BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
LEWIS G. CARPENTER)

Appearances:

For Appellant: Leo J. Rabinowitz, Attorney at Law

For Respondent: W. M. Walsh, Assistant Franchise Tax Commissioner; Harrison Harkins Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 18593 of the Revenue and Taxation Code (formerly Section 19 of the Personal Income Tax Act) from the action of the Franchise Tax Commissioner in overruling the protest of Lewis G. Carpenter to a proposed assessment of additional tax in the amount of $189.87 for the taxable year ended December 31, 1935.

In 1925, Appellant's father purchased from a mutual life insurance company two single premium life insurance policies upon the Appellant's life at a cost of $104,126. The minor children of Appellant were designated as beneficiaries. For a period of ten years with respect to one policy and for a period of five years with respect to the other, the Appellant was not permitted to change the beneficiaries of the policies or to surrender the policies for their cash values, or, in fact, to exercise any rights whatever with respect to them. The privileges of change of beneficiary and surrender, however, were reserved to the Appellant upon the termination of the restrictive periods. Upon the death of Appellant, the Appellant's children, as beneficiaries, were to receive the proceeds of the policies, and any dividends payable were to accumulate at interest to be settled at Appellant's death in the same manner as the principal amounts.

In 1927, while the restrictions on Appellant's control of the policies were in force, he was appointed upon petition to the Superior Court as guardian of the estates of his minor children, and in that capacity secured a court order authorizing him to withdraw accrued and future dividends and use them for the payment of premiumsfor additional insurance upon his life for the benefit of the children. During the period 1925 to 1934, the dividends accruing in the amount of $26,036.76 were withdrawn by Appellant and applied to the purchase of life insurance. The restrictive period on both policies having ended in 1935, the Appellant exercised his right to surrender the policies, receiving $31,685.50 in cash and $76,776.50 in supplemental insurance contracts total of $108,462.

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A deficiency was determined by the Commissioner on the theory that Appellant's father made two separate gifts of certain of the legal incidents of ownership in the policies to Appellant and Appellant's children, and that the donor's basis (applicable under Section 7(d) of the Act for the purpose of determining gain from property acquired by gift after December 31, 1920) must, accordingly, be apportioned between the donees. Upon the basis that dividends of a mutual insurance company represent an overpayment of premium or cost (Penn Mutal Life Insurance Co. v. Lederer, 252 U. S. 523; Mutual Benefit Life Insurance Co. v. Herold, 198 Fed. 199, aff'd 201 Fed. 918. Mutual Benefit Life Insurance Co. v. Richardson, 192 Cal. 369), the Commissioner attributed to the gift to Appellant's children a portion of the donor's basis, that portion being measured by the dividends in the amount of $26,036.76. The remainder of the donor's basis or $78,089.24 was attributed to the gift to Appellant.

Appellant relies upon the language of Section 7(b) 2 of the Personal Income Tax Act in effect in 1935, arguing that this provision clearly indicates that amounts received under a life insurance policy other than (amounts paid by reason of the death of the insured are not taxable until the aggregate of the amounts received exceeds the aggregate premiums. Since the dividends were not received by Appellant for his own benefit, it is contended that they cannot be considered as part of the aggregate amounts received within the meaning of this Section.

The Appellant contends further that in any event the Commissioner's theory is erroneous for the donor's basis-and, consequently, the donee's basis cannot be changed after the donor has, disposed of the property (citing Forrestal v. Commissioner, 120 F. (2d) 223, affirming 41 B.T.A. 1080). Thus it is urged that the basis of the donor, which became the basis of the Appellant, cannot be changed by reason of dividends paid to others than the Appellant.

We cannot agree with the Appellant that Section 7(b)2 of the Act requires that he be allowed to use the aggregate cost of the policies to his donor as his basis in a situation where, as here, only some of the legal incidents of ownership of the insurance policies were given to him and others were given to his children. In our opinion, Section 7(b) 2 establishes a basis for the purchaser of life insurance, but if a gift of the insurance is made, this Section must be read with Section 7(d) of the Act in order that the basis of the donee, or bases of the donees, may be established. The impropriety of Appellant's position would be clearly manifested if all the legal incidents of ownership of a life insurance policy were equally divided between two donees. The Appellant's reasoning in such a case would permit each donee to claim the full aggregate premiums paid by the donor as the basis against which the amount received by each could be set off in order to determine the excess, if any, of the amount received by each over that basis.

It is to be noted that the Commissioner by his adjustment did not seek to reduce Appellant's basis derived from his donor

because of the subsequent receipt of dividends received by Appellant's children. Rather, he maintains that the children's receipt and ownership of the dividends establishes that they also received a gift to which must be apportioned some part of the donor's basis. The rule of Forrestal v. Commissioner supra that the substituted basis of the donee cannot be changed by any' action of the donor after the gift is made, is, therefore, inapplicable.

Before Appellant's taxable income from the surrender of the insurance policies could be ascertained it would of course be necessary to know the portion of his donor's basis applicable to the gift received by him. Ordinarily, the donor's basis in a transaction such as this would be apportioned between Appellant and his children by reference to the present value of the gifts to them at the time they were made. See Guggenheim v. Rasquin, 312 U. S. 260; Powers v. Commissioner, 312 U. S. 259; Federal Regulations (Gift Tax) 108 Sec. 86.19(i). Appellant has submitted no evidence tending'to establish the amount of his basis, i.e., the portion of the basis of his donor applicable to the gift to him. the portion of the basis of his donor applicable to the support of a presumption of correctness and the Appellant has the burden of proving it to be wrong (Welch v. Helvering, 290 U.S. 111, 115; Lucas v. Structural Steel Co., 281 U. S. 264 290, 371), and the Appellant has failed to present and evidence as to the basis to be applied in determining his income from the transaction, our record gives us no alternative other than to uphold the Commissioner's determination.

ORDER

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, pursuant to Section 18595 of the Revenue and Taxation Code that the action of Chas. J. McColgan, Franchise Tax Commission& in overruling the protest of Lewis G. Carpenter to a proposed assessment of additional tax in the amount of $189.87 for the taxable year ended December 31, 1935, be and the same is hereby sustained.

Done at Sacramento, California, this 19th day of June, 1946, by the State Board of Equalization.

Wm. G. Bonelli, Member
J. H. Quinn, Member
Thomas H. Kuchel, Member

ATTEST: F. S. Wahrhaftig, Acting Secretary