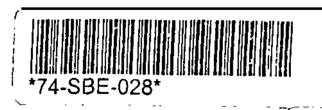

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE 'STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
JACOB AND GOLDIE BLANCK)

Appearances :

For Appellants: Robert R. Clamage
Public Accountant

For Respondent: Gary M. Jerrit
Counsel

OPI'NION

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 Jacob and Goldie Blanck against proposed assessments of additional personal income tax in the amounts of $791.25, $2,439.69 and $469.52 for the years 1967, 1968 and 19 69, respectively.

Appellants reside in Los Angeles. Their primary source. of income for the years in question was the rental of real property owned by them. Their joint personal income tax returns for the years

in question were audited and a notice of proposed assessment was issued on October 29, 1971. Respondent proposed numerous adjustments which form the basis of this appeal. These adjustments are discussed below:

1967

Appellants exchanged property located on Santa Rosalia Drive for property located on South Cloverdale Avenue in Los Angeles, and reported $3,989.65 as taxable income. The rationale behind their computation is unclear. Respondent recomputed the taxable income as $6,193.00. This computation recognized the gain to the extent of the lesser amount of the realized gain or the total of the cash received by appellants, plus the net reduction in appellants' outs tanding mortgage liability.

Appellants deducted 50 percent of their net oil royalty income on the basis that the income represented gain from the sale of a long-term capital asset. Respondent disallowed the deduction in view of the fact that there is no federal or California law which allows capital gain treatment for net oil royalty income.

1968

Among other sales of real property, appellants sold parcels located on South Crenshaw Boulevard, South Ridgeley Drive and South Cloverdale Avenue in Los Angeles. On their return, appellants treated these sales as installment sales and reported the gain on the installment basis. However,- respondent determined that appellants received over 30 percent of the sales price for each parcel during the year of sale. Therefore, respondent denied installment sales treatment for these transactions on the basis that section 17578 of the Revenue and Taxation Code limits installment sales treatment to sales in which the taxpayer receives no more than 30 percent of the selling price in the year of the sale.

Appellants exchanged property located on Western Avenue in Los Angeles for property located in Hesperia, realizing a loss of about $10,000 on the transaction. The appellants claimed the loss on their return. Respondent denied the claimed loss on the basis that section 18081, subdivision (a), of the Revenue and Taxation Code provides that no gain or loss shall be recognized where property held for productive use in the taxpayer's trade or business, or for investment

purposes, is exchanged for property of a like kind.

1969

Appellants sold a vacant lot located on Western Avenue. in Los Angeles which had been held as investment property for 16 months. The transaction resulted in a loss which appellants treated as an ordinary loss on their return. Respondent determined that appellants did not hold the property for sale to customers in the ordinary course of business and that the property was not associated with appellants' trade or business. Therefore, respondent concluded that the loss realized on the transaction was a capital loss rather than an ordinary loss and adjusted appellants' income accordingly.

Appellants owned all of the shares of Golden Park, Inc., a California corporation. During 1969, they received interest income payments of $2,172.03 from the corporation. None of this income was reported on appellants' 1969 return. Respondent included all of the interest income after appellants were unable to give any explanation for their failure to include these payments. However, respondent did allow, as a reduction to interest income, $1,675.67 in tax exempt interest from United States Treasury bills which appellants had mistakenly included in their income for 1969.

During the years in question respondent also disallowed part or all of the deductions claimed for legal expenses associated with the defense of appellants' son in a delinquency proceeding, automobile expenses which were unsubstantiated, and other unsubstantiated miscellaneous expenses.

Initially, appellants maintain that respondent's assessments for 1967 and 1968 are barred by the federal government's three-year statute of limitations. However, contrary to appellants' position, section 18586 of the California Revenue and Taxation Code provides that a notice of proposed deficiency assessment must be issued within four years after the return in question is filed. Since appellants' returns were filed on April 15, 1968, 1969 and 1970, respectively, and the proposed assessments were all issued on October 29, 1971, none of the assessments are barred by the statute of limitations.

Next, appellants maintain that respondent improperly computed the amount of recognized gain from the exchange of the Santa Rosalia Drive property for the Cloverdale Avenue property.

However, an examination of the record indicates that respondent properly computed the recognized gain in accordance with the rules set forth in section 18081 of the Revenue and Taxation Code. That is, gain was recognized only to the extent of the lesser amount of the realized gain, or the total of the cash received by appellants plus the net reduction in the outstanding mortgages for which appellants were liable. A computation which involves a similar transaction is contained in California Administrative Code, title 18, regulation 18081(d)-2.

Appellants also challenge respondent's disallowance of installment sales treatment to the gain recognized from the 1968 sales of three parcels of real property. Appellants contend that they did not receive over 30 percent of the selling price for each parcel during the year of sale and, thus, did not violate the requirements of section 17578 of the Revenue and Taxation Code authorizing installment sales treatment. That section prohibits installment sales treatment where, in the year of sale, the payments, exclusive of evidences of indebtedness of the purchaser, exceed 30 percent of the selling price. It is appellants' position that "selling price", for the purpose of section 17578, means selling price plus depreciation taken by the seller on the property sold.

Appellants' interpretation is not reconcilable with the statutes. The amount of gain resulting from a sale or other disposition of property, including an installment sale, is the excess of the amount realized from 'the sale or other disposition over the adjusted basis. (Rev. & Tax. Code, § 18031, subd. (a); see 2 Mertens, Law of Federal Income Taxation § 15.10, p. 33.) For the purpose of computing gain or loss, adjusted basis is cost less depreciation. (Rev. & Tax. Code, §§ 18041, 18042, and 18052.) Therefore, in determining whether the seller has received excessive payments in the year of sale, so as to preclude an election to treat the sale on the installment basis, depreciation must be deducted from the seller's basis rather than added to the sales price as maintained by appellants. The record indicates that when the payments received by appellants during the year of sale are so computed, they exceed the 30 percent limitation. Therefore, appellants were not entitled .to report the three sales in question on the installment basis.

Appellants have advanced other arguments with respect to certain other adjustments made by respondent which have been

given due consideration. However, after review of the record we have determined that such arguments are entirely without merit.

In line with the facts and conclusions set forth above we find that respondent's determination in this matter was proper and must be sustained.

ORDER

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 Jacob and Goldie Blanck against proposed assessments of additional personal income tax in the amounts of $791.25, $2,439.69 and $469.52 for the years 1967, 1968 and 1969, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 1st day of August, 1974, by the State Board of Equalization.

[signature], Chairman

[signature], Member

[signature], Member

____________________, Member

____________________, Member

ATTEST: [signature], Secretary