



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
ROLAND P. BISHOP and DOROTHY W. BISHOP)

Appearances:

For Appellant: Claude I. Parker and John A. Rowe, Jr.,
Attorneys at Law

For Respondent: W. M. Walsh, Assistant Franchise Tax Com-
missioner; J. J. Arditto, Franchise Tax
Counsel

OPINION

This appeal is made pursuant to Section 19057 of the Revenue and Taxation Code (formerly Section 20 of the Personal Income Tax Act) from the action of the Franchise Tax Commissioner in denying the claim of Roland P. Bishop and Dorothy W. Bishop for a refund of personal income tax and interest in the amount of \$3,111.84 for the taxable year ended December 31, 1936.

Although a number of issues were initially raised by the parties on this appeal, all but two have been abandoned; the pertinent facts relating to the remaining issues being as follows:

The Oakwood Syndicate (hereinafter referred to as the Syndicate) was formed in 1923 for the purpose of acquiring and subdividing certain real properties. Prior to 1934, Appellants had acquired certificates of beneficial interest in the Syndicate at a total cost of \$52,726.50, as well as Syndicate bonds having a par value of \$96,400.00. In addition, they made unsecured advances to the Syndicate in the total amount of \$6,065.39 subsequent to 1933 and prior to April, 1936. The Syndicate was in default on all its outstanding bonds at all times subsequent to 1933. In the latter part of 1935 the Three Cities Land Company was organized for the purpose of acquiring the Syndicate's assets and the Appellants and all other holders of Syndicate bonds thereafter transferred their bonds to that Company for proportionate shares of its stock. In April, 1936, the Three Cities Land Company foreclosed on the Syndicate bonds and purchased all the Syndicate assets at the foreclosure sale for an amount less than the total par value of the bonds.

It is Appellant's contention, and their joint return for the calendar year 1936 was prepared in accordance therewith, that as a result of the foregoing transactions they sustained deductible losses as follows:

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(1) In an amount equal to the cost basis of their Syndicate certificates of beneficial interest (\$52,726.50) upon the foreclosure sale of Syndicate assets in April, 1936, inasmuch as the certificates became worthless at that time.

(2) In an amount equal to the sum of their unsecured advances to the Syndicate (\$6,065.39), upon the foreclosure sale in April, 1936.

The Commissioner, however, upon audit of Appellants' 1936 return, disallowed both these deductions (as well as others no longer in issue) and advised Appellants that an additional tax was due for the year. Appellants protested the determination of additional tax, but nevertheless paid the amount thereof when their protest was denied. Thereafter, Appellants filed a claim for the refund of that tax, together with the interest attaching thereto, and this appeal is from the denial of that claim.

Although the Commissioner originally argued that the Syndicate was properly to be regarded as a partnership, he subsequently conceded, as contended by the Appellants, that it was an association. He does not dispute Appellants' contention that their Syndicate certificates became worthless upon the foreclosure sale of Syndicate assets in 1936. Rather, it is his contention that the proprietary interest represented by the certificates was not terminated by the foreclosure sale, that the proprietary interest was continued by virtue of Appellants' status as stockholders of the company which acquired the Syndicate assets upon foreclosure, and that the deduction of a loss resulting from Appellants' ownership of the Syndicate certificates must, therefore, be postponed pending the disposition of the proprietary interest originally represented by the certificates.

In support of his position, the Commissioner cites United Gas Improvement Co. v. Commissioner of Internal Revenue, 142 Fed. 2d 216 and directs our attention to the following additional facts: (1) Appellant's nephew had also been a holder of Syndicate certificates and bonds; (2) the combined holdings of Appellants and their nephew compromised approximately twenty-five per cent of the total number of certificates issued and approximately eighty-seven per cent of the total par value of outstanding bonds; (3) Appellants and their nephew subsequently held approximately eighty-seven per cent of the stock issued by the corporation which acquired the assets formerly owned by the Syndicate. He then argues that these additional facts, complementing the facts previously set forth, establish the existence of a continuity of ownership in corporate assets identical to the continuity of ownership found to exist in the factual situation presented for decision in the United Gas Improvement Co. case, and that the decision in that case should, accordingly, be followed in this appeal.

