



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
MORTGAGE GUARANTEE COMPANY AND)
MORTGAGE SERVICE CO., ITS ASSIGNEE)

Appearances:

For Appellant: Charles W. Lyon and Clay Robbins,
Attorneys at Law.

For Respondent: W. M. Walsh, Assistant Franchise
Tax Commissioner; Burl D. Lack,
Chief Counsel; Milton A. Huot;
Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 27 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes of 1929, as amended) from the action of the Franchise Tax Commissioner in denying the claims of Mortgage Guarantee Company and Mortgage Service Co., its assignee, for refunds of tax in the amounts of \$14,381.08 and \$29,642.96 for the taxable year 1942, and in the amounts of \$15,261.88, \$6,949.59 and \$622.14 for the taxable years 1943, 1944 and 1945, respectively.

The claim for refund in the amount of \$29,642.96 for the taxable year 1942 duplicates the other claim for that taxable year in the amount of \$14,381.08 and the claim for the taxable year 1943 in the amount of \$15,261.88. Appellant's income for the year 1942 served as the measure of its tax liability for the taxable years 1942 and 1943 and the \$29,642.96 claim was apparently filed as a precautionary measure due to uncertainty on its part as to the correct procedure in such a case. The difference in the amounts of the other 1942 claim and the 1943 claim is due to the fact that the financial corporation rate (fixed under Section 4a of the Act) applied to Appellant varied in 1942 and 1943. The \$29,642.96 claim for the taxable year 1942 should, accordingly, be rejected as a duplicate of the other claim for that year and the claim for the taxable year 1943.

Mortgage Guarantee Company was a mortgage insurance company organized and acting under the mortgage insurance laws of the State of California (Civil Code, Division 1, Part 4, Title 2, Chapter 8) until November 1, 1941. Prior to 1932 it carried on a business of lending money on notes secured by mortgages or deeds of trust, hereinafter referred to as secured notes, and thereafter placing many of these secured notes in

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trust with Title Insurance and Trust Company under trust agreements. It then sold to the public mortgage participation certificates and policies of mortgage insurance which purported to convey a pro rata share of the secured notes in one of the trusts and to insure the payment thereof'.

The trust agreements stated that the secured notes were to be held in trust for the benefit of the Mortgage Guarantee Company and its assignees. The Appellant reserved the right to collect the interest on the secured notes, withdraw them from the trusts and to substitute new ones in the trusts. It was required, however, to keep securities in the trusts equal in value to the amount of mortgage participation certificates outstanding. The trust agreements also gave the Appellant the right to receive back all the securities in any one of the trusts whenever it reacquired all the purported assignments relating to that particular trust.

The mortgage participation certificates and policies of mortgage insurance provided that Mortgage Guarantee Company had the right to repurchase the certificates on 60 days notice before two dates in each year and the Company guaranteed that the holders would be repaid the purchase price of the certificates plus interest by 'specified dates. The certificates carried a fixed rate of interest and the Appellant retained any interest paid on the secured notes held in trust above this rate, purportedly as a premium for mortgage insurance and other services.

In 1932 many of the secured notes held by the Trust Company were in default and real estate values were greatly depreciated. As a result the State Insurance Commissioner issued an order forbidding the issuance of any more policies of insurance by the Appellant. In the following years some of the debtors did not meet their obligations, and the trusts acquired real property through mortgage foreclosures or sales under deeds of trust. During this period Mortgage Guarantee Company repurchased some of the mortgage participation certificates at less than face value, and in 1941 it bought the remaining outstanding certificates. The trustee then transferred all the assets of the trusts to the Appellant in accordance with the trust agreements.

Subsequently, some of the real properties that were acquired from the trust were sold by the Appellant and the question raised in this appeal is the amount of gain realized or loss sustained by the Appellant as a result of these sales. It contends that the basis to be applied in determining the gain or loss from the sale of each of such properties was its fair market value at the time it was acquired by the trustee while the Commissioner maintains that the basis of each property was its fair market value at the date of its transfer from the trustee to Mortgage Guarantee Company.

