

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
JACX AND LIAN N. WYBENGA) No. 84A-705-GO

For Appellants: Jack Wybenga,
in pro. per.

For Respondent: Eric J. Coffill
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 Jack and Lian N. Wybenga against a proposed assessment of additional personal income tax in the amount of \$2,957.42 for the year 1975.

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

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The issue presented for decision is whether appellants' are entitled to a deduction **for** losses of a limited partnership known as **Beefalo** Breeding Associates in an amount in excess of the \$13,000 allowed by respondent for the year at issue.

On December 4, 1975, Jack Wybenga (hereinafter "appellant") executed a power-of-attorney form which appointed **R. K. Mandell** as Attorney in Fact for him with the power to enter into certain enumerated transactions for his benefit. Thereafter, on or about December 12, 1975, **Mandell**, acting with such authority, entered into a limited partnership agreement with Beefalo Breeding Associates (hereinafter "**Beefalo**" or "**the partnership**") on behalf of appellant.

Beefalo's limited partnership agreement provided, in part, that its business was to "**engage in, conduct and carry on the business of animal husbandry with the primary purpose of producing grass-fed animals and to purchase, acquire, produce, breed and crossbreed cattle, beefalo and other forms of livestock. . . .**" (See Limited Partnership Agreement For Beefalo **Breeding Associates** (hereinafter "Agreement") at 2, attached to appellants' April 30, 1984, protest letter.) That same Agreement provided that each limited partner was to contribute \$29,000 for each partnership unit with \$13,000 to be contributed in cash upon the execution of the subscription Agreement and with the remaining \$16,000 to be represented by a negotiable promissory note payable, without interest, on June 1, 1976. (Agreement at 6.) The partnership indicated that it intended to raise **\$1,015,000** from the subscription of such units. (Agreement at 5.)

In accordance with such subscription Agreement, on or about December 16, 1975, on behalf of appellant, **Mandell** paid Deefalo \$13,000 in cash and executed a promissory note of \$16,000 for the benefit of Beefalo, payable on June 1, 1976. The Agreement provided that should a **subscriber default in** the payment of such note, the interest of such person in the partnership would cease as of the day of default and said interest, including the initial cash payment of \$13,000 would inure to the benefit of the partnership and its remaining partners. (Agreement at 6.)

The schedule K-1, entitled "Partner's Share of Income, Credits, Deductions, etc.", attached to appellants' 1975 personal income tax return indicated that

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their distributive share of **Beefalo's** losses in 1975 amounted to \$38,018 plus \$1,864 in additional first-year depreciation, or a total of \$39,882 distributive loss. Accordingly, appellants claimed a partnership loss of \$39,882 arising from their interest in Beefalo for 1975. Upon audit, respondent disallowed all of such partnership loss in excess of \$13,000 on the ground that appellants had not substantiated their partnership basis in Beefalo in 1975 over and beyond their \$13,000 cash investment. (Resp. **Ex. A.**)

On appeal, appellant **argues** that the \$16,000 note referred to above and his ratable share of a **nonre-**course note allegedly executed by Beefalo in 1975 of which his share was \$49,760 should be added to his basis in Beefalo for 1975. Respondent counters that, in 1975 when the \$16,000 promissory note was contributed to Beefalo, the basis of such note to appellant was zero so that its value could not be added to appellant's partnership basis in Beefalo at that time. (Resp. Br. at 8.) Moreover, respondent contends that appellant has failed to establish that the fair market value of the property securing the partnership debt reflected by his claim to a \$49,760 increase in his 1975 Beefalo basis reasonably approximated the principal amount of the debt as is required. (Resp. Br. at 11.) With respect to such \$49,760 increase, by letter dated November 13, 1985, appellant answered that an Internal Revenue Service audit, as evidenced by a document attached to that letter denoted as examination changes, indicates that he could support **\$19,427.19** of the claimed \$49,760 increase. Notwithstanding this document, respondent argues that the changes reflected are for the years 1976 through 1978 and **not** 1975, the **year at issue** here, which makes it impossible to determine whether the property referred to is the same property at issue for 1975 or that appellant's extrapolation from that document to 1975 has been substantiated. (Resp. Ltr., Dec. 17, 1985.)

It is beyond dispute that a partner's allocable share of partnership losses is limited to the extent of the basis of his interest in the partnership. (Rev. & Tax. Code, § 17858.) Accordingly, the determinative factual inquiry here is what was appellant's basis in Beefalo in 1975.

Where a partnership is acquired by a contribution of property **to the** partnership, the contributor's basis in the acquired interest is determined by reference to the adjusted basis of the property so contributed.

