BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
ANDREW L. ANDREOLI)

Appearances:

For Appellant: Alex Googooian
Attorney at Law

Leroy B. Shane
Certified Public Accountant

For Respondent: John D. Schell
Counsel

O P I N I O N

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Andrew L. Andreoli against a proposed assessment of additional personal income tax in the amount of $1,723.96 for the year 1966.

The sole issue presented by this appeal is whether appellant may elect not to recognize the gain he realized from the involuntary conversion of a piece of real property.

In 1955 appellant, a resident of Arcadia, California, purchased a parcel of unimproved realty in Northridge, California, for $4,750. Although at various times he intended to build a residence or an apartment building on this property, appellant ultimately decided to leave it unimproved because he was certain that it would eventually be condemned. Consequently, when that eventuality came about in 1965, appellant was holding the property for the sole purpose of realizing the appreciation in its value. On February 24, 1965, the

State of California acquired it for the use of San Fernando. Valley State College, paying appellant an agreed price of $58,735.10.

Frior to July 1966, appellant owned 50 percent of the stock in San Andell Co., a corporation engaged in the business of servicing swimming pools. Sometime during that month, he purchased the remaining stock in San Andell Co. for $65,000, becoming its sole shareholder. At the time of this purchase, San Andell Co. owned a single parcel of completely improved real property in San Gabriel,; California. The company's business building was located on a part of this lot, and the remaining portion of the parcel was paved with blacktop. Most of the blacktopped area was used as parking space for employees and customers of the pool service business and as a driveway from the street to the building. The remainder of .the parcel, comprising about 20 percent of its total area, was either rented or offered for rent to nearby businesses for parking purposes.

A fence bisected the parcel into two nearly equal parts. The back half, containing the building, was zoned M-3. The front half, containing the rental area, driveway, and pool service parking, was zoned C-3.

In his 1966 income tax return appellant did not report the gain realized from the condemnation of his Northridge property, claiming that he was entitled to elect nonrecognition of the gain under sections 18082-18084 of the Revenue and Taxation Code. Those sections provide, in pertinent part, as follows:

> 18082. If property ins a result of its destruction- in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily. or involuntarily converted --
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> * * *
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> (c) Into money or into property not similar or related in service or use to the converted property, and the disposition of the converted properly ... occurred after December 3.2, 1952, the gain (if any) shall be recognized except to the extent hereinafter provided in Section 18083.

> 18083. If the taxpayer during the period specified in Section 18084, for the purpose of replacing the property so converted, purchases other property similar or related in service or use to the property so converted, or purchases stock in the acquisition of control of a corporation owning such other property, at the election of the taxpayer the gain shall be recognized only to the extent that the amount realized upon such conversion (regardless of whether such amount is received in one or more taxable years) exceeds the cost of such other property or such stock. [Emphasis added.]
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> 18084. The period referred to in Section 18083 shall be the period beginning with the date of the disposition of the converted property, or the earliest date of the threat or imminence of requisition or condemnation of the converted property, whichever is earlier, and ending --
>
> (a) One year after the close of the first taxable year in which any part of the gain upon the conversion is realized;. ..

Respondent determined that nonrecognition was not proper in this case because the San Andell Co. did not own property "similar or related in service -or use" to the condemned parcel. Appellant contends that the C-3 zoned half of the San Gabriel parcel qualifies as replacement property for purposes of section 18083.

Sections. 18082-18084 are based on nearly identical provisions of federal law contained in section 1033 of the Internal Revenue Code of 1954. For both federal and state income tax purposes, these nonrecognition provisions are intended to relieve a taxpayer from unanticipated tax liability arising out of involuntary conversions of his property, provided that he replaces the converted property within the time allowed. (Filippini v. United States, 318 F.2d 841; Appeal of John F. and Elizabeth L. Anderson, Cal. St. Bd. of Equal., Sept. 12, 1968.) However, the statutes are not designed to permit a tax-free alteration in the nature of the taxpayer's investment. (Liant Record, Inc. v. Commissioner, 303 F.2d 326; Appeal of John F. and Elizabeth L. Anderson, supra.) Consequently,

postponement of the tax turns on whether the replacement property is "similar or related in service or use" to the converted property.

Nearly all courts now agree that the similarity of the original and replacement properties is to be determined by a comparison of the services or uses which the two properties have to the taxpayer-owner. Put another way:

> The trier of fact must determine from all the circumstances whether the taxpayer has achieved a sufficient continuity of investment to justify non-recognition of the gain, or whether the differences in the relationship of the taxpayer to the two investments are such as to compel the conclusion that he has taken advantage of the condemnation to alter the nature of his investment for his own purposes. [Emphasis in the original.] (Filippini v. United States, 318 F.2d at 844-5.)

A comparison of appellant's relationship to the Northridge and San Gabriel properties compels the conclusion that the two represent vastly different investments. The Northridge parcel was vacant and unused, while the San Gabriel lot was used in appellant's pool service business and also produced rental income. Appellant was called on to manage and maintain the replacement property from day to day, but the condemned parcel made no demands on appellant's time because it was a totally idle investment held only for long-term appreciation in value. As such, it also was not subject to the risks that it would cease to produce current income or to be useful in appellant's business.

Accordingly, respondent was correct in determining that the condemned and replacement properties were not sufficiently "similar or related in service or use."

ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

Appeal of Andrew L. Andreoli

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Tnxntion Code, that the action of the Franchise Tax Hoard on the protest of Andrew L. Andreoli against a proposed assessment of additional personal income tax in the amount of $1,723.96 for the year 1966 be and the same is hereby sustained.

Done at Sacramento, California, this 5th day of January, 1971, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: _____, Secretary