

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 423

November 9, 1982

BASIS: PROPERTY ACQUIRED ON DEATH AFTER REPEAL OF INHERITANCE TAX LAW

Syllabus:

This department has been asked whether, for California income tax purposes, the basis of property acquired as the result of the death of a decedent after the repeal of the Inheritance Tax Law on June 9, 1982, will be adjusted or "stepped-up," to fair market value.

Decision:

The basis of property described in Revenue and Taxation Code Section 18045 subdivisions (a) through (d) will be adjusted to the fair market value on the date of the decedent's death.

The basis of property described in subdivision (f) will not be affected by repeal of the Inheritance Tax Law.

The basis of property described in subdivisions (e), (g) and (h) will not be adjusted to fair market value but will remain at cost.

Discussion:

Revenue and Taxation Code Section 18044 provides generally that the basis of property in the hands of a person who acquires that property from a decedent shall be the property's fair market value on the date of the decedent's death. Section 18045, in subdivisions (a) through (h), defines property which is deemed to have been acquired from a decedent.

Subdivisions (a) through (d) of Section 18045 deal with property which passes by inheritance, in trust or under a general power of appointment. These subdivisions contain no reference to the California Inheritance Tax Law. The basis of property defined in these subdivisions will be adjusted to fair market value.

Subdivision (f) deals with the surviving spouse's share of community property assets. It does not apply in the case of decedents who died after 1975. Property defined in this subdivision will not be affected by repeal of the Inheritance Tax Law.

Subdivisions (e) and (g), respectively, deal with the surviving spouse's share of community property assets and the survivor's interest in a joint and survivor's annuity. Language in these subdivisions refers to the California Inheritance Tax Law. Similar language in subdivision (f), formerly subdivision (e), has been interpreted to mean that the basis of property in the hands of survivors is adjusted to fair market value only if certain assets of the decedent are subject to California inheritance tax. See Mel v. Franchise Tax Board, 119 Cal. App.3d 898, modified 120 Cal. App.3d 682(e) (1981). After repeal of the Inheritance Tax Law, this requirement cannot be met. The basis of property described in these subdivisions will not be adjusted to fair market value but will remain at cost.

Subdivision (h) provides a stepped-up basis for property, such as joint tenancy property, not described in any other subdivision of Section 18045, which is acquired by reason of death, form of ownership or other conditions, if by reason thereof the property is required to be included in determining the value of the decedent's estate under Division 2 part 8 of the Revenue and Taxation Code.

Subdivision (h) long has been interpreted to mean that the basis of property is adjusted to fair market value in the hands of the survivor only if the property was subject to the California Inheritance Tax Law. FTB Legal Ruling No. 330, July 30, 1968, CCH 204-020, Appeal of William F. and Dorothy M. Johnson, Cal. St. Bd. of Equal., October 6, 1976, CCH 205-543, P-H 58, 025-O. This interpretation is consistent with administrative and judicial construction of similar language in former subdivision (e) of Section 18045. See Mel v. Franchise Tax Board, supra. It is entitled to great weight and unless clearly erroneous may not be overturned. See Select Base Materials Inc. v. Board of Equalization, 51 C.2d 640 (1959).

The above interpretation effectuates the legislative purpose of subdivision (h) as evidenced by its history. Except for its effective date and statutory cross referencing, subdivision (h) is identical to Internal Revenue Code section 1014 subsection (b)(9). As the parallel language indicates, the California provision was intended to conform California Personal Income Tax Law to federal law.

The federal provision was enacted to provide a basis adjustment to property which was included in the decedent's gross estate for federal estate tax purposes, but which, because it is passed outside the probate estate, did not qualify under prior law for a stepped-up basis. See Senate Finance Committee Report, 83rd Cong., 2nd Sess., 1954, reprinted at 1954 U.S. Code Cong. & Ad. News pp. 5065-5067; Mertens, Law of Federal Income Taxation, vol. 3A Sections 21.67, 21.69, 21.81. Thus, under the federal provision, a taxpayer obtains a stepped-up basis only on property which is subject to federal estate taxation. The benefit of obtaining a stepped-up basis for federal income tax purposes is correlated with the burden of being subject to federal estate taxation. The

established interpretation of subdivision (h) similarly correlates the benefit of obtaining a stepped-up basis for California income tax purposes with the burden of being subject to a distinct, additional California death tax. After repeal of the Inheritance Tax Law, California does not and cannot impose a death tax burden which is distinct from and in addition to the federal estate tax. The pick-up tax provisions of new Division 2 Part 8 merely authorize the state to collect an amount which, in the absence of those provisions, would go to the federal government as estate tax.

Based on the above, after repeal of the California Inheritance Tax Law, the basis of property described in subdivision (h) will not be adjusted to fair market value but will remain at cost.

It has been suggested that subdivision (h) should be given a literal reading. Specifically it has been suggested that after repeal of the Inheritance Tax Law contained in former Division 2 Part 8 and re-enactment of the pick-up tax in new Division 2 Part 8, the phrase in subdivision (h) which provides that property obtains a stepped-up basis if it was required to be included in the decedent's estate under Division 2 Part 8, now means that property obtains a stepped-up basis if it was subject to the pick up tax. Such interpretation of subdivision (h) is in error. It defeats the legislative purpose of conforming California law to federal law. It does not correlate the burden of being subject to a distinct, additional California death tax with the benefit of obtaining a stepped-up basis for California income tax purposes. The apparent purpose of a statute may not be sacrificed to a literal construction. See Select Base Materials v. Board of Equalization, supra; Alford v. Pierno, 27 C.A.3d 682 (1972). The suggested literal reading is contrary to the established meaning of subdivision (h), discussed above. The language of subdivision (h) has acquired a technical meaning, as a term of art, which may not be discarded in favor of a literal interpretation. See County of Sacramento v. Hickman, 66 C.2d 841 (1967). A pick-up tax essentially the same as that re-enacted in new Division 2 Part 8 existed throughout the taxable years with which the above-cited administrative and judicial interpretations of subdivision (h) and (f) were concerned. The proposed literal reading of subdivision (h) is plainly inconsistent with those pronouncements, which held that only property subject to the California Inheritance Tax Law, not property subject only to the pick-up tax, obtains a stepped up basis under subdivision (h).