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(Rev. & Tax. Code; § 17882.) **Section** 17882 is substantially similar to Internal Revenue Code section 722. Revenue Ruling **80-235** (1980-2 C.B. 229, 330) states that the contribution of a partner's personal, written obligation "does not increase the basis of the partner's interest under section 722 of the Code because the partner has a zero basis in the written obligation." Instead, the ruling continues, payments on such written obligation are added to the partner's basis in the partnership as the payments are actually made. Moreover, the tax court has affirmed that position. In Oden v. Commissioner, ¶ **81,184** T.C.M. (P-H) (1981) at **598**, the court declared that where a taxpayer "incurred no cost in making the note, its basis to him was zero." Accordingly, pursuant to the mandate of Internal Revenue Code section 722, a taxpayer "is not entitled to increase his partnership basis by the face amount of the allegedly transferred note." (Oden v. Commissioner, supra at 598.) In the instant **matter**, appellant has not shown that any payments on the \$16,000 note were made in 1975. Accordingly, appellant is not entitled to increase his partnership basis by the face amount of such note nor deduct any partnership losses allocated to such note.

In addition to contributions made at the time of acquisition, "[a]ny increase in a partner's share of the liabilities of a partnership . . . [is] considered as a contribution of money by such partner to the partnership." (Rev. & Tax. Code, § 17915, subd. (a).) Thus, for the year at issue, a limited partner's basis in the partnership property includes his allocable share of the nonrecourse debts of the partnership. However, both parties agree that inclusion of such debts in a partner's basis is allowed "only so long as the fair market value of the property **securing** the debt reasonably approximates the principal amount of the debt." (Brannen v. Commissioner, 722 F.2d 695, 701 (11th Cir. **1984**).)^{2/} As

^{2/} As respondent acknowledges on page 13 of its brief, some uncertainty exists with respect to the precise standard. In Flowers v. Commissioner, 80 T.C. 914, 942, fn. 42 (**1983**), the tax court noted that in some opinions the test used was whether the stated purchase price unreasonably exceeds the fair market value of the property while in other opinions the test used was whether the principal amount of the nonrecourse **indebtedness** unreasonably exceeds the fair market value of the property. Neither the tax court in Flowers nor the Court of Appeals in Brannen expressly decided which test should

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indicated above, appellant also has argued that his basis in Beefalo for the year at issue should be increased by his ratable share (i.e., \$49,760) of a nonrecourse note allegedly executed by Beefalo in 1975. However, by letter dated November 13, 1985, appellant modified such claim by alleging that he could substantiate only **\$19,427.19** of the fair market value of the property securing the alleged debt rather than \$49,760 as initially claimed. The sole basis for such modified claim is an Internal Revenue Service document reflecting an audit of Beefalo for the years 1976, 1977 and 1978, which states that the Internal Revenue Service disallowed \$713,500 of the **\$1,100,000** claimed as depreciation of fixed depreciable assets, allowing some \$386,500 for those years. Appellant then assumes that 10 percent depreciation was taken in 1975 so that the fair market value of the fixed depreciable assets equaled **\$429,444.00** in 1975 and that his ratable share of such assets amounted to **\$19,427.19** at this time. Appellant concludes that this document and his assumption adequately substantiated the fair market value of the property securing the alleged nonrecourse debt.

Respondent, of course, counters that this document prepared for 1976, 1977, and 1978, does not clearly relate to the year before us and that, accordingly, appellant has not adequately met his burden of proving respondent's determination to be in error. (Appeal of Estate of William H. Russell and Lorraine Russell, Cal. St. Bd. of Equal., Apr. 6, 1978.) On the basis of the record before us, we must agree with respondent. Foremost in our review of this document is the fact that the total amount of the corrected value of fixed depreciable assets of \$386,500 reflected therein and even the amount projected by appellant of \$429,444 for 1975 is more than adequately covered by the basis reflected by the total initial cash contributed in 1975 and payments actually made in 1976 of some \$638,000. Accordingly, the Internal Revenue Service document does not, in and of itself, substantiate any increased amount in **the** partner's shares of liabilities allegedly incurred by Beefalo, but may only reflect the initial capitalization already accounted for. While Beefalo may have incurred other indebtedness and other losses, the subject document does not establish whether Beefalo incurred the subject nonrecourse debt

2/ (Continued)

apply. In light of our review of the Internal Revenue Service document noted below, no reason exists to determine which test is correct in the instant appeal.

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and, - if it did, whether the Brannen test had been met. On this basis, we must conclude that appellant has not met his burden of proving respondent's determination to be erroneous.

For the reasons cited above, respondent's determination must be sustained.

