



Appeal of Edgar C.. and Barbara J.. Rutherford

The issue for determination is whether respondent properly computed the gain realized by appellants on the foreclosure of a loan secured by certain real property.

Prior to and during the year in question Edgar C. Rutherford (hereafter appellant) was engaged in the 'business of loaning money. 'In 1963 appellant loaned Virgil L. and Leora Buck \$140,000. Security for the 'loan was in the form of a note secured by a deed of trust on 2,300 acres of real property owned by the Bucks in Mendocino County., California. No principal or interest payments were due on the note until 1965, and in fact no payments were ever made. In 1967 the Bucks declared bankruptcy and on May 15, 1969, appellant purchased the Mendocino property for \$50,000 at the bankruptcy trustee's foreclosure sale..

Pursuant to -Revenue and Taxation Code section 1720 7, subdivisions (a) and (b), and respondent's regulation 1720 7 (f), subdivision (1) , appellants claimed a bad debt deduction on their 1969 personal income tax return in the amount of the debt which remained unsatisfied after appellant's purchase of the Mendocino property. 'This deduction in the amount of \$135,128 was derived by subtracting appellant's \$50,000 purchase price from \$185,128. ('The \$185,128 figure was comprised of the original \$140,000 loan plus additional advances made by appellant.) Respondent allowed the bad debt deduction, but proposed the deficiency assessment now before us on the ground that appellants failed to report the gain realized upon acquisition of the Mendocino property, as required by respondent's regulation 17207(f), subdivision (2).

Regulation 17207(f) provides.:

Sale of Mortgaged or Pledged Property.

(1) Deficiency Deductible as Bad Debt.

(A) Principal Amount. If mortgaged or pledged property is lawfully sold (whether to the creditor or another purchaser) for less than the amount of the debt, and the portion of the indebtedness remaining unsatisfied after the sale is wholly or partially uncollectible, the mortgagee or

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pledgee may deduct such amount under Section 17207(a) (to the extent that it constitutes capital or represents an item the income from which has been returned by him) as a bad debt for the taxable year in which it becomes wholly worthless or is charged off as partially worthless. See Reg. 17207(c).

(B) Accrued Interest. Accrued interest may **be included** as part of the deduction allowable under this paragraph, but only if it has previously been returned as income.

(2) Realization of Gain or Loss.

(A) Determination of Amount. If, in the case of a sale described in paragraph **(1)** of this regulation, the creditor buys in the mortgaged or pledged property, loss or gain is also realized, measured by the difference between the amount of those obligations of the debtor which are applied to the purchase or bid price of the property (to ~~the~~ extent that such obligations constitute capital or represent an item the income from which has been returned by the creditor) and the fair market value of the property.

(B) Fair Market Value Defined. The fair market value of the property for this purpose shall in the absence of clear and convincing proof to the contrary be presumed to be the amount for which it is bid in by the taxpayer.

(C) Basis of Property Purchased. If the creditor subsequently sells the property so acquired, the basis for determining gain or loss upon the subsequent sale is the fair market value of the property at the date of its acquisition by the creditor.

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Appellants rely on the presumption contained in regulation 17207(f), subdivision (2) (B), in asserting that the fair market value of the property upon acquisition was the bid price of \$50,000. They maintain that since fair market value equalled the "...amount of those obligations of the debtor which are applied to the purchase or bid price...", (reg. 17207(f), subd.(2) (A)), there was no gain. Respondent, on the other hand, maintains that the fair market value of the property upon acquisition was \$200,000 and therefore gain was realized to the extent of the difference between the \$50,000 bid price and fair market value. Support for respondent's fair market value figure was offered in the form of several independent appraisal reports made prior to appellant's acquisition of the property, and certain correspondence between appellant's attorney and prospective buyers of the Mendocino property. All of the appraisals and correspondence indicated the value of the property to be \$200,000 or more.

Section 1720'7 of the Revenue and Taxation Code and respondent's regulation 17207(f) were patterned after similar federal provisions (Int. 'Rev. Code, of 19'54, § 166; Treas. Reg. 1.166-6(a)). Past interpretations of the federal provisions are therefore relevant in interpreting California law. (See Meanley v. McColgan, 49 Cal. App. 2d 203 [121 P.2d 45] (1942).) In Community Bank, 62 T.C. 503 (1974), the United States Tax Court indicated that in the absence of clear and convincing proof to the contrary, the taxpayer's burden of proving fair market value is met upon proof of the 'bid price. Here, the bid price was undisputedly \$50,000. The question thus becomes whether respondent herein has offered clear and convincing proof to the contrary. In our view, respondent has offered such proof in the form of the aforementioned appraisal reports and correspondence. (See Clifford J. Heath, et al., T.C. Memo., June 3, 1971).

Since we have concluded that respondent overcame the presumption contained in regulation 17207(f), subdivision (2) (B), the burden of proving the erroneousess of respondent's fair market valuation and resulting deficiency assessment was upon appellants. (See

Community Bank, supra.) The record discloses only **appellants'** unsupported statements to the effect that the property as a whole was unsaleable and that no other bids were made on it. Such unsupported statements are insufficient to carry appellants' burden of proof, especially in light of the evidence offered by respondent. Under these circumstances, we have no alternative but to sustain respondent's determination of fair market value and the resulting deficiency assessment.

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

Done at Sacramento, California, this 3rd day of
February, 1977, by the State Board of Equalization.

ATTEST: W. N. Almond Executive Secretary