



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

'In the Matter of the Appeal of,)
E. F. HUTTON CALIFORNIA COMPANY)

For Appellant: Jeffrey P. Hahn
Attorney at Law

For Respondent: James C. Stewart
Counsel

O P I N I O N .

This appeal is made pursuant to section **26075**, subdivision (a), of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of E. F. Hutton California Company for refund of franchise tax in the amount of **\$169,512** for the income year **1975**.

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The question presented for decision is whether appellant **has** established that reasonable cause existed for a late election under section 24307 of the Revenue and Taxation Code to exclude income realized on the repurchase of debentures.

In 1975, California Windsor Company, predecessor to appellant, reacquired a portion of its outstanding debentures at a discount. This repurchase resulted in income of **\$1,923,799** from discharge of indebtedness under Revenue and Taxation Code section 24271, subdivision **(a)(10)**. For the income year 1975, the federal and state tax returns of California Windsor Company were prepared by the accounting firm of Arthur Young & Company. The returns reported the income from the repurchase of the debentures as taxable income.

In 1978, California Windsor Company was acquired by the appellant; E. F. Hutton California Company. Appellant's accounting firm, Touche Ross & Co., determined that California Windsor Company would have **realized a** savings in state taxes for 1975 if it had elected to exclude the debenture income from gross income under sections 24307 and 24918 of the Revenue and Taxation Code. Sections **24307** and 24918 provide that a taxpayer may exclude from its income the amount of discharged indebtedness by filing a consent to a reduction in the basis of its assets. Appellant filed an amended return in which it elected to reduce the basis of California Windsor Company's assets by the amount of the debenture income and to exclude such amount from gross income. As a result of the amended return, respondent audited California Windsor Company and determined that it did not have reasonable cause for failure to make a timely election.

Appellant claims that California Windsor Company did not make the election to reduce basis *on* its '1975 return solely because Arthur Young & Company failed to advise it of the availability of the election. Appellant argues that if it had been so advised, it would have made the election because an election to reduce basis was the only reasonable course available to it for several reasons. First, except for 1975, the company has a history of losses from 1969 through 1979. The income generated by the debenture repurchase was accounting income. There was no real income which the company could use to pay the tax. Second, under the election, California Windsor Company would have reduced its basis in its stock in E. F. Hutton Life Insurance Company, which is the principal subsidiary of California Windsor Company and its successor.

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If this asset were sold, California Windsor Company would have no reason to exist. Thus, a reduction in basis was the only logical election because the tax would be postponed indefinitely. Appellant contends that California Windsor Company engaged a tax expert, advised the expert of all relevant information and relied upon it to prepare its return. If California Windsor Company had been properly advised of its options, the election to adjust basis would have been timely made. Therefore, appellant contends, reasonable cause exists for filing a late consent.

Section 24307 of the Revenue and Taxation Code states that the consent to adjust basis **must be** filed at such time and in such manner as prescribed by the Franchise Tax board by regulation. California Administrative Code, title 18, **regulation** 24307(b) provides:

In order to take advantage of the exclusion from gross income provided by Section 24307(a), a taxpayer must file with its return for the income year a consent to have the basis of its property adjusted in accordance with the regulations prescribed under Section 24918 which are in effect at the time of filing such return. See **Reg. 24918(a)** and 24918(b). In special cases, however, where the taxpayer establishes to the satisfaction of the Franchise Tax Board reasonable cause for failure to file the necessary consent with its original return, it may file the consent with an amended return or claim for credit or refund; and in such cases, the consent **shall be** to the regulations which, at the time of filing the consent, are applicable to the income year for which such consent is filed. In all cases the consent shall be made by or on behalf of the taxpayer on a form similar to Federal Form 982, in accordance with these regulations and the instructions on the form or issued therewith. (Emphasis added.)

The Legislature has indicated a clear intent to vest the Franchise Tax Board with broad discretion regarding the acceptance of late filed consents. In view of the legislative delegation of authority to prescribe regulations on filing consents under section 24307, the issue is narrowed to whether respondent abused its discretion by rejecting appellant's late consent. (Columbia Gas System, Inc. v. United States, 473 F.2d 1244, 1250-1251 (2d Cir. 1973).) By the terms of regulation 24307(b),

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appellant must establish to the satisfaction of the **Franchise** Tax Board that reasonable cause exists for **failure** to file a consent with the original return and also that this is a special case.

There are no California cases interpreting' regulation 24307(b). However, there are several cases interpreting substantially the same federal regulation. (Treas. Reg. **§ 1.108(a)-2**, T.D. 6928, 1967-2 Cum.Bull. 250, 251.) In both cases, the courts held that the Commissioner of Internal Revenue's refusal to accept delinquent consents was not an abuse of discretion.

In Columbia Gas Systems, Inc. v. United States, *supra*, the taxpayer claimed reasonable cause existed for **filing** a late consent because at the time it filed its original return, it was unaware of the possibility that it might be deemed to have realized income from the discharge of indebtedness **upon conversion** of its debentures. The court rejected this as reasonable cause because the taxpayer was "at all times fully aware of all of the material facts of the transaction." (473 F.2d at 1251.)

In William Magill, 70 T.C. 465 (1978), the taxpayers claimed that their consent was **filed** late because they were unaware of the election to adjust basis and the need to file a consent.- The taxpayers blamed their ignorance of the law on their own lack of **sophistication** in tax matters and the incompetence of their accountants. The court found that the taxpayers must have known that the indebtedness had been discharged. The court **held** that since the taxpayers were aware of the material facts, the commissioner did not **abuse** his discretion in rejecting the election.

The present case is not meaningfully **distinct** from Magill and Columbia Gas Systems, *supra*. These cases 'hold that ignorance of the **law does** not constitute reasonable cause for late filing of an election to adjust basis. It is undisputed that California Windsor **Company** was aware of the discharge of indebtedness and aware that such discharge of indebtedness resulted in taxable income. Since **California Windsor Company** was aware of the material facts, we cannot say that respondent has abused its discretion in rejecting appellant's late election.

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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 26077 of the Revenue and **Taxation** Code, that the action of the Franchise Tax Board in denying the claim of E. F. Hutton California Company for refund of franchise tax in the amount of \$169,572 for the income year 1975, be and the same is hereby sustained.

Done at Sacramento, California, this 26th day of October , 1983, by the State Board of Equalization, with Board Members Mr. Bennett, Mr. **Collis**, Mr. **Dronenburg**, Mr. Nevins and Mr. Harvey present.

William M. Bennett, Chairman

Conway H. Collis, Member

Ernest J. Dronenburg, Jr., Member

Richard Nevins, Member

Walter Harvey*, Member

*For Kenneth Cory, per Government Code section 7.9