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CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 194

January 7, 1957

TAXABILITY OF INCOME UNDER SEC. 17596: DATE OF ACCRUAL OF INCOME FROM TRUST WHERE THERE IS A CHANGE IN BENEFICIARY'S RESIDENCE

Syllabus:

Section 17596 is to be construed by applying the principles of Helvering v. Enright's Estate, 312 U.S. 636, which construed similar wording in the federal statute regarding the accrual of income of decedents to the date of death. Under these principles the word "accrued" in Sec. 17596 is not limited in application to its normal accounting meaning, but was intended to include all items reasonably capable of valuation which are due the taxpayer prior to the change of residence, despite the fact that they might not have "accrued" in the normal accounting sense.

Where trust income is currently distributable, the beneficiary's right to the income becomes fixed or vested at the time that the fiduciary receives the right to receive it. Since the right to receive the income is unconditional and the income is certain in amount, there is an accrual at that time to the beneficiary within the meaning of Sec. 17596. As a result all such items that have "accrued" as of that date must be included or excluded from taxpayer's return for the year of the residence change. Taxpayer will, of course, be entitled to deduct all expenses incurred by the trust for the same period regardless of the fact that they may not have accrued in an accounting sense.

The above conclusion is supported by the decision in Bach v Rothensies, 124 F2d 306, dealing with the treatment of trust income under Sec. 42 of the Internal Revenue Code. The court applied the Enright rule to tax to the beneficiary, all income which had accrued up to the date of death of the beneficiary, although it had not been received at that date by the decedent or the trustee. The income of the trust appears to have been currently distributable.

Where the trust income can be accumulated or distributed at the fiduciary's discretion, however, a different conclusion is reached.

In such case the beneficiary's right to the income is not vested or unconditional at the time that the fiduciary acquires the right to receive it. The beneficiary may never receive the trust income. His entire rights are conditional upon the fiduciary's action. Under such circumstances there is no "accrual" to the beneficiary under Sec. 17596 until the fiduciary takes his action, either to declare a particular amount distributable or actual distribution is made. The fact that the beneficiary is not taxable on the trust income until it is received or declared distributable, however, does not prevent its taxability to the trust. A trust is a taxpayer within the meaning of Sec. 17004 and subject to the provisions of Sec. 17596 the same as an individual. Amounts which it has acquired a right to receive without the necessity of distribution would "accrue" under Sec. 17596 under the same conditions as discussed above in connection with beneficiaries of a trust where all the income is currently distributable. Accordingly if a change in residence status of a fiduciary or a beneficiary causes a change in the taxable status of the trust, all trust income which it had a right to receive at the time of the change would "accrue" within the meaning of Sec. 17596 and would be taxable or nontaxable depending upon whether the trust is acquiring a resident or nonresident status.

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