BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of	)	
	)	No. 83A-988-GO
JOHN H. AND MARIE E. NORTON	)	

For Appellants: Allen M. Nelson

For Respondent: Donald C. McKenzie
Counsel

O P I N I O N

This appeal is made pursuant to section 18593[1/] of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of John H. and Marie E. Norton against a proposed assessment of additional personal income tax in the amount of $1,316.29 for the year 1977.

1/ Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the year in issue.

The central issue presented is whether respondent properly revised appellants' income for 1977 to reflect its conclusion that all partnership obligations of a limited partnership, of which appellants owned an interest, were discharged in 1977.[2/]

In 1974, appellants invested $5,000 in cash for a 6.51 percent interest in Mineral Investment Diversification Company (hereinafter "MIDCO"), a limited partnership organized on December 10, 1974, to invest in three mineral investment companies which, in turn, engaged in funding the operations of three exploratory limited partnerships which were to engage "in exploring, testing, and conducting feasibility studies on three specific placer gold mining properties in the vicinity of Auburn, CA." (Resp. Ex. A.) Interviews with Warren Hofstar, the general partner of MIDCO, by respondent's auditors, indicated that in 1974 and 1976, MIDCO entered into certain contracts with these other partnerships which obligated it to pay to them a total of $258,000, $76,000 of which was apparently in cash with the remaining $182,000 financed through contracts. (Resp. Br. at 1 and 2.) Appellants included the ratable share of the $182,000 debt (i.e., 6.51 percent, or $11,848) in their partnership basis for MIDCO for a total basis of $16,848 (i.e., $11,848 plus cash investment of $5,000). On their 1974 personal income tax return, appellants deducted $15,262 in MIDCO partnership losses and on their 1976 personal income tax return they deducted an additional $1,953 for such losses.

On audit, respondent concluded that all partnership activities ceased in 1977. Respondent stated that "[n]o more payments were made on the contracts and it appears that all contracts and obligations were abandoned." (Resp. Br. at 2.) Based on this conclusion, respondent determined that appellants recaptured their 6.51 percent share of the debt in 1977 "because the debt was extinguished on which appellants had previously taken

2/ In its June 11, 1980, letter in reply to appellants' protest, respondent stated that "[a]n alternative proposed assessment [was] also being issued for the earlier year" on alternative theories. That year and those theories are not before us in this appeal, and, accordingly, no further discussion of those subjects is warranted here.

deductions." (Resp. Br. at 2.)[3/] Accordingly, respondent increased appellants' ordinary income by their partnership share of the extinguished indebtedness. Denial of appellants' protest led to this appeal.

On appeal, respondent framed the issue as whether appellants had "shown that they did not realize income on the extinguishment of a debt for which they had previously taken deductions." (Resp. Br. at 1.) In answer, appellants admitted that "if it can be shown that a debt of the partnership has been discharged . . ., [such] discharge . . ., [could] flow through as income" to the limited partners. (App. Br. at 4.) Indeed, it is well settled that the forgiveness in any manner, outside of limited exceptions not at issue here, constitutes taxable income to the debtor. (Rev. & Tax. Code, § 17071, subd. (a)(12); Rev. & Tax. Code, § 17142.)

However, appellants contend that there was, in fact, no such discharge of the partnership obligations. Appellants state that they have no evidence that MIDCO "wound up its affairs in 1977 other than [MIDCO's] stated intent in the partnership agreement to wind . . . up [its affairs] on or shortly after January 1, 1977." Moreover, they state that they have "no information that there was forgiveness of any note." (App. Br. at 2.) Appellants conclude that they "cannot provide evidence of a negative fact. . . ." (App. Br. at 3.)

The underlying or implicit problem in this appeal is the consequences of the apparent termination of a "burned out" tax shelter. "This situation [may arise] after the loss deductions anticipated from the tax shelter have been realized and the investor is faced with the prospect of realizing substantial taxable income . . . from the disposition or termination of the investment." (Kurtz, Commissioner's Remarks On Abusive Tax Shelter Issues, 55 Taxes 774, 778 (1977); see also, Ginsburg, The Leaky Tax Shelter, 53 Taxes 719 (1975).) These situations can create substantial compliance problems when taxpayers simply "forget" about the termination of the tax shelter. While the "tax aspects of the disposition or termination of tax shelter ventures can be quite complex, there is relatively little in the way of

3/ Respondent also denied a deduction for state disability insurance. However, appellants have not protested this action and apparently have conceded the correctness of this action.

litigation with respect to this area." (Ginstling, "Getting Out of Tax Shelters," 38 N.Y.U. Institute on Federal Taxation 33, 33-5 (1980).) As indicated above, in the instant appeal, respondent has sought to reduce such complexity by framing the issue in terms of whether appellants have satisfied their burden of proving its determination to be in error.

It is, of course, well established that respondent's determinations are presumed to be correct and that it is the taxpayer's burden to prove any error. (Appeal of Ambrose L. and Alice M. Gordos, Cal. St. Bd. of Equal., March 31, 1982.) However, the presumption is a rebuttable one and will only support a finding in the absence of sufficient evidence to the contrary. (Caratan v. Commissioner, 442 F.2d 606 (9th Cir. 1971); Robert Louis Stevenson Apartments, Inc. v. Commissioner, 337 F.2d 681 (8th Cir. 1964); Cohen v. Commissioner, 266 F.2d 5, 11 (9th Cir. 1959); Wiget v. Becker, 84 F.2d 706, 707 (8th Cir. 1936).) Moreover, the law imposes much less of a burden upon a taxpayer who is called upon to prove a negative--that he did not receive the income which the taxing agency claims--than it imposes upon a taxpayer who is attempting to sustain a deduction. (Levine v. Commissioner, 31 T.C. 1121, 1124 (1959); Beers v. Commissioner, 34 B.T.A. 754, 758 (1936); Appeal of Janice Rule, Cal. St. Bd. of Equal., Oct. 6, 1976.) Respondent's determinations cannot, however, be successfully rebutted when the taxpayer fails to present credible, competent, and relevant evidence as to the issues in dispute. (Appeals of George H. and Sky G. Williams, et al., Cal. St. Bd. of Equal., Jan. 5, 1982.)

In the instant appeal, appellants, arguing that they "cannot provide evidence of a negative fact," have failed to produce any documentation concerning the status of the partnership's obligations in the year at issue. It seems to us that evidence such as book entries concerning the status of the subject obligations obtainable from MIDCO's general partner or from the mineral investment companies or the exploratory limited partnerships may have constituted the type of tangible evidence needed to support their assertions. (See discussion in Appeal of Oscar D. and Agatha E. Seltzer, Cal. St. Bd. of Equal., Nov. 18, 1980.) Moreover, as we stated in Seltzer, we cannot overlook the fact that appellants were not persons who were ignorant of the methods of business and law. On the contrary, the record reveals that appellants were sophisticated investors who had had significant "business and financial experience." (Statement of

Suitability and Intent, December 30, 1974.) Their failure to produce any such evidence bears heavily against them. Under these circumstances, we must accept as correct respondent's determination.

Appeal of John H. and Marie E. Norton

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 John H. and Marie E. Norton against a proposed assessment of additional personal income tax in the amount of $1,316.29 for the year 1977, be and the same is hereby sustained.

Done at Sacramento, California, this 4th day of February, 1986, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Collis, Mr. Bennett, Mr. Dronenburg and Mr. Harvey present.

Richard Nevins, Chairman

Conway H. Collis, Member

William M. Bennett, Member

Ernest J. Dronenburg, Jr., Member

Walter Havey*, Member

*For Kenneth Cory, per Government Code section 7.9