



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
ESTATE OF TOM CANNON)

Appearances:

For Respondent: Harrison Harkins, Assistant Franchise Tax
Counsel

O P I N I O N

This appeal is made pursuant to Section 19 of the Personal Income Tax Act (Statutes of 1935, p. 1090, as amended) from the action of the Franchise Tax Commissioner in overruling the protests of Estate of Tom Cannon to the proposed assessments of additional taxes for the years ended December 31, 1935 and December 31, 1936, in the amounts of \$1,708.35 and \$431.93, respectively.

The proposed assessments have resulted from the action of the Respondent in (1) decreasing the deduction allowed the estate for depletion of oil and gas wells and (2) increasing the gross income of the estate by reason of the cancellation of certain debts upon payment by the estate of only a portion of the amount due. It is contended on behalf of the estate that neither of these actions was in accord with the provisions of the Act relating to the computation of net income. Independentl: of these considerations, it is contended that the proposed assessments are improper because on October 30, 1937, the Respondent issued his certificate, pursuant to Section 26 of the Act, to the effect that all taxes due from the estate had been paid or secured.

Section 8k of the Personal Income Tax Act of 1935 provides as follows:

"The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114 of the Revenue Act of 1934 which section and all sections of said revenue act referred to therein are hereby referred to and incorporated with the same force and effect as though fully set forth herein, provided, however, that the words 'with the approval of the secretary' shall be deemed omitted."

Section 114b(3) of the Revenue Act of 1934 provides as follows:

"In the case of oil and gas wells the allowance for depletion under section 23(m) shall be 27½ per centum

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"of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance under section 23(m) be less than it would be if computed without reference to this paragraph."

The precise point here in controversy concerns the computation of net income for the purpose of applying the 50 per cent limitation specified in the above provision. It appears that in the computation of its taxable net income, intangible drilling and development costs were deducted by the estate, and the Respondent contends that therefore they must likewise be deducted in applying the limitation provision,

Section 8(g) of the Bank and Corporation Franchise Tax Act, as amended by Statutes of 1935, p. 962, also incorporates the provisions of the Federal Revenue Act of 1934 relating to depletion, and in the Appeal of Franco Western Oil Company, decided this day, the same question was presented as is involved in this appeal. Our decision there, upholding the Commissioner's requirement that intangible drilling and development costs deducted in computing taxable net income likewise be deducted in computing the 50 per cent limitation on the depletion deduction, we believe to be determinative on this appeal,

The remaining items included in the proposed assessments resulted from the discharge in the year 1935, upon payment of \$18,559.91, of debts due from the estate in the amount of \$43,794.82, and from the discharge in the year 1936, upon payment of \$170.97, of debts in the amount of \$2,148.07, the difference between the debts and the amounts paid in satisfaction thereof being treated by the Commissioner as gross income. Under Kirby Lumber Co. v. United States, 284 U. S. 1, the above items represent taxable income to the extent that these transactions increased the net worth of the estate. (See Dallas Transfer & Terminal Co. v. Commissioner, 70 F. (2d) 95, and Lakeland Grocer Co. v. Commissioner, 36 B. T. A. 289.)

The record discloses the following facts concerning the financial condition of the estate: As of the date of the decedent's death in 1931, the net worth; as fixed by the inheritance tax appraiser, was over \$100,000, and on December 31, 1934, according to the books of the estate, it was over \$50,000, and in 1937, after the satisfaction of all claims, the remaining assets were sold for approximately \$50,000. The only fact that has been referred to as indicating that the estate was ever insolvent is the willingness of certain creditors to accept partial payment in full satisfaction of their claims.

In our opinion the aforementioned facts do not justify the conclusion that the estate was insolvent at any time. It

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follows that the cancellation of the debts must be regarded as increasing the net worth of the estate in the amounts asserted by the Commissioner.

The remaining issue relates to the effect of the Respondent's certificate, which was given on October 30, 1937, and was to the effect "that all taxes due and payable . . . have been paid or secured as required by said act." It is contended on behalf of the Appellant that since the proposed assessments were for the years 1935 and 1936, the effect of the certificate is to be determined by reference to the provisions of the Act as it read during those years, when Section 26 of the Personal Income Tax Act provided that "the certificate of the Commissioner and the receipt for the amount of tax therein stated shall be **conclusive as** to the payment of the **tax.**" This provision was deleted, however, in the 1937 amendments to the Act, and it was specifically provided that the certificate should not relieve the estate of liability, and in addition, it was provided that any fiduciary distributing an estate without payment of taxes should be personally liable for all unpaid taxes to the extent of **such** distributions. These amendments became effective on August 27, 1937, and there is nothing in their provisions or in any other provisions of the amending act (Statutes of 1937, p. 1831) which lends any support to the position that the 1937 amendments to Section 26 do not apply with respect to **certificat** issued after that date, even though they cover taxes for the years 1935 and 1936.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the action of Chas. J. **McColgan**, Franchise Tax Commissioner, in overruling the protests of Estate of Tom Cannon to proposed assessments of additional taxes in the amounts of **\$1,708.25** and \$434.93 for the years ended December 31, 1935, and December 31, 1936, respectively, be and the same are hereby sustained.

Done at Sacramento, California, this 7th day of July, 1942, by the State Board of Equalization.

R. E. **Collins**, Chairman
Wm. G. **Bonelli**, Member
George R. **Reilly**, Member
Harry B. **Riley**, Member

ATTEST: Dixwell L. Pierce, Secretary