

## CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 270

September 17, 1964

### COMPUTATION OF TAX: METHOD OF COMPUTING INCOME FROM INSTALLMENT METHOD SALES WHERE SALES OCCURRED PRIOR TO STATUTUORY AMENDMENT

#### Syllabus:

Taxpayer subdivided a tract of property, and sold the lots during the years 1948 to 1952 on the installment plan. Income was reported on the installment basis on returns for the years 1952 to 1956.

The circumstances under which the property was developed and sold resulted in the conclusion that the lots were not capital assets under the law in effect in the years in which the sales were made.

In 1955, special provisions were enacted in Sections 18197 to 18199 of the Personal Income Tax Law to govern the treatment of sales of real property subdivided for sale. If these provisions were applicable to the above sales, a part of the gain would be treated as ordinary income and the remainder as capital gain.

Sections 18197 to 18199 enacted into the California law substantially the provisions of Section 1237 of the Internal Revenue Code of 1954, except that in the California statute no section was adopted comparable to subsection (c), the "effective date" provision of the Federal section. That subsection of the Federal statute provides that the section shall apply only with respect to sales occurring after the beginning of the year in which the law was enacted. It was apparently concluded, in drafting the new provisions for the Personal Income Tax Law, that Section 17034 of the Law obviated the need for a similar provision in the California statute. This section prescribes that the provisions of the Personal Income Tax Law enacted in 1955 affecting changes in the computation of taxes are applicable only in the computation of taxes for taxable years beginning after December 31, 1954. A similar provision is also contained in the act which adds Sections 18197-18199. (Stats. 1955, Ch. 959, Sec. 46.)

Where sales of property on the installment method occurred prior to the effective date of the 1955 amendment, is income returned thereafter, on the basis of installment payments subsequently received, computed in accordance with the 1955 statute?

In the absence of a provision limiting the application of Sections 18197-18199 to sales occurring after a specified date, the only limitation

appears to be that the sections are applicable in the computation of taxes for taxable years beginning after December 31, 1954. Since the computation of tax requires the determination of taxable income, the fundamental issue would seem to be whether taxable income arising from installment sales is determined according to the law in effect when the income is returned, as installment payments are actually received.

A case directly in point is Snell v. Commissioner, 99 Fed. 2d 891. In that case, income from the sale of property was capital gain under the law in effect at the time of sale but would have been ordinary income under the law in effect during the years in issue in which the installment payments were received. It was held that income was determined according to the treatment provided by the law in effect in the years in which the payments were received. On a related question, that of determining the applicable percentage of capital gain to be taken into account, it was likewise held in Harry B. Golden, 47 BTA 94, that the statute in effect in the year installment payments were received is controlling. See, also, Mertens, Law of Federal Income Taxation, Sec. 15.11, and Legal Memorandum 424, September 2, 1959.

Regulation 17531-17533(c) of the 1954 Personal Income Tax Law, made applicable to the 1955 Law by Regulation 19263 [19253], provides that "Income from sales reported on the installment basis shall be taxed in accordance with the law in effect in the year or years such payments are received." Although it may be contended that the regulation applies only to such matters of taxation as rates and percentages taken into account, it is certainly arguable that the language of the regulation, "income . . . shall be taxed," encompasses the entire process of determining taxable income.