REFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
)
CLAUDE D. AND JESSIE V. PLUM)

Appearances:

For Appellants: Claude D. Plum

For Respondent: Jack L. Rubin, Junior Counsel

OPINION

These appeals are made pursuant to Section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Claude D. and Jessie V. Plum, husband and wife, to proposed assessments of additional personal income tax in the amount of $1,567.18 against Appellants jointly for the year 1950 and in the amount of $265.76 against Jessie V. Plum for the year 1951. Since the appeals were taken, the Franchise Tax Board has conceded that the assessment for the year 1950 should apply only against Claude D. Plum and that the assessment against Jessie V. Plum for the year 1951 should be reduced to $30.04.

The first transaction involved in these appeals concerns a tract of land purchased by Mr. Plum, transferred to his wife and then sold by her. Sometime prior to 1947, Mr. Plum planned to engage in the lumber business. He acquired an option to purchase a tract of land for $27,500.00 to use as a site for the business, In April, 1948, he and another person purchased the land at the option price. Mr. Plum paid only $2,386.81 and received half of the tract, 112 acres, as his separate property. In the same month he gave his wife a deed of trust on the land to secure a loan from her of $21,000, which was evidenced by a promissory note, and to secure any future loans that she might make to him.

His wife later made additional loans to him, all evidenced by promissory notes, and his total debt to her by March 10, 1950, was $47,912.61. On that date he executed a deed, granting the fee interest in his land to Mrs. Plum in consideration for the cancellation of all of the notes. On each note is written "Cancelled Mar 10 - 1950 Jessie V. Plum." Mrs. Plum thereafter gave her husband further sums of money, not evidenced by notes, in the amount of $1,711.32. The deed was recorded on October 11, 1950. The notes were not surrendered

by Mrs. Plum until 1951. On July 16, 1951, Mrs. Plum sold the land for $84,300.00.

The second transaction concerns residential property purchased by Mrs. Plum on December 6, 1950, as her separate property. She sold this property on April 11, 1951, at a loss of $411.01. She neither resided on the property nor rented it during the period of her ownership,

Before proceeding to questions specifically raised by Appellants we consider it desirable to state some of our conclusions with respect to the first transaction, as to which Appellants! position appears somewhat uncertain, (1) The transfer of the land by Mr, Plum and the cancellation of his debts by Mrs. Plum must be considered to have occurred on March 10, 1950. The fact that the deed was not recorded until a later date is not material (Sections 1054 and 1055 of the Civil Code; Federal Home Loan-Bank v. Long Beach Federal Savings and Loan Association, 122 Fed. Supp. 401, 423). (2) Although the promissory notes were not surrendered until 1951. they were actually extinguished on March 10, 1950, when the land was transferred in agreed payment of them (Section 3200 of the Civil Code; Merrill v. First National Bank of San Diego, 94 Cal. 59; Dodds v. Spring, 174 Cal. 412; O'Donnell v. Kennedy 120 Cal. App. 2d Supp. 926). (3) Mrs. Plum's holding period hor the purpose of computing the gain on her sale of the land commenced on March 10, 1950, when she first acquired ownership of the land (Shattuck v. Helvering 119 Fed. 2d 902). These conclusions accord with the determination of the Franchise Tax Board.

The first question specifically raised is whether Mr. Plum realized a taxable gain when he transferred the 112 acre tract of land to his wife, The Franchise Tax Board has assessed a tax upon the difference between his cost basis, $2,386.81, and the amount of debts cancelled by Mrs. Plum on March 10, 1950, $47,912.61. Mr, Plum contends that he did not realize a taxable gain because he was insolvent before and after the transaction.

Mr. Plum states that prior to March 10, 1950, he owed his wife $47,912.61, and another person, $5,000.00, while his only assets were cash in the amount of $144.94 and the land, which he valued at $11,240.00. Thus, he concludes that he was insolvent to the extent of $41,527.61. He also stated that he was insolvent on October 1, 1950, prior to the recording of the deed, based on calculations which assume that he still owned the land, He further states that on October 15, 1950, after the deed was recorded, he owed the $5,000.00 debt plus $150.00 in interest thereon, had only a small amount of cash,

and was insolvent to the extent of $5,049.00. He has submitted an affidavit of an attorney who represented him in the past, which states that during the year 1950 Mr. Plum was in financial straits and was in arrears on a number of obligations,

The Federal courts have held in certain cases that the taxpayer did not realize a taxable gain of the difference between the cost of property transferred to a creditor and the amount of a debt thereby extinguished, where the taxpayer was insolvent before and after the transaction (Dallas Transfer & Warehouse Co, v. Commissioner, 70 Fed. 2d 95; Turney's Estate v. Commissioner, 126 Fed. 2d 712; Springfield Industrial Building Co., 38 B.T.A. 1445; Texas Gas Distributing Co., 3 T. C. 57. Cf. Lakeland Grocery Co., 36 B.T.A. 289).

This rule, however, has never been extended beyond a situation where the taxpayer was insolvent before, as well as after, the transaction; and a clear showing of actual insolvency, as opposed to mere financial distress, has been required (Fifth Ave. - Fourteenth St. Corp. v. Commissioner, 147 Fed. 2d 453; Twin Ports Bridge Co., 27 B.T.A. 346; Peninsula Properties Co., Ltd., 47 B.T.A. 84; Lutz & Schramm Co., 1 T. C. 682).

Moreover, in a case where the property was equal in value to the debt extinguished, the transaction was considered equivalent to an ordinary sale, and the difference between the cost of the property and the debt discharged was held taxable regardless of the taxpayer's insolvency (Home Builders Lumber Co. v. Commissioner, 165 Fed, 2d 1009). The following legal commentators agree that a sale of property in satisfaction of a debt may result in taxable gain even though the seller is insolvent. (Darrell, "Discharge of Indebtedness and the Federal Income Tax," 53 Harv. L. Rev. 977, 993, 994; Warren and Sugarman, "Cancellation of Indebtedness and Its Tax Consequences," 40 Columbia L. Rev. 1326 1342, 1343, 1353; Powell "Federal Taxation - Tax Problems in debt Cancellation," 31 Marquette L. Rev. 288, 292; Wright, "Realization of Income Through Cancellations, Modifications, and Bargain Purchases of Indebtedness," 49 Mich. L. Rev. 667. 687; Mertens, Law of Federal Income Taxation, §11.21, footnote 63).

Thus, it is apparent that the question of taxability turns upon the value of the land. We have only Mr. Plum's unsupported statement that it was worth $11,240.00 at the time of its transfer to his wife, In view of the fact that his wife sold the land approximately one year later for $84,300.00, we would not be justified in finding that the land was worth less than the debts at the time of its transfer to Mrs. Plum or that Mr. Plum was then insolvent. To the

contrary, it would appear that the value of the property then exceeded the amount of his indebtedness, We therefore uphold, the action of the Franchise Tax Board on this issue.

Appellants next contend that Mrs. Plum's basis for determining the gain on her sale of the tract of land was $49 623.93, the total amount advanced by her to Mr. Plum prior to October 11, 1950, when the deed was recorded. They state that Mrs. Plum agreed to accept the land as consideration for any advances she might make after execution of the deed,, Such a promise by her at that time would be completely uncertain and illusory, She was not thereby obligated to give Mr. Plum anything beyond the cancellation' of the then existing debts, We conclude that her basis was $47,912.61, the amount of the obligations cancelled when the land was transferred to her on March 10, 1950, as determined by the Franchise Tax Board,

The final issue is whether Mrs. Plum may deduct the loss which she sustained on the purchase and sale of the residential property, She may deduct this loss only if it was incurred in a transaction entered into for profit (former Section 17306, now 17206, of the' Revenue and Taxation Code);. On the basis of statements made at the original protest hearing before the Franchise Tax Board, that Board determined that Mrs. Plum purchased the property to use as her residence, and not as a profit-making venture. There is no evidence, to. the contrary, Where property was acquired for use as a personal residence, a loss on the sale thereof has been held not deductible *even* though the residential. purpose was abandoned prior to the sale and'the property was not actually used as a residence,, since it was not converted to rental or other income producing purposes (Jones v. Commissioner, 152 Fed, 2d 392). In that case the result was not affected by the fact that the taxpayer made improvements to aid in the-sale of the property.

Appellants appear to believe that the Franchise Tax Board may not now disallow the loss on the residential property because in earlier proceedings it erroneously computed a gain on this transaction and included it in Mrs. Plum's gross income, They indicate that the Franchise Tax Board has been inconsistent, It should be noted,, however, that the gain on the sale of any property, including a residence, is taxable unless otherwise provided, At the time of this transaction there were no provisions to the contrary (Cf. former Section 17690.1, now 18091, effective in 1952). Deductible losses, on the other hand, were limited by former Section 17306 (now 17206) to, in so far as is relevant here, losses incurred-in a transaction entered into for profit.

Appeals of Claude D. and Jessie V. Plum

O R D E R

Pursuant to the views expressed in the Opinion of the Board on file in these proceedings, 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 the Franchise Tax Board on the protests of Claude D. and Jessie V. Plum to proposed assessments of additional personal income tax in the amount of $1,567.18 against Appellants jointly for the year 1950 and in the amount of $265.76 against Jessie V. Plum for the year 1951, be and the same is hereby modified as follows: the assessment for the year 1950 is made effective against Claude D. Plum only and the assessment against Jessie V. Plum for the year 1951 is reduced to $30.04,

Done at Los Angeles, California, this 19th day of November, 1958, by the State Board of Equalization,

Geol R. Reilly Chairman

J. H. Quinn, Member

Paul R. Leake, Member

_____, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary