order: (1) Unemployed public assistance recipients; (2) Unemployed persons receiving neither public assistance nor unemployment insurance; (3) Employed public assistance recipients. The provisions of this act expire January 1, 1971.

In addition, provisions have been added relating to a special bad debt deduction and a credit against the bank and corporation franchise tax for banks, savings and loan associations and other financial institutions which make noninsured loans to low and moderate income families for single family residential housing purposes.¹⁶

The special deduction and credit apply only to loans made on or after January 1, 1969, are available as to income years beginning on or after January 1, 1969, and remain in effect only as to income years commencing prior to December 31, 1970. On or before November 1, 1969, the Savings and

16. Cal. Stats. 1968, ch. 1462, amending § 24348, and adding § 26082 to the Rev. & Tax. Code.

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Loan Commissioner is to submit a report to the legislative analyst on the effect of the bill, and the legislative analyst is to report to the legislature on or before the 30th day of the 1970 session.

For purposes of the franchise tax, a deduction has been granted corporations commercially domiciled in California for dividends received from insurance companies under certain circumstances.¹⁷ The deduction is available to such corporations if they own at least 80 percent of each class of stock of the insurance company and if the insurance company is subject to the gross premiums tax at the time of payment of the dividends. If the insurance company has gross income from sources within and without the state, the deduction is computed according to a formula based on gross receipts, payroll, and property factors.

Professional Corporations

Provision has been made for the formation of professional corporations, which may encourage incorporation by doctors, dentists, and lawyers.¹⁸ Such corporations now are included in the definition of corporations in section 23038 of the Bank and Corporation Tax Law.

Unitary Business Criteria

Useful discussion of the criteria to be applied in determining whether a business is unitary is set forth in *Standard Register Co. v. Franchise Tax Board*.¹⁹ This case involved the question whether the operations of the company's Pacific division in the western states and divisions operating in other parts of the United States were to be regarded as constituting a single nationwide unitary business operation. The taxpayer's operations in the western states were conducted in plants acquired from another company, Sunset McKee, in 1955. Most of the personnel formerly employed by Sunset McKee

17. Cal. Stats. 1968, ch. 1379, adding § 24410 to the Rev. & Tax. Code.

19. 259 Cal. App.2d 125, 66 Cal. Rptr. 803 (1968).

18. Cal. Stats. 1968, ch. 1375.

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 were put on the payroll of the Standard Register Company. The taxpayer contended that the operations of the Pacific division should be treated as separate from its other business operations while the Franchise Tax Board contended that Standard Register was conducting a single nationwide unitary business. The court in upholding the position of the Franchise Tax Board observed that although in many respects the Pacific division acted independently, the financing, general direction and control of the Pacific division by the eastern headquarters were sufficient to constitute Standard Register a single unitary business operation. The case reaffirms the principle that the presence of certain elements of independent operation by a division of a business is insufficient to negate the existence of a unitary business operation where interdependence of the various divisions also exists.

The Property Factor in the Apportionment Formula

Under the Uniform Division of Income for Tax Purposes Act,²⁰ rented property is to be included in the property factor of the apportionment formula at eight times annual rental. In *McDonnell Douglas Corp. v. Franchise Tax Board*,¹ which arose before the adoption of the uniform act, manufacturing plant facilities provided by the federal government for use by Douglas without charge were excluded from the property factor by the state taxing authorities. The propriety of this action was upheld by the trial court. The supreme court reversed the trial court and held that under the circumstances there involved, it was improper to exclude the non-owned property from the property factor of the apportionment formula. During World War II, Douglas Aircraft Corporation (one of the corporate predecessors of the plaintiff) had built aircraft for the federal government. Some of the aircraft were built in California plants owned by the corporation while other aircraft were constructed in plants supplied by the federal government located both in and outside of Cali-

²⁰ Cal. Rev. & Tax. Code, Sections 25120 et seq.

¹ 69 Cal.2d —, 72 Cal. Rptr. 465, 446 P.2d 313 (1968).

California. Most of the aircraft were built under cost-plus-fixed-fee contracts with the federal government.

The Franchise Tax Commissioner used the traditional three-factor formula of property, payroll and sales to arrive at Douglas' income from California sources. The Commissioner, however, excluded from the property factor the out-of-state plants which Douglas used, but did not own. As a result, in the formula utilized by the Commissioner, the California portion of the property factor ranged from 93.67 percent to 100 percent during the years in question. The taxpayer contended that to avoid an arbitrary result the non-owned plants should be included or, alternatively, a two-factor formula of payroll and sales should be used. The taxing agency contended that it was appropriate to base one factor (property) of the allocation formula on the "invested capital" approach. The court after disapproving the formula utilized by the Commissioner remanded the case to the trial court to permit the taxing agency to select a proper formula.

Another problem relating to the property factor of the apportionment formula concerns the treatment of mobile equipment such as aircraft. Legislation previously discussed,² which provided a special method for computing the value of mobile equipment of an airline for ad valorem property tax purposes, applies the same approach for the property factor of the apportionment formula to be utilized under the Bank and Corporation Tax Law. This measure provides that the property factor for the aircraft of an air carrier or air taxi under section 25101.3 of the Revenue and Taxation Code shall be based on the provisions of section 1152. Thus, in determining what portion of the value of the taxpayer's aircraft is to be included in the California property factor of the formula, the provisions of section 1152 come into play and involve the following: The time in this state both in the air and on the ground of the taxpayer's certified aircraft as compared with total time everywhere of such aircraft is determined for a representative period; this element is given a

2. Cal. Stats. 1968, ch 1306, adding §§ 1150-1156 to the Rev. & Tax Code.

weight of 75 percent; and the remaining 25 percent is attributed to the result of comparing arrivals and departures within the state of the taxpayer's certificated aircraft with total arrivals and departures everywhere of such aircraft. For purposes of the franchise tax the value of property owned or rented is determined under the provisions of section 25130, rather than under section 1152. Thus, for franchise tax purposes, property owned by the taxpayer is valued at its original cost and property rented by the taxpayer is valued at eight times the net annual rental rate.

Taxpayer Not Permitted to Disregard Form of Transaction

*W. E. Hall Co. v. Franchise Tax Board*³ involved the application of the California franchise tax to the sale by a parent corporation, W. E. Hall, to an independent corporation, Rheem, of the assets of a wholly-owned subsidiary, Pacific, which were transferred to the parent in the process of liquidation of the subsidiary. The procedure was followed at the request of the purchaser which desired to acquire the assets from a solvent going concern. The trial court concluded that the sale was made by Pacific to Rheem and that the sale to the parent was not a distribution in liquidation but that Hall was only acting as a conduit for its subsidiary. The Franchise Tax Board took the position that the transfer to the parent was a distribution in complete liquidation and that the parent took the subsidiary's basis and realized a gain on the transaction.

The court of appeal accepted the contentions of the Franchise Tax Board and reversed the trial court. In that regard, the court held that the corporations were bound by the form in which they framed the transaction. The court pointed out that the parent, having obtained the benefits of the transaction, should also accept the burdens.

3. 260 Cal. App.2d 179, 66 Cal. Rptr. 911 (1968).

Nonprofit Corporation Membership Fees

*Federal Employees Dist. Co. v. Franchise Tax Board*⁴ involved the question whether the two dollar membership fee paid by members of a nonprofit corporation operating a discount store was to be regarded as income subject to the franchise tax. These membership fees were the sole source of the corporation's equity capital. The court of appeal refused to follow a federal case⁵ involving a very similar situation and held that the membership fees were to be regarded as equity capital and, therefore, not taxable. The court indicated it was applying an objective test to determine the nature of the transaction rather than the subjective test of the intent of the parties which it believed the federal court had applied. The court concluded that since a permit from the Commissioner of Corporations was required for the issuance of the membership and the members had a right to vote, the membership certificate could be regarded as stock even though it was nontransferable, paid no dividends, and was acquired for the purpose of trading at the discount store.

Personal Income Tax

One of the principal changes in the personal income tax field resulted in bringing the California tax treatment of annuities under an annuity, endowment, or life insurance contract into line with the federal income tax provisions by amending numerous sections of the Revenue and Taxation Code, commencing with section 17101.⁶

In 1968 the voters again rejected a constitutional amendment⁷ which would have allowed the legislature to provide for reporting and collecting personal income taxes by reference to the provisions of the present or future taxing statutes of the United States.

