BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
GORE BROS, INC.)

Appearances:

For Appellant: A. D. Vencill, Certified Public Accountant

For Respondent: W. M. Walsh, Assistant Franchise Tax Commissioner; Mark Scholtz and Hebard Smith, Associate Tax Counsels

O P I N I O N

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 on the protest of Gore Bros. Inc., to a proposed assessment of additional franchise tax in the amount of $2,539.74 for the taxable year 1942.

Appellant borrowed money in 1929 and 1930 to provide funds for deposit in a brokerage account through which it was purchasing securities on margin and authorized the creditors to liquidate its security holdings as might be advisable for the protection of the account. The sums advanced to it were originally carried on its books as an account payable, but on March 15, 1933, it executed notes to the creditors in the total sum of $69,762.05, which represented the amounts borrowed less the amounts realized upon the sale of all the securities. The amount of the loss, being the amount for which the notes were subsequently executed was included in the computation of the loss sustained upon the liquidation of the stocks reported in Appellant's franchise tax return for the taxable year 1931. Its total loss for the income year 1930 reported in the return far exceeded the $69,762.05. During 1941 the notes were satisfied through a compromise agreement by the payment of $6,976.20.

On its return for the income year 1941, the Appellant listed under the designation "Discount on Notes Payable" an item of $62,833.42, representing the amount of the indebtedness from which it was relieved under the compromise agreement. The Commissioner concluded, however, that that amount represented indebtedness canceled or forgiven within the meaning of Section 6(d) of the Bank and Corporation Franchise Tax Act and, inasmuch as Appellant's assets exceeded its liabilities by more than that amount after the cancellation or forgiveness he included the $62,853.42 in Appellant's gross income for 1941 and issued his proposed assessment accordingly.

In support of its position that this action of the Commissioner was erroneous, the Appellant has cited only Helvering v. American Dental Co., 318 U.S. 322, and Bowers v. Kerbaugh Empire Co.,271 U.S. 170. The former is cited for the proposition that inasmuch as (1) no tax benefit resulted to Appellant by reason of the inclusion of the $69,762.05 in the total stock loss set forth in its return for 1930 and the exclusion of that sum would not have created any tax liability for Appellant in that or any subsequent year and (2) the forgiveness was gratuitous and a gift to Appellant, the cancellation of the indebtedness in 1941 did not result in income to it in that year, The latter is cited for the proposition that the effect of the cancellation of the indebtedness was merely to reduce a prior loss to Appellant and the amount canceled was properly reported as a direct credit to surplus and not to income.

The action of the Commissioner, in our opinion, must be sustainei Section 6(d), as in effect in 1942, read as follows:

> "If the indebtedness of a bank or corporation is canceled or forgiven in whole or in part without payment, the amount so canceled or forgiven shall constitute income to the extent the value of the property (including franchises) of the bank or corporation exceeds its liabilities immediately after the cancellation or forgiveness,"

The condition set forth by this provision for the inclusion of the canceled or forgiven indebtedness in gross income, i.e., that the corporation's assets exceed its liabilities immediately after the transaction by at least the amount included in income, is met in the present case.

The authorities cited by the Appellant do not establish that the Commissioner's position is erroneous. The American Dental Co. case turns upon an interpretation of Section 22(a) and 22(b)(3) of the Federal Revenue Act of 1936. The Court there found that the facts brought the transaction in question within the moaning of the term "gift" as used in the particular context in Section 22(b)(3) to such an extent as to exclude the amount of the canceled indebtedness from the general definition of gross income. The Bank and Corporation Franchise Tax Act, however, does not have an exclusionary provision similar to Section 22(b)(3) of the Federal law, and, unlike the Federal law, specifically provides for the inclusion in gross income of the amount of any cancellation or forgiveness of a debt if the condition above mentioned is met.

Bowers v. Kerbaugh Empire Co., supra, is distinguishable from the present case in that it did not involve any question of cancellation of indebtedness and there was no statutory provision applicable to the factual situation there involved specifically requiring the inclusion of any amount in gross income as does Section 6(d) in the case at hand,

In seeking to introduce a tax benefit concept Appellant undoubtedly has in mind the decision in Dobson v. Commissioner of Internal Revenue, 320 U.S. 489. In that case, however, the Court stated

> "We are not adopting any rule of tax benefits. We only hold that no statute or regulation having the force of one and no principle of law compels the Tax Court to find taxable income in a transaction where as matter of fact it found no economic gain and no use of the transaction to gain tax benefit."

Here, however, there is in Section 6(d) a statutory provision applying to the factual situation and declaring that gross income results from the transaction in question. The authorities relied upon by the Appellant do not, accordingly, sustain its position that the amount of the canceled indebtedness should be excluded from its gross income for 1941.

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 25 of the Bank and Corporation Franchise Tax Act, that the action of Chas. J. McColgan, Franchise Tax Commissioner, on the protest of Gore Bros., Inc., to a proposed assessment of additional tax in the amount of $2,539.74 for the taxable year 1942 be and the same is hereby sustained.

Done at Sacramento, California, this 6th day of January, 1949, by the State Board of Equalization.

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

ATTEST: Dixwell L. Pierce, Secretary