BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
CARL H., JR. AND MADONNA GROSS)

For Appellants: Robert J. Gentile
Certified Public Accountant

For Respondent: Bruce W. Walker
Chief Counsel

John A. Stilwell, Jr.
Counsel

O P I N I O N

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 Carl H., Jr. and Madonna Gross against proposed assessments of additional personal income tax and penalty for failure to file a timely return in the amounts of $543.57 and $330.65, respectively, for the year 1971; and pursuant to section 19058 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of Carl H., Jr. and Madonna Gross for refund of personal income tax in the amount of $1,004.00 for the year 1971.

The issues, for determination are:: (1) whether respondent's determination which was based on a corresponding federal determination was erroneous; (2) whether appellants correctly valued the notes which they received from the sale of real estate: and (3) whether respondent properly assessed a 25 percent penalty for failure to file a timely return.

In 1974 respondent received an audit report from the Internal Revenue Service disclosing two changes to the taxable income as reported on appellants' 1971 federal return. The changes involved: the partial disallowance, to the extent of $22,500, of a bad debt which appellants claimed as a $45,000 short-term capital loss; and the disallowance, in its entirety, of a $5,950 deduction for "away from home" business expenses.

Respondent was unable to locate a return from appellants for 1971, and, on January 10, 1975, requested appellants to file a return for 1971. On February 11, 1975, appellants filed a return showing a tax liability of $689, but remitted no payment. Appellants' state return claimed the same $45,000 bad debt deduction and $5,950 deduction for away from home business expense that had previously been disallowed by the Internal Revenue Service. On September 11, 1975, respondent issued a notice of proposed assessment adopting the federal adjustments and proposing the assessment of a penalty f'or delinquent filing and a penalty for failure to furnish information. Thereafter, appellants submitted a payment in the amount of $1,004. Apparently, this amount represented the self assessed tax liability reflected on appellants' delinquent return, the 25 percent late filing penalty and interest. However, the $1,004 payment bore no relationship to the amount of respondent's proposed assessment which appellants protested.

The basis for appellants' protest was that they had contested the federal adjustments and their, action was still pending before the United States Tax Court. Appellants' Tax Court petition was settled on April 8, 1976, by stipulation between the parties on the basis of no deficiency or overpayment. The schedule supporting the computation of ultimate tax liability disclosed that the bad debt issue was settled by allowing $40,000 of the $45,000 claimed,. and that no change was made with respect to the disallowance of the entire amount of away from home expenses. The reason for the determination that no deficiency or overpayment existed was the allowance of an investment credit which exactly offset the amount of additional tax resulting from the two adjustments.

Despite appellants' agreement with the adjustments in issue at the federal level, they contend that the federal action is not applicable for state purposes since they only

agreed to it because no additional liability resulted therefrom. However, appellants failed to produce any evidence supporting the alleged incorrectness of the final federal adjustments. Accordingly, respondent followed the federal action to the extent applicable under state law by: (1) revising its adjustment to the claimed bad debt deduction in accordance with the federal settlement, (2) affirming its disallowance of the away from home business expense deduction, (3) withdrawing the penalty for failure to furnish information requested, and (4) affirming its assessment of the 25 percent penalty for filing a delinquent return. With respect to the late-filing penalty, respondent now takes the position that the penalty assessment should be $135.89 instead of $330.65. Appellants filed a timely appeal from this action.

On April 15, 1976, during the course of the protest proceedings, appellants filed a claim for refund of the $1,004 previously paid, in the form of an amended return. Although the Tax Court's stipulated judgment was entered on April 8, 1976, prior to the filing of the amended return, appellants failed to take into account the final federal adjustments. In the amended return, appellants reduced the gain from the sale of certain apartments by $22,500 on the basis that the value of the notes received in the transaction was overstated by that amount in their original return. Although respondent requested supporting details for the reduction of the gain on the apartment sale, appellants' only response was that the value of the notes received from the buyer actually reflected a fair market value less than stated. Since respondent took no action on the claim for refund within six months after it was filed, it has been deemed denied pursuant to section 19058 of the Revenue and Taxation Code.

The first issue is whether respondent's action, based on a corresponding federal determination, was erroneous.

