



Appeal of Worlicombe Corporation

Interest was payable annually beginning March 1, 1965, at a rate of 9 percent. The note provided that the buyers could pay any part of the principal before March 1, 1969, and could prepay interest for the years 1964, 1967, and 1968 at any time before 1969. Interest for the years 1964, 1967, and 1968 was paid during the fiscal year ended August 31, 1964.

As the seller of a half interest in the land, appellant's shares of the sales price, the initial cash payment and ownership of the note were \$120,500, \$5,000, and \$81,750, respectively.

On August 17, 1964, appellant filed a certificate of election to dissolve. It did not dissolve, however, during the year ended August 31, 1964. As of that date the installment note had not been satisfied, sold, distributed, or otherwise disposed of.

As a corporation doing business in California appellant was subject to a franchise tax measured by net income. (Rev. & Tax. Code, § 23151.) As a commencing corporation with a first taxable year of less than 12 months appellant's franchise tax for the year ended August 31, 1964, was to be measured by its net income during that year. (Rev. & Tax. Code, § 23222.)

In its franchise tax return for the income and taxable year ended August 31, 1964, appellant reported the gain on the sale of the land by the installment method provided by sections 24667 and 24668 of the Revenue and Taxation Code. Under that method a taxpayer reports as income for each year that proportion of the payments received in that year which the gross profit realized or to be realized when payment is completed bears to the total contract price.

Respondent included in appellant's income for the year ended August 31, 1964, an additional amount of \$34,229.05. This amount is the balance of the gain which would have been reportable under the installment method if appellant had remained in business subject to the franchise tax and if the note had ultimately been paid in full. It is respondent's position that this amount represents "unreported income" which must be included in the measure of tax for the year in question under section 24672 of the Revenue and Taxation Code. Section 24672 provides in part as follows:

Appeal of Worlicombe Corporation

. Where 2. taxpayer *elects to report* income arising from the sale or other disposition of property ... [by the *instalment* method] ... , and the entire income, therefrom has not been reported prior to the year that the taxpayer ceases to be subject to the tax measured by net income ... , the unreported income shall be included in the measure of the tax for the last year in which the taxpayer is subject to the tax....

Appellant agrees that section 24672 applies, but contends that the *instalment* note received on the sale of the land had little or no market value and that, therefore, the income added by respondent was excessive.

Appellant has not made it clear why it considers the market value of the note to be relevant. In the earlier stages of argument, it cited section 24670 of the Revenue and Taxation Code, which provides that where an installment obligation is distributed or disposed of otherwise than by sale or exchange, then gain or loss is 'to be measured by the difference between the basis of the obligation and the fair market value of the obligation at the time of the disposition. That section does not apply, however, since appellant did not dispose of the obligation during the year in question. Although appellant apparently recognized in the final stage of argument that section 24670 did not apply, it continued to maintain its position that the market value of the note was less than face value.

Implicit in appellant's position is the assumption that "unreported income" within the meaning of section 24672 is limited by the market value of the note and does not exceed the income which would have been reportable in the year of the sale if appellant had not elected to report on the installment method. Respondent on the other hand, regards the "unreported income" as the amount which would have been reportable if appellant remained subject to franchise tax and the face amount of the note were ultimately paid in full. We find it unnecessary to decide the question of statutory interpretation thus obliquely presented, in view of our following conclusion with respect to the market value of the note,

Appeal of Worlcombe Corporation

The burden of proving that the fair market value of the note was less than its face amount is on appellant. (A. & A. Tool & Supply Co. v. Commissioner, 182 F.2d 300; Cal. Admin. Code, tit. 18, §5036.) Relevant factors in determining the value of the note include the financial condition of the maker, the value of the property securing the note, the maturity date, and the interest rate. (Commissioner v. Kellogg, 119 F.2d 115; A. & A. Tool & Supply Co. v. Commissioner, supra; Sallie M. Wortham, 3 B.T.A. 1307; Estate of Wallace Caswell, 17 T.C. 1190, rev'd on other grounds, 211 F.2d 693; Gertrude H. Blackburn, 20 T.C. 204; Retail Properties, Inc., T.C. Memo., Dkt. No. 94706, Sept. 18, 1964.)

Upon weighing the relevant factors, we find that appellant has failed to establish that the fair market value of the note was less than its face amount. Appellant does not question the financial responsibility of the maker. It alleges that the face amount of the note exceeded the net value of the land that secured the note but has not established the net value of the land by competent evidence. Appellant emphasizes that the first payment of principal was not due until almost five years after the sale and that a substantial part of the interest was paid in advance. The effect of the late maturity date, however, was offset by the high interest rate of 9 percent. The fact that part of the interest was paid before it was due does not reduce the original value of the note, since the note carried with it the right to all interest. We are not here concerned with the value of the note after the interest was paid.

Since it is undisputed that section 24672 accelerated the "unreported income," and since the "unreported income" is the same whether it is based on the market value or the face value of the note, we will sustain respondent's action.

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,

Appeal of Woricombe Corporation

IT IS HEREBY ORDERED, AD JUDGED AND DECREED, pursuant to section 25657 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Woricombe Corporation against a proposed assessment of additional franchise tax in the amount of \$1,976.72 for the income and taxable year ended August 31, 1964, be and the same is hereby sustained.

Done at Sacramento, California, this 1st day of September, 1966, by the State Board of Equalization.

Scott Kelle, Chairman  
John W. Lynch, Member  
James P. Leake, Member  
Paul Choi, Member  
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ATTEST: [Signature], Secretary