

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 085

June 17, 1958

DEDUCTIONS: ALLOCABLE TO EXEMPT INCOME

Syllabus:

Expenses attributable to Federal tax litigation involving income which was neither earned while the parties were residents of California nor from California sources are not deductible under the Personal Income Tax Law.

Taxpayers became residents of California in 1947. On their 1949 return, prepared on a cash basis, deductions were claimed for interest and attorney's fees paid during the year on Federal tax deficiencies for periods prior to the time taxpayers became residents of California. The deficiencies arose from the disallowance of a family partnership and an appeal was taken to the Tax Court. The partnership had no income from California sources. Advice is requested whether such deductions were allowable under the Personal Income Tax Law.

Under section 17285(a), formerly section 17351(e), of the Personal Income Tax Law no deduction can be claimed for an item of expense which is allocable to income wholly exempt from taxation. The partnership income which was the subject of the Federal litigation was earned outside California by a nonresident and accordingly exempt under Chapter 3 of the Personal Income Tax Law. Since the expenses were directly allocable to that income, they are within the provisions of section 17285 and accordingly not deductible.