4. 260 Cal. App.2d 937, 67 Cal. 951, 11 L.Ed.2d 970, 84 S.Ct. 967 Rptr. 696 (1968).

5. *United States v. Federal Employees Distributing Co.*, 322 F.2d 891 (9th Cir. [1963]), cert. denied 376 U.S.

6. Cal. Stats. 1968, ch. 1417.

7. Proposition No. 4.

Standard Deduction Increase

Another legislative change in the personal income tax area has been an increase in the standard deduction. It has been doubled, for single persons from \$500 to \$1000 and for married couples from \$1000 to \$2000.⁸ This provision was primarily designed to give relief to renters although it is available to all taxpayers who do not itemize their deductions. Generally, homeowners will itemize deductions for property taxes and for interest on the mortgage rather than use the standard deduction.

Estate Certificates

The requirement that fiduciaries of estates obtain a certificate from the Franchise Tax Board to be filed in the probate court was modified by a statutory enactment which amends section 19262 of the Personal Income Tax Law.⁹ The amendment requires a certificate from the Franchise Tax Board (for the probate court) to the effect that all taxes imposed by the Personal Income Tax Law upon the estate or the decedent have been paid and that all taxes which may become due are secured by bond, deposit or otherwise. The requirement applies only if the value of the assets of an estate exceeds \$50,000 and assets having a total value of \$5,000 are distributable to one or more nonresident beneficiaries.

Deductions and Credits for Foreign Tax Payments

The availability under the personal income tax law of deductions and tax credits for taxes paid to other countries was considered in *Tetreault v. Franchise Tax Board*.¹⁰ In this case the court of appeal upheld the denial by the Franchise Tax Board of a deduction from California personal income tax or a credit against such tax of amounts withheld by Japan

8. Cal. Stats. 1968, ch. 1, First Ex. Sess, adding §§ 129, 218, 219, 224, 255.1, and 471 to the Rev. & Tax. Code. (This legislation also gives some property tax relief to homeowners, as mentioned earlier in this article.)

9. Cal. Stats. 1968, ch. 465.

10. 255 Cal. App.2d 277, 63 Cal. Rptr. 326 (1967).

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for income tax with respect to income realized by the taxpayers from a law partnership conducted in Japan. Under Japanese law the taxpayers were precluded from exchanging any of the income generated by the foreign partnership for American dollars. The court pointed out that the state has broad powers to levy taxes in the absence of express restrictions in the state constitution. Article XIII, section 11 of the California Constitution, relating to income taxes, does not require a deduction or credit for taxes imposed by a foreign country. The court rejected contentions that the Japanese tax, which was similar to the federal withholding tax, was an expense of doing business. The court also held that there was no denial of equal protection because a tax credit was allowed for taxes paid to sister states but not to foreign countries. The court also rejected the argument that income generated by activities in connection with the Japanese law partnership was exempt from state taxation as foreign commerce.

Sales and Use Tax

The past year saw few significant developments in California, in the sales and use tax field. *Western Contracting Corp. v. State Board of Equalization*¹¹ was the only important California appellate decision in the period covered by this survey. It involved the application of the use tax to the components of a dredge built out of state by a corporation which planned to use it anywhere in the world, and which first used it for its intended purposes in California. The court held that if at the time of construction it could be anticipated that the dredge would be used in California, the requirement that the components be purchased for use in California was satisfied though the corporation had not engaged in business in this state for several years. The court concluded that by virtue of the nature of the Western Contracting operation the probability of a California use of the dredge did exist at the time its components were purchased, and since the dredge

¹¹ 265 Cal. App.2d —, 71 Cal. Rptr. 472 (1968).

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was in fact used in California the use tax was properly applicable to the cost of its component parts.

Excessive Reimbursements and Resale Certificates

There were statutory changes in section 6054.5 of the Revenue and Taxation Code relating to excess sales tax reimbursement. With respect to such reimbursement, the sales tax in California is imposed on the retailer but the retailer may obtain reimbursement for the tax from the customer. If the retailer collects excess reimbursement, either because the transaction was not taxable or because too much reimbursement was collected on a taxable transaction, the question arises as to what is to be done with the excess amount collected. Under the amended statute, if the excess reimbursement is not returned to the customer, the State Board of Equalization may collect the excess from the retailer, including amounts the retailer collected from the customer by mistake.¹² Prior to the amendment, section 6054.5 only provided for a retailer to transmit to the board such excess reimbursement as was knowingly computed by the retailer.

Changes were made with respect to property purchased under resale certificates.¹³ Sections 6094 and 6244 of the Revenue and Taxation Code were amended to provide that if property is purchased under a resale certificate and then loaned to customers while property is being repaired for the customer by the lender, a tax applies that is measured by fair rental value rather than sales price. This is an expansion of the provision already in the statute applying the same measure of tax with respect to property purchased under a resale certificate but loaned to customers while they are awaiting delivery of property purchased or leased from the lender. The amendment also provides that if the property purchased under a resale certificate is used frequently for purposes of demonstration or display while held for sale in the regular course of business and is used partly for other purposes, the measure of the tax is the fair rental value of the property for the period of such other use or uses.

12. Cal. Stats. 1968, ch. 501.

13. Cal. Stats. 1968, ch. 1034.

Insurance Tax

California's retaliatory tax on foreign insurers was upheld in *Atlantic Insurance Co. v. State Board of Equalization*.¹⁴ The court of appeal held that a Texas statute which provided for lower tax rates in proportion to an insurance company's investment in Texas securities was discriminatory against California insurers. Consequently, the court concluded that it was appropriate to apply the California retaliatory tax, which had been upheld by the supreme court in an earlier case,¹⁵ to Texas companies. The Court held that application of the tax to foreign insurers did not deny equal protection but was designed to operate to promote uniformity of tax treatment.

A proposed constitutional amendment which would have granted special tax treatment to certain types of insurance company revenues failed to pass. Proposition 6 on the 1968 ballot would have permitted the exclusion, from the base of the gross premiums tax on insurance companies, of premiums on contracts providing retirement benefits for persons employed by public or private schools or by nonprofit organizations engaged in scientific research.

Local Revenues

In the field of local revenues, greater flexibility will be afforded by several constitutional amendments. Proposition 7 adopted by the voters at the Nov. 5, 1968 election adds section 12 to Article XIII of the California Constitution. The section authorizes the allocation of money from the State General Fund to cities and counties for local purposes. The California Constitution formerly required state funds so allocated to be used by the political subdivision for state purposes. This amendment may allow some tax reforms by permitting money collected from state taxes to act as replacement funds for some taxes presently raised locally, but which taxes may be regarded as producing undesirable consequences.

¹⁴. 255 Cal. App.2d 1, 62 Cal. Rptr. 784 (1967), app. dismd. 390 U.S. 529, 20 L.Ed.2d 86, 88 S.Ct. 1208.

¹⁵. *Franklin Life Insurance Co. v. State Board of Equalization*, 63 Cal.2d 222, 45 Cal. Rptr. 869, 404 P.2d 477 (1965).

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The voters also approved a constitutional amendment¹⁶ which permits the legislature to authorize counties, cities and counties, and cities to contract to apportion between themselves revenues from sales and use taxes imposed by them but collected by the state. Such agreements to apportion tax revenue would require approval at an election by the majority of the voters of each local entity involved. This constitutional provision is implemented by the addition of sections 55700 to 55706 to the Government Code.¹⁷

In order to encourage uniformity in local sales taxes, section 7203.5 was added to the Revenue and Taxation Code to provide with certain exceptions¹⁸ that the State Board of Equalization shall not administer the Bradley-Burns local sales and use tax ordinances for any city, city or county, or county which imposes a sales or use tax in excess of the 1 percent local sales and use tax levy authorized by sections 7202 and 7203 of the Revenue and Taxation Code.¹⁹

Licensing Ordinances

In *Long v. City of Anaheim*,²⁰ the court of appeal construed the licensing ordinances of Anaheim and Garden Grove as exempting from their licensing requirements the "Weekly People," the political newspaper of the Socialist Labor Party. The publication resulted in a continuing financial loss for the paper even though a five-cent charge was made for the newspapers. The court construed the term "business" to mean carrying on a trade or activity with a view to profit or livelihood. It deemed the ordinance inapplicable to a nonprofit, noncommercial venture. The court indicated its construction of the ordinance avoided a possible holding of unconstitutionality on the basis of abridgement of freedom of speech or freedom of the press. It further stated that a person is exempt from taxation upon any act of distributing information or

16. Proposition 8, adding section 25.5 to Article XIII of the California Constitution.

17. Cal. Stats. 1968, ch. 991.

18. The city of Los Angeles was al-

lowed special treatment for a six-month period ending April 1, 1969.

19. Cal. Stats. 1968, ch. 1265.

20. 255 Cal. App.2d 191, 63 Cal. Rptr. 56 (1967).

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opinion of any kind, whether political, scientific or religious in character, when done solely in an effort to spread knowledge and ideas with no thought of commercial gain.

In *Cooper v. Michael*,¹ the court, placing substance over form, invalidated a Glenn County licensing ordinance on the basis that it was a revenue-raising measure prohibited by section 16100 of the Business and Professions Code. The court disregarded a declaration in the title that the ordinance was for "police regulation" and a provision in section 1 of the ordinance that it was an exercise of the county's "police power and for the purpose of regulation." The court found no regulatory provisions in the body of the ordinance. The court further found that in the circumstances under which the ordinance was enacted, charges which could amount to \$100 a year were revenue in nature. The court noted that the license fee was not gauged to the cost of processing since an additional sum of \$1.00 per license was added to cover processing costs.

Inheritance and Gift Taxes

Rejected Bequests

Two cases involving the inheritance tax consequences of the rejection of a bequest were recently decided. The sole issue presented in *Estate of Nash*² was whether a portion of the inheritance tax could be avoided by the rejection of the transfer of a remainder interest in the residue of an estate provided for in a probated will. Section 13409 of the Revenue and Taxation Code provides that if a transferee under a will renounces his rights under the will, the inheritance tax is nevertheless computed in accordance with the terms of the will admitted to probate. The trial court applied section 13409 of the Revenue and Taxation Code and fixed the tax as if the bequest had not been rejected. The executor argued that the rejection of the bequest resulted in a partial intestacy with the property passing as community property. In the

1. 257 Cal. App.2d 176, 64 Cal. Rptr. 842 (1967).

2. 256 Cal. App.2d 560, 64 Cal. Rptr. 298 (1967).

alternative the executor contended that section 13409 was an unconstitutional deprivation of due process. The court of appeal rejected both of these arguments and held that the legislature, subject to constitutional limitations, could tax an inheritance as it saw fit. The court concluded that section 13409 which establishes the basis on which the tax is to be computed is reasonable and constitutional.

In *Estate of Varian*³ the rule of the *Nash* case was applied when a beneficiary's disclaimer of a life estate resulted in the property passing to a charitable organization although a direct gift to the charity would have been exempt under section 13842.

Pickup Tax

The so-called pickup tax provision in section 13441 of the Revenue and Taxation Code was judicially construed in two cases. In *Estate of Amar*⁴ the basic state inheritance tax was paid and allowed as a credit against the federal estate tax. The estate was closed. Thereafter, claim was made for the so-called "additional" or "pickup" tax. This latter tax is described by the court in the following language:

[T]he federal government allows an amount as a credit against the federal estate tax due for state inheritance taxes paid, but it bases the credit allowable on its own tables. Under section 13441, if the amount allowable is more than that actually paid to the state, the difference is imposed as an additional tax, and the money is paid to the state government, and the federal credit is increased. There is no increase in the total tax bill of the estate; the amount that would have been paid the federal government is simply paid to the state government instead, and is subtracted in the form of a larger credit from that amount that is owed to the federal government.⁵

3. 264 Cal. App.2d —, 70 Cal. Rptr. 335 (1968).

4. 255 Cal. App.2d 404, 63 Cal. Rptr. 444 (1967).

5. 255 Cal. App.2d at 406, 63 Cal. Rptr. at 446.

Objection to payment of the "pickup" tax was based on a challenge of the procedure for its collection. It was argued that this tax might not be imposed until after the final determination of the federal tax, in which case it might be too late to obtain federal tax credit for the additional amount paid. The court suggested the following solution:

. . . When the estate is valued for federal tax purposes, notification and tender of the amount of any additional tax should be made; it then is paid to the state and claimed as a credit against the federal estate tax.⁶

In *Estate of Callaway*,⁷ the allowable credit against federal estate taxes because of State death taxes was \$107,472.03. In the absence of the pickup tax provisions in section 13441 the State inheritance tax would have been limited to \$11,255.00 because of the provisions of section 14071 of the Revenue and Taxation Code providing a State credit when there are successive transfers in a five-year period to Class A transferees. The court held that by virtue of the pickup tax provisions, the State was entitled to an additional \$96,217.03, the difference between \$107,472.03 and \$11,255.00. In the court's view, the legislature did not intend, by allowing the prior transfer credit provided for in section 14071, to defeat its purpose to receive the maximum pickup tax provided for by section 13441.

The Effect of Foreign Law on Inheritance Tax

The effect of foreign law on the imposition of the inheritance tax was also considered in two cases. *Estate of Erdman*⁸ held that for inheritance tax purposes the controller, although not a party to the litigation, was bound by the determination of an Illinois court that an attempt to exercise a power of appointment over trust property located in Illinois was ineffective. Illinois was the state in which the power

6. 255 Cal. App.2d at 407, 63 Cal. Rptr. at 446.

7. 263 Cal. App.2d —, 69 Cal. Rptr. 921 (1968).

8. 264 Cal. App.2d —, 70 Cal. Rptr. 774 (1968).

was created and in which the property subject to the power was located. It was also the state of domicile of the donor. The court held that the Illinois decision was binding on the husband who had attempted to exercise the power and was not collusive. The court concluded that to allow California to impose the tax on the basis that the power was in fact exercised, despite the contrary decision of the Illinois court, would violate the due process clause of the United States Constitution.

In *Estate of Wilson*⁹ the court held that bequests to foreign charities located in England and Scotland were not exempt from the California inheritance tax under Revenue and Taxation Code section 13842. The court held the reciprocity requirement that the other country not levy a death tax of any character with respect to a transfer to a California charitable corporation was not satisfied even though under the foreign law there was no inheritance tax. It reasoned that since the United Kingdom imposes a death tax on estates over a certain amount with no charitable exemption its death tax is indirectly imposed on bequests to charitable trusts in California.

Other inheritance tax decisions included *Estate of Sperry*¹⁰ which involved construction of section 13672 of the Revenue and Taxation Code in connection with property held by husband and wife in joint tenancy and *Estate of Dobbins*¹¹ which raised the question whether there was an exercise of a power of appointment within the meaning of section 13693 of the Revenue and Taxation Code as it read in 1962.

Gift Tax Determination Procedures

The 1968 legislature made a number of changes in procedures relating to gift tax determinations and the manner in which such determinations may be challenged.¹²

9. 265 Cal. App.2d —, 71 Cal. Rptr. 822 (1968).

10. 258 Cal. App.2d 728, 66 Cal. Rptr. 217 (1968).

11. 258 Cal. App.2d 262, 65 Cal. Rptr. 704 (1968).

12. Cal. Stats. 1968, ch. 709.

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Prior to the 1968 amendment of section 15801, the controller generally was required to issue his gift tax determination within three years after the return was filed. The amendment permits the controller to issue the determination after the expiration of the three-year period if agreed upon in writing with the taxpayer.

Under section 15804–15806, and 16251, the controller's determination became final 60 days after notice was given and thereafter had the force and effect of a judgment in a civil action unless the taxpayer paid the tax as determined under protest and filed suit for refund within the 60-day period. The 1968 legislation changes these provisions to permit the taxpayer, without first paying the tax as determined, to file suit to have the tax modified in whole or in part at any time within three years after it becomes delinquent. The tax becomes delinquent under the new law 90 days after notice of the first determination is given. The new law also gives the controller the power, without suit having been filed by the taxpayer, to amend an erroneous determination at any time within three years after it was made.