Section 18451 of the Revenue and Taxation Code Provides, in part, that a taxpayer shall either concede the accuracy of a federal determination or state wherein it is erroneous. It is well settled that a determination by the Franchise Tax Board based upon a federal determination is presumed to be correct and the burden.is on the taxpayer to overcome that presumption. (Todd v. McColgan, 89 Cal. App. 2d 509 [201 P.2d 414] (1949); Appeal of Robert J. and Evelyn A. Johnston, Cal. St. Bd. of Equal., April 22, 1975.)

Here, appellants- assert that they consented to the final federal determination simply because no federal tax was due, although they maintain that they had evidence to Prove

their entitlement to the deductions claimed. A taxpayer does not overcome the presumption that a federal determination is correct merely by alleging that the action was agreed to because it would result in no tax liability. (Cf. Appeal of Robert J. and Evelyn A. Johnston, supra.) Although appellants assert that they have evidence to support their position, none has been forthcoming despite requests to produce such substantiation. In the absence of any evidence tending to show that the federal determination was erroneous, respondent's action in this regard must be sustained.

The second issue concerns appellants' valuation of notes received from the sale of real estate. In this regard, section 18031 of the Revenue and Taxation Code provides, in part:

> (a) The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in Section 18041 for determining gain....
>
> (b) The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

The burden of proof is upon appellants to establish that the fair market value of the notes received was less than their face value. In the absence of persuasive evidence to the contrary, a secured, interest bearing, negotiable note, by a maker financially able to pay, is regarded as the equivalent of cash in the amount of its face value. (Walter I. Bones, 4 T.C. 415 (1944); Appeal of Roe C. and Rhoda M. Hawkins, Cal. St. Bd. of Equal., Jan. 10, 1963.)

Appellants' only attempt to substantiate their position was their unsupported statement that they actually received $22,500 less than the face value of the notes, and that the fair market value of the notes at the time of receipt was, therefore, $22,500 less than their face value. Appellants have not provided any evidence that at the time they received the notes in exchange for their real property there was any reason to believe that the full face value of the notes would not be paid. Their asserted failure to obtain the full face Value Of the notes does not establish that the fair market value of the notes was less than their face value in the year of receipt. In the absence of any substantiation, the value of the notes must be regarded as equivalent to the face amount of such notes.

If, at a time subsequent to the date of sale, appellants receive less than the face value of the notes, the loss sustained must be reported in the year in which the final payment on each such note was received. (Arrowsmith v. Commissioner, 344 U.S. 6 [97 L.Ed. 6] (1952).) Therefore, in light of appellants' failure to establish that the fair market value of the notes was less than their face value at the time of receipt, appellants could deduct a loss on the notes in the appeal year only if the final payment on such notes was received in 1971. Since appellants have not established that fact, this avenue is also closed to them. Consequently, appellants' claim for refund, which was based on the reduction in the gross sales price and the gain realized on the sale of real property, was properly denied.

The last issue concerns the application of the late filing penalty. Appellants' 1971 tax return was due April 15, 1972. Since they did not file their return until February 11, 1975, and gave no explanation for the late filing, the 25 percent penalty mandated by section 18681 of the Revenue and Taxation Code was properly applied. (Appeal of Clyde L. and Josephine Chadwick, Cal. St. Bd. of Equal., Feb. 15, 1972.)

For the above reasons, respondent's action in this matter, as modified concerning the penalty amount, must be sustained. Of course, to the extent applicable, the $1,004 paid by appellants shall be applied against their liability.

Appeal of Carl H., Jr. and Madonna Gross

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 Carl H., Jr. and Madonna Gross against proposed assessments of additiohal personal income tax and penalty for failure to file a timely return in the amounts of $543.57 and $330.65, respectively, for the year 1971, be and the same is hereby modified in accordance with respondent's concession; and pursuant to section 19060 of the Revenue and Taxation Code that the action of the Franchise Tax Board in denying the claim of Carl H., Jr. and Madonna Gross for refund of personal income tax in the amount of $1,004.00 for the year 1971, be and the same is hereby sustained.

Done at Sacramento, California, this 16th day of August, 1979, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member