BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
)
ROCCO M. MATTEUCCI and)
JOSEPHINE. M. MATTEUCCI)

Appearances:

For Appellants: Louis Ferrari, Jr., Attorney at Law

For Respondent: Burl D. Lack, Chief Counsel
F. Edward Caine, Associate Counsel

O P I N I O N

These appeals are made pursuant to Section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Rocco M. Matteucci and Josephine M. Matteucci, husband and wife, to proposed assessments of additional personal income tax against each of them in the amount of $621.52 for the year 1945. Certain of the adjustments in the proposed assessments have been paid and are not Questioned here, although they are included in the amount of the proposed deficiency assessments.

Rocco M. Matteucci, hereinafter referred to as Appellant, has been for many years a stockholder of Transamerica Corporation and of Bank of America National Trust and Savings Association. Since 1925 he has made substantial purchases of shares of stock directly from those corporations by giving his notes for the purchase price, secured by pledges of the securities. For the period from January 1, 1940, to November 30, 1945, Appellant was obligated to pay, and had been paying, interest on the notes due the two corporations at the rate of 4½% per annum. Dividends on stock pledged as security for the loans were paid directly to the corporation and applied against interest on