The primary determination to be made, therefore, is whether the events that took place in 1941 were such as to lend

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to a change in the basis of the property transferred from the trustee to the Appellant at the time of the termination of the trusts. This requires an examination of the nature of the transactions between Mortgage Guarantee Company and Title Insurance and Trust Company.

At the time of the transfers of the secured notes to the Trust Company the fact that the Appellant retained the right to collect the interest on the secured notes, withdraw them from the trusts, substitute different ones in the trusts and terminate the trust upon the reacquisition of all the mortgage participation certificates indicates that the Appellant did not give up all its interest in the secured notes to the trustee, and did not assign all its rights in those notes to the holders of the mortgage participation certificates. The Appellant, therefore, at all times retained considerable control over the secured notes. When Mortgage Guarantee Company purported to assign the secured notes in the mortgage participation certificates, in effect all it was doing was borrowing money on the strength of the certificates which were secured by the obligations held in trust. This is borne out by the fact that the certificate holders had no right to obtain the secured notes, that they were paid a fixed rate of interest, and that they were guaranteed by the Appellant that the principal would be repaid to them by a certain date. In reality, the holders of the certificates were looking to Mortgage Guarantee Company as the party primarily liable on the certificates: This is the view the California Supreme Court has taken in regards to the issuance of mortgage participation certificates, and it has held that the transfer to the trustee of the secured notes in such a situation is no more than a pledge thereof to guarantee the payment of the mortgage participation certificates. Western Mortgage and Guarantee Company v. Gray, 215 Cal. 191, 201. See also Mortgage Guarantee Company v. Rogan, 41 F. Supp. 932, 435; and Mortgage Guarantee Company v. Welch, 38 Fed. 2d 184, in which the federal courts appear to take a similar view of such transactions.

Since under this view of the transaction real ownership of the secured notes and the foreclosed and purchased property was at all times in Mortgage Guarantee Company and never passed to the trustee or the certificate holders (Sparks v. Caldwell, 157 Cal. 401), there was no sale or exchange of the property upon the dissolution of the trust, which, in reality, was no more than the terminating of a security device that was no longer needed. There was, as a result, no change in the basis of the property at this time. See Estate of James J. Doty, T.C. Memo Op. Dkt. No. 14, 488, October 25, 1948.

The proper basis for the property, accordingly, is its fair market value at the time it was acquired by way of mortgage foreclosures or sale under a trust deed. Helvering v. Now President Corporation, 122 Fed. 2d 92. Evidence to the contrary not having been submitted, the bid price of the property is presumed to be its fair market value at the date of the sale

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(Helvering v. New President Corporation, supra; Tiscornin v. Commissioner of Internal Revenue, 95 Fed. 2d 678) and it was so regarded by the Appellant. It follows, therefore, that the position of the Appellant must be upheld.

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 denying the claim of Mortgage C-uarantee Company and Mortgage Service Company, its assignee, for a refund of tax in the amount of \$29,642.96 for the taxable year 1942 be and the same is hereby sustained; that the action of said Commissioner in denying the claims of said Mortgage Guarantee Company and Mortgage Service Company, its assignee, for refunds of tax in the amounts of \$14,381.08, \$15,261.88, \$6,949.59 and \$622.14 for the taxable years 1942, 1943, 1944 and 1945, respectively, be and the same is hereby reversed; the Commissioner is hereby directed to credit said amounts of \$14,381.08, \$15,261.88, \$6,949.59 and \$622.14 against any taxes due from said Mortgage Guarantee Company and Mortgage Service Company, its assignee, and to refund the balance to said Companies and otherwise to proceed in conformity with this order.

Done at Sacramento, California, this 15th day of December; 1948, by the State Board of Equalization.

Wm. G. Bonelli, Chairman
J. H. Quinn, Member
J. L. Seawell, Member
Geo. R. Reilly, Member
Thomas H. Kuchel, Member

ATTEST: Dixwell L. Pierce, Secretary