



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
SECURITY TRUST AND SAVINGS BANK OF SAN DIEGO)

Appearances:

For Appellant: Fred E. Lindley, Attorney at Law

For Respondent: W.M. Walsh Assistant Franchise Tax
Commissioner; James J. Arditto, Franchise
Tax Counsel

OPINION

This appeal is made pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes of 1929, as amended) from the action of the Franchise Tax Commissioner in overruling the protest of Security Trust and Savings Bank of San Diego to a proposed assessment of additional tax in the amount of \$2,054.29 for the taxable year ended December 31, 1938.

The determination of the deficiency by the Commissioner resulted from his addition to the taxable income reported by the Appellant of a gain of \$9,649.29 from the sale of bonds and a gain of \$18,746.54 from the sale of properties acquired at foreclosure sales. The Appellant has conceded that the inclusion of the gain from the sale of bonds in taxable income was proper.

The Appellant had loaned varying amounts on the security of certain real properties, Upon default of the borrowers, Appellant acquired the properties through bids at the foreclosure sales, but did not secure deficiency judgments against the debtors. Deductions from gross income were not claimed in Appellant's returns of income for the years of the purchases in the amounts of the differences between the then existing values of the properties and the unpaid amounts of the obligations.

It is the contention of Appellant that in determining gain or loss from the subsequent sale of the properties in the income year 1937, the basis to be used is the amount of the loans outstanding against the properties and not their value at the time of their acquisition by it. To rule otherwise, Appellant argues, is to tax it on gains not actually realized and to treat it unfairly as it is now barred by the statute of limitations from claiming deductions for losses or bad debts in connection with its loans against the properties.

The position of the Appellant cannot, in our opinion, be upheld. The difference between the unpaid balance of a loan and the fair market value at the date of foreclosure of the property securing the loan is properly to be regarded as a bad

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debt and a deduction in that amount should have been made by Appellant from gross income on its return for the year of foreclosure. Commissioner of Internal Revenue v. Spreckels, 120 Fed. 2d 517; Rogan v. Commercial Discount Company 149 Fed. 2d 585. The fair market value of the property then becomes its basis and a subsequent sale results in gain or loss computed on that basis. Bondholders Committee v. Commissioner of Internal Revenue, 315 U.S. 189; Hadley Falls Trust Company v. United States, 110 Fed. 2d 887; Helvering v. New President Corporation, 122 Fed. 2d 92.

Evidence was not offered herein as to the fair market value of the properties on the dates of their respective foreclosures. While Appellant stated that the properties were bid in for nominal amounts, it has not attempted to show how those amounts were determined or the extent to which they differed from fair market value. In the absence of proof to the contrary, the fair market value of the properties must be presumed to be the amounts for which they were bid in by the creditor. Tiscornia v. Commissioner of Internal Revenue, 95 Fed. 2d 678; Helvering v. New President Corporation, supra; Pelham Hall Company, 33 B.T.A. 329.

The Commissioner determined Appellant's tax liability as respects the transactions here in question by including in its taxable income the excess of the subsequent sales prices of the properties over the amounts of their respective bid in prices. In the light of the foregoing authorities, his action must be sustained. In a supplemental memorandum Appellant directed attention to the fact that the Commissioner had incorrectly transferred a figure from its return to the Notice of Additional Franchise Tax Proposed to be Assessed, dated June 12, 1940, and that this error resulted in an erroneous computation. It is to be observed, however, that the error was corrected in the Commissioner's Notice of Action upon Taxpayer's Protest, dated June 25, 1941, from which this appeal was taken.

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 that the action of Chas. J. McColgan, Franchise Tax Commissioner, in overruling the protest of Security Trust and Savings Bank of San Diego to a proposed assessment of additional tax in the amount of \$2,054.29 for the taxable year ended December 31, 1938, pursuant to Chapter 13, Statutes of 1929, as amended, be and the same is hereby sustained.

Done at Los Angeles, California, this 19th day of November, 1946, by the State Board of Equalization.

W.m G. Bonelli, Member
J. H. Quinn, Member
Thomas H. Kuchel, Member

ATTEST: F. S. Wahrhaftig, Acting Secretary