The continuity of interest there found to exist was however, predicated upon a finding by the Court that the stock, with respect to which a loss was being claimed by the taxpayer, had

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been exchanged for other stock upon a non-taxable transaction within the purview of Section 112(b)(3) of the Revenue Act of 1936. In the case before us, even if we assume a reorganization as implied by the Commissioner, the evidence has failed to establish that Appellants exchanged their Syndicate certificates for stock or for anything else of value, Appellants' rights as stockholders of the Three Cities Land Company were acquired solely in exchange for their Syndicate bonds and, inasmuch as no loss is being claimed in connection therewith, the United Gas Improvement Co. case cannot be relied upon as authority for the Commissioner's position.

The facts of this appeal do, however, parallel those upon which a decision was had in Tiscornia v. Commissioner of Internal Revenue, 95 Fed. 2d 678. In that case the taxpayer, similarly to the Appellants herein, was both a stockholder of X Company and a holder of its secured and unsecured notes. Upon X Company's default in the payments due on its secured notes, the trust deed securing the notes was foreclosed and the corporate assets purchased by the trustee for the benefit of the secured noteholders. The Y Company was thereafter organized, and it issued proportion; shares of its stock to the secured noteholders in exchange for the former assets of X Company. At the time of the foreclosure sale of X Company's assets, it, like the Oakwood Syndicate, was insolvent, and neither its stockholders as such, nor the holders of its unsecured notes, succeeded to any interest in Y Company. The foreclosure sale of X Company's assets occurred in 1928, but, for reasons not material on this appeal, Tiscornia took the identical position taken by the Commissioner herein and contended that he had not incurred a deductible loss as a result of the foreclosure sale of X Company's assets. The Court, however, overruled this contention and held that the investment in X Company represented by the stock and unsecured notes was a loss sustained in 1928 when the foreclosure sale occurred and that as respects the secured notes, the holders of which had received stock in the Y Company, a loss occurred in 1929 when that Company became insolvent.

Inasmuch as the Appellants herein are not claiming a deductible loss in connection with their investment in the bonds of the Oakwood Syndicate, the Tiscornia case, in our opinion, adequately supports their position and justifies the deductibility as a loss of their investment in the Syndicate's certificates of beneficial interest in the year those certificates became worthless as a result of the foreclosure sale of the Syndicate's entire assets. See also Glenn v. Courier-Journal Job Printing co., 127 Fed. 2d 820.

With respect to the loss claimed to have been sustained by virtue of the unsecured advances made to the Syndicate by Appellants, the Commissioner takes the position that the advances were made without expectation of repayment and must, therefore, be treated as capital contributions rather than loans. If this line of reasoning is followed the amount of those advances is properly to be added to the purchase price of Appellants' Syndicate certificates in determining the loss sustained by Appellants when the

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certificates became worthless in 1936. The Appellants, on the other hand, maintain that the amounts advanced constituted bona fide loans which became worthless and were properly charged off in 1936, and that Appellants properly deducted the amount of the loans as a bad debt loss incurred in that year. Inasmuch as a loss in the amount of the unsecured advances would be a proper deduction pursuant to either the Appellants' or the Commissioner's line of reasoning, it is held, without further discussion, that Appellants sustained a total loss in 1936 in an amount equal to the cost of their Syndicate certificates plus the amount of the unsecured advances to the Syndicate.

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 19060 of the Revenue and Taxation Code, that the action of Chas. McColgan, Franchise Tax Commissioner, in denying the claim of Roland P. Bishop and Dorothy W. Bishop for refund of personal income tax and interest in the amount of \$3,111.84 for the taxable year ended December 31, 1936, be and the same hereby is modified. Said action is hereby reversed in so far as it was based on the Commissioner's disallowance of deductions from gross income in the total amount of \$58,791.89 in determining Appellants' taxable net income for said year; in all other respects said action is hereby sustained. The Commissioner is hereby directed to proceed in conformity with this order and to grant Appellants' claim for refund in accordance therewith.

Done at Sacramento, California, this 12th day of December, 1946, by the State Board of Equalization.

George R. Reilly, Member
Wm. G. Bonelli, Member
J. H. Quinn, Member

ATTEST: F.S. Wahrhaftig, Acting Secretary