



BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
CHARLOTTE LEWIS )

Appearances:

For Appellant: Robert C. Davis  
Certified Public Accountant

For Respondent: Bruce R. Langston  
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 Charlotte Lewis against proposed assessments of additional personal income tax in the amounts of \$8,996.47, \$1,197.14, \$449.06, and \$781.29 for the years 1973, 1974, 1975, and 1976, respectively,.

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The sole issue presented for decision is whether appellant has shown that respondent erroneously calculated her basis in her community property share of stock.

Appellant Charlotte Lewis and her husband Sidney Lewis owned 50 percent of the outstanding stock of Hollytex Carpet Mills (hereafter "**Hollytex**"). The other 50 percent of Hollytex was owned by Ralph Mishkin. Sidney Lewis died in 1971. Thereafter, Ralph Mishkin exercised his option to purchase Hollytex pursuant to a buy-sell agreement. In 1973, after substantial litigation, the parties entered into a new agreement which provided that appellant would transfer to Ralph Mishkin the 50-percent stock interest she and her deceased husband had owned as community property. The agreement also provided that both parties would release each other from all debts owed. The net effect of the mutual releases was a cancellation of \$69,955 which Mr. Mishkin owed appellant and her late husband. In return, Mr. Mishkin agreed to pay appellant \$1,025,000 over the next ten years.

On her 1973 tax return, appellant reported interest, but not the capital gain, from the sale of her **Hollytex** stock. She apparently considered her basis in her community property share of the stock to be equal to half of the total sale price. Respondent audited appellant's returns for tax years 1972 through 1977 and determined that the Hollytex stock owned by appellant and her late husband was community property. Respondent assigned a basis equal to the fair market value of the stock at the date of her husband's death to the one-half community property interest in Hollytex acquired by appellant from her deceased husband. (Rev. & Tax. Code, § 18044.) Respondent assigned a cost basis to appellant's one-half community property interest in the Hollytex stock. (Rev. & Tax. Code, § 18042;)

In order to determine the basis of appellant's one-half interest, respondent added the par value common stock and the paid-in capital in excess of par value to compute the cost basis of 100 percent of the stock. These figures were obtained from the balance sheet of Hollytex's 1969 federal income tax return. Appellant's one-half community property interest in 50 percent of the shares represented 25 percent of the company. Therefore, respondent determined an amount equal to 25 percent of the total common stock and paid-in capital to be appellant's cost basis. To this figure respondent added

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\$34,978. This amount represented appellant's basis in her community share of the \$69,955 owed to appellant and her late husband by Ralph **Mishkin.**<sup>1/</sup> Respondent added this component to appellant's basis for the stock because the shares were transferred and the indebtedness was released pursuant to the 1973 agreement. Thus respondent's calculation of appellant's cost basis was as follows:

Hollytex common stock:	\$ 37,500
Paid-in surplus in excess of par:	101,115
Net indebtedness:	34,978
	<u>\$173,593</u>

Appellant argues that her cost basis in the Hollytex stock is \$203,095, computed by adding the net indebtedness of \$34,978 to \$168,117, which is one-half of \$336,235. This latter figure was taken from a "Statement of Financial Condition" of Sidney and Charlotte Lewis, dated December 31, 1961. Among the assets listed is "Investment in Hollytex Carpet Mills" at "\$336,235." A disclaimer stating that the statement is "**Based on information** furnished by client and from books and records without audit" is printed at the bottom.

The question of a taxpayer's cost basis is an issue of fact. (Vaira v. Commissioner, 444 F.2d 770 (3d Cir. 1971).) The determination of the Franchise Tax Board is prima facie **correct**, and the taxpayer bears the burden of establishing a different cost basis. (Moore v. Commissioner, 425 F.2d 713 (9th Cir. 1970); Appeal of Frank Miratti, Inc., Cal. St. Bd. of Equal., July 23, 1953.)

Appellant has not sustained her burden of proof in this case. The parties agree that the basis of appellant's stock should be its cost, but we cannot determine from the financial statement submitted by appellant

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<sup>1/</sup> Initially respondent did not add appellant's deceased **husband's** one-half community property interest in the indebtedness to the basis of his one-half interest in the Hollytex stock. However, after receiving a revised probate inventory, respondent concedes on appeal that the correct basis for the property inherited from appellant's husband includes the decedent's additional basis of **one-half** of \$69,955, or \$34,978. Accordingly, respondent has determined that the assessment for 1973 should be decreased by **\$2,881.47** to **\$6,115.00**.

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whether the \$336,235 figure assigned to the Hollytex stock was its historical cost or present value in 1961. The bottom figure on the statement purports to give Mr. and Mrs. Lewis's net worth. This would indicate that the \$336,235 figure was present value. Further, the financial statement was prepared from unaudited records and information provided by the client. We cannot consider such evidence persuasive,

Appellant contends that a corporation's common stock and paid-in surplus accounts on its federal income tax returns do not **purport to** represent the shareholders' cost basis of stock. Therefore, appellant asserts that respondent has erred in choosing its method of calculation over the financial statement proffered by appellant, which ostensibly purports to represent cost basis.

While admittedly the method used by respondent does not conclusively establish appellant's cost basis, such a determination is not possible in this case where appellant has presented so little evidence of cost. In such a case, respondent could properly have made a determination that the basis was zero. (Jimmy Spurgeon, ¶ 77,326 P-H Memo, T.C. (1977); John Calderazzo, ¶ 75,001 P-H Memo. T.C. (1975).) We **also note** that on the Marital Property Declaration form completed by appellant for the estate of her husband, appellant indicated that their original investment in Hollytex was \$2,000. From this, respondent could have concluded that appellant's original cost basis was one-half that investment. Instead, respondent calculated a basis of \$173,593. In light of the limited evidence at its disposal, we believe that respondent's calculation is a reasonable determination of basis that is, in fact, very generous to appellant.

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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 Charlotte Lewis against proposed assessments of additional personal income tax in the amounts of **\$8,996.47, \$1,197.14**, \$449.06, and \$781.29 for the years 1973, 1974, 1975, and 1976, respectively, be and the same is hereby modified in accordance with respondent's concession regarding the assessment for 1973. In all other respects, the action of the Franchise Tax Board is **sustained**.

Done at Sacramento, California, this **12th** day of September, 1984, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Dronenburg, Mr. **Collis** and Mr. Bennett present.

Richard Nevins \_\_\_\_\_, Chairman  
Ernest J. Dronenburg, Jr. \_\_\_\_\_, Member  
Conway H. Collis \_\_\_\_\_, Member  
William M. Bennett \_\_\_\_\_, Member  
\_\_\_\_\_, Member