CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 397

August 9, 1976

SPECIAL TAX CREDITS APPLIED TO TRUST ACCUMULATION DISTRIBUTIONS

Syllabus:

In 1969, 1971 and in 1973 special tax credit provisions were incorporated into the California Revenue and Taxation Code.

Revenue and Taxation Code Sections 17762-17778 provide for the tax treatment of accumulation distributions from complex trusts to beneficiaries, including the throwback of these distributions to prior taxable years of the recipient beneficiary.

The following questions are presented:

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1. If a distribution is made in 1973, or in years thereafter, and the adjusted gross income of the beneficiary in that year is such that a 100% special tax credit applies for that year under Revenue and Taxation Code Section 17069 (Stats. 1973), does the credit apply to the tax related to the accumulation distribution in the throwback years?

2. If 1973 or years thereafter is a throwback year of the accumulation distribution, should the amount of the throwback income be added to adjusted gross income before determining the tax credit provided under Revenue and Taxation Code Section 17069 (Stats. 1973)?

3. If an accumulation distribution is made in 1973 and years thereafter and a portion of the distribution is properly allocated to the year of distribution, should that distribution be included in adjusted gross income for the distribution year for purposes of determining the special tax credit under Revenue and Taxation Code Section 17069 (Stats. 1973)?

4. If a taxpayer was not required to file a return in 1969 or 1971 because of low or no income, can he obtain the benefit of the special tax credits provided in those years?

Decision:

1. No.

2. Yes.

3. Yes.

4. Yes.

Discussion:

Since 1968 the following special tax credits have been allowed under the Personal Income Tax Law:

For taxable year 1969, Revenue and Taxation Code Section 17065 (Stats. 1969, Ch. 1464); for taxable year 1971, Revenue and Taxation Code Section 17069 (Stats. 1971, Ch. 1, First Extraordinary Session); and for taxable year 1973 and years thereafter, Revenue and Taxation Code Section 17069 (Stats. 1973, Ch. 952).

Under Revenue and Taxation Code Section 17069 (Stats. 1973) taxpayers with income in 1973, and years thereafter, below certain prescribed limits receive a 100% credit against tax computed for that year.

The application of these tax credit provisions to the assessment of tax on trust accumulation distributions must consider the mechanics of the mechanics of the throwback rules applied to such distributions. The purpose of the throwback rules for distribution of accumulated trust income to beneficiaries by complex trusts is to prevent a shift of tax burden to a trust from the beneficiaries. Cal. Admin. Code, tit. 18, Reg. 17771(a).

Under the throwback rules of Revenue and Taxation Code Sections 17771-17778, an accumulation distribution is thrown back from the year of distribution to prior years to the extent of the distributable net income of the trust in those prior years. In effect, the appropriate portion of the accumulation distribution is allocated to the prior year and is added to the gross income of the recipient beneficiary as if he received the distribution in that prior year. A partial tax is computed for the year of distribution in the regular fashion. A partial tax is also computed for each of the throwback years as if the distribution were all or a portion of the recipient's income in those years. Appropriate credit is given for tax already paid by the recipient in that year and by the trust on the accumulated income in that year. Income of the trust which is currently distributed in the year of distribution is not subject to the throwback rules. The tax due in the distribution year is the aggregate of the tax computed for each throwback year plus that due for the distribution year separately.

Under Revenue and Taxation Code Section 17069 (Stats. 1973), if the taxpayer's adjusted gross income is less than a specified amount in years 1973 and thereafter, a 100% tax credit is allowed. The question arises whether the credit applies to all of the tax, including that associated with the thrown back distributions, if the income of the recipient, in that year, is such that he is entitled to a 100% credit.

1. The tax credit allowed under Section 17069 (Stats. 1973) is based upon the "net tax" computed on income for that year. The term "net tax" is defined by Revenue and Taxation Code Section 17069.5 as that imposed under either Revenue and Taxation Code Section 17041 or Section 17048,less certain credits not pertinent here. The clear language of both of those sections refers to the tax imposed upon income for the taxable year in question. Under the throwback rules the distribution is taxed as if it was received in the throwback year. The tax for each year, including the distribution year is computed separately. Therefore, if the adjusted gross income of the beneficiary for 1973, and years thereafter, is such that the 100% tax credit applies, the credit applies only to the regularly computed tax for that year and not to the tax relating to the accumulation distribution in the throwback years.

2. If 1973 or a year thereafter is a throwback year, the same principles set forth above will apply. That is, the distribution thrown back is added to gross income. Each year stands separately. The distribution is taxed in the throwback year as if it were part of the beneficiary's income. The tax credit under Section 17069 (Stats. 1973) is based upon the final adjusted gross income including the throwback distribution.

3. The concepts set out above can also be applied to the case where the year of the accumulation distribution is 1973, or year thereafter, and part of the distribution is properly allocable to that year as a current distribution. The tax for the throwback years is computed separately as described above. The current distribution is added to any other income of the beneficiary for the distribution year and the appropriate tax credit allowed based upon the final adjusted gross income for the distribution year.

4. Both Revenue and Taxation Code Section 17065 (Stats. 1969) and Revenue and Taxation Code Section 17069 (Stats. 1971) require that a timely return be filed before the tax credit is available. But if a beneficiary has insufficient income in any year, he is not required to file a return. If later he receives an accumulation distribution which is thrown back to either or both 1969 and 1971 resulting in a tax attributed to those years, it would be unreasonable to deny the tax credit associated with those years assuming that the beneficiary otherwise qualified. In the usual case the beneficiary does not know the amount or even the probability of receiving a distribution. It is thus concluded that the beneficiary is entitled to the credit to the extent allowable in the throwback years. Of course, in determining the amount of the credit, other income that was reportable in those years must be added to the amount of the distribution.

In addition, it may be noted that there is no express provision in Revenue and Taxation Code Section 17069 (Stats. 1973) requiring the filing of a timely return in order that the tax credits may be taken. It must be assumed that the Legislature did not intend to limit the benefits of that section to those filing timely returns. Daley v. State Dept. of Social Welfare, 276 Cal. App.2d 801, 81 Cal. Rptr. 318 (1969).