



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
ELIZABETH D. DAVENPORT (MAYBERRY))

For Appellant: William H. Cree, Jr.
Attorney at Law

For Respondent: Michael E. **Brownell**
Counsel

O P I N I O N

This appeal is made pursuant to section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Elizabeth D. Davenport (Mayberry) against a proposed assessment of additional personal income tax in the amount of **\$97,305.00** for the year 1972.

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The issue presented is whether the transaction which occurred between appellant and her former spouse on December 21, 1972 was a taxable sale of appellant's interest in the couple's investment property.

Appellant and her former spouse, Dr. Donald J. Davenport, were married **on October 16, 1941**. They separated in June 1971; the dissolution of their marriage was final on June 8, 1972.

In anticipation of the dissolution of their marriage, appellant and her spouse executed a Property Settlement Agreement on May 30, 1972 (hereinafter referred to as "the agreement"). The agreement provided that Dr. Davenport would pay to appellant, for **her** support, the sum of **\$1,100** per month. These payments were to terminate upon the death **of either** Dr. or Mrs. Davenport, upon Mrs. Davenport's remarriage, or upon such time as Mrs. Davenport had received a total of **\$250,000**. With regard to the Davenports' community property, the agreement provided for an immediate division of their residence, the husband's medical practice, and certain personal property, including personal effects, automobiles, insurance policies, and **household** furnishings. In addition to these items, the Davenports owned, as community property, a considerable amount of investment property, including stocks and bonds, **real** estate, interests in joint ventures, and notes receivable (hereafter referred to as "investment properties"). The agreement stated that as of May **30, 1972**, the total fair market value of the investment properties as estimated by Dr. Davenport was less than the Davenports' community obligations. The agreement also stated that Dr. Davenport thought that if the investment properties were retained and sold at **the proper** times, their cumulative value would surpass the obligations. Pursuant to the terms of the agreement, the Davenports agreed to become "partners" in the ownership **of the** investment properties, and further agreed that **Dr.** Davenport would manage the properties and would have the **authority** to sell them. The agreement provided that all the investment properties would be sold within five years; that the proceeds of the sales would first be used to **pay the** community obligations; and that any remaining proceeds would be divided equally between Dr. and Mrs. Davenport. Dr. Davenport was to receive \$24,000. per year from the profit produced by the investment **properties** as-payment for managing the properties.

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The agreement was, approved by the superior court, and the interlocutory judgment awarded each spouse as his or her sole and separate property one-half of the "partnership" formed by appellant and her former husband to retain ownership of the **investment** properties.

In October 1972, Dr. Davenport, through his attorney, indicated a desire to obtain complete ownership of the investment properties. He offered to pay appellant the following: \$50,000 in cash and a promissory note in the amount of \$200,000 less the total support payments he had made since the marriage dissolution. He also **offered** to assume sole liability for all the community debts, which equaled **\$9,955,506**. Appellant accepted this offer and executed a letter agreement on December 21, 1972. In this letter agreement, she relinquished all her interest in the investment properties and her right to any further support. Dr. Davenport delivered \$50,000 cash and his note for \$192,300 (\$200,000 less \$7,700, which represented support payments previously made).

Respondent determined that the December 1972 transaction was a taxable transfer of appellant's interest in the investment properties and calculated the amount appellant realized by adding the \$50,000 cash, the face amount of the note, and appellant's **one-half** share of the former community property **liabilities**. Respondent determined that the entire gain was **short-term** capital gain since the "partnership" interest was held less than one year. A notice of proposed assessment reflecting these **determinations** was issued. Respondent's denial of appellant's subsequent protest led to this appeal.

Respondent has agreed to make certain adjustments to the amount of tax initially assessed if its position on appeal is upheld. First, it has conceded that part of the amount received by appellant was in exchange for her relinquishment of the right to **receive** spousal support, and not taxable. **Respondent** has determined the present value of this right to be \$51,624, and has reduced the amount realized by that amount. Respondent has also agreed that it was an error **to include** in the amount realized the face value of the note received. Respondent has calculated the discounted value of the note to be \$182,221 and has included this sum, rather than the note's face value, in the amount realized. Finally, respondent has conceded that the holding period

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of a partnership interest is tacked to the holding period of the assets contributed to the partnership. Thus, regardless of whether the "partnership" is treated as a partnership for tax purposes or not, the character of the gain realized by appellant, if any, depends on the length of time appellant has held the individual investment properties.

Appellant disagrees with respondent's characterization of the **December 1972** transaction as a sale. She contends that the transfer of the investment properties was merely the final step necessary to effectuate a division of her and Dr. Davenport's community property. To support her conclusion, appellant asserts that at the time of the dissolution of her marriage, she and Dr. Davenport agreed to retain ownership of the investment properties as community property. She claims that none of the consideration she received from her former husband was payment for the investment properties; rather that the entire **amount was** a lump sum payment **in place** of periodic support payments, and, as such, was completely tax-free.

Initially, we note that the parties disagree as to whether the "partnership" created **between** appellant and Dr. Davenport by the agreement was a partnership for tax purposes. **However**, it is not necessary to reach this question since, in this appeal, the income tax consequences, if any, would be the same whether the "partnership" was treated as a **partnership** or whether, for tax purposes, appellant and Dr. Davenport were merely co-owners of the investment properties.

Appellant's claim that the investment properties remained community property until December 1972 is without merit. **It is** well established that in order for property to be community property, there must be a valid marriage, and that community property is converted to separate property by a judgment of **dissolution** of marriage. (See Wilkinson v. Wilkinson, 12 **Cal.App.3d** 1164 [91 **Cal.Rptr.** 372] (1970); Warburton v. Kieferle, 135 **Cal.App.2d** 278 [287 **P.2d** 1] (1955); **Civ. Code** §§ 5110, 4800.) The superior court awarded to appellant, as her sole and separate property, a **one-half interest** in the "partnership" which held the investment properties. This award was in accordance with the property settlement agreement which was incorporated into the court's decree of dissolution, and therefore effected a final judicial determination of appellant's property rights. (See **Civ. Code**, § 4800; Kelley v. Kelley, 73 **Cal.App.3d** 672 [141 **Cal.Rptr.** 33] (1977).)

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Appellant now claims that she and **her husband** did not intend the investment properties to be converted to separate property, and asserts that they agreed to retain ownership of the investment properties **as** community property. The only evidence presented to support this assertion is that the agreement refers to the investment properties as "community assets." We find this evidence insufficient in view of the contents of the agreement, the Superior Court's decree, and the settled principle that community property exists only when there is a marriage. We conclude that appellant and her husband intended to divide all of their community property at the time they executed the agreement, and that a division of their community property was completed when the court entered its interlocutory judgment of dissolution of marriage. Thus, the transfer of appellant's interest in the investment properties from appellant to Dr. Davenport was a transfer of her separate property and, to the extent she received consideration, was a taxable sale.

Appellant's claim that the cash and promissory note she received from her former husband were entirely in exchange for her right to support is also not supported by the evidence. The letter agreement appellant signed in December 1972 states that at such time as Dr. Davenport had paid the total amount of the promissory note, all of his obligations to appellant "for support and maintenance and for her interest in the community assets of the parties, will **have been paid.**" This letter agreement contains no indication that the consideration was given solely for the release of appellant's support rights. In fact, the language from the letter agreement quoted above leads to the opposite conclusion; that the payment was for appellant's interest in the investment properties as well as in exchange for her contingent right to support. **We** are also led to this conclusion by the fact that appellant's right to support as agreed to in the original property settlement agreement was worth substantially less than the amount Dr. Davenport agreed to pay in December 1972. The agreement gave appellant the contingent right to periodic support payments totaling a maximum of \$250,000. The value of this right as of December 1972 would be less than this maximum amount since the payments were to be made in monthly installments and would terminate under certain circumstances. Respondent calculated the discounted value of the support right as of December 1972 to be \$51,642. Dr. Davenport paid to appellant a total of **\$10,187,727** (\$50,000 cash, a note which **has** been valued

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by respondent at **\$182,221**, and the assumption of **appellant's liabilities** in the amount of **\$9,955,506**). Appellant has not questioned the value placed by respondent upon either the note or the marital **support right**. **Since** the value of the consideration given by **Dr. Davenport** was far in excess of the support right **relinquished** by appellant, we must conclude that the **payment was** not solely in exchange for appellant's relinquishment of this right.

Appellant has failed to show that the December **1972** transaction was an equal division of **community** property; she has also failed to prove that the consideration she received was entirely in exchange for her marital right of support. Therefore, we conclude that appellant's one-half interest in the investment properties was her separate property. She received **consideration** for the transfer of this separate property, and thus, a taxable sale occurred. Based on the foregoing, the action of **respondent, as** modified by its concessions, **must be** sustained.

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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, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the **Franchise** Tax Board on the protest of Elizabeth D. Davenport (Mayberry) against a proposed assessment of additional personal income tax in the amount of **\$97,305.00** for the year 1972, is hereby modified to reflect the concessions of respondent as described in the foregoing opinion. In all other respects, the action of the Franchise Tax Board is hereby sustained.

Done at Sacramento, California, this **31st** day of March , **1982**, by the State Board of Equalization, with Board **Members** Mr. Reilly, **Mr.** Dronenburg and Mr. Nevins present.

_____, Chairman
George R. Reilly _____, Member
Ernest J. Dronenburg, Jr. _____, Member
Richard Nevins _____, Member
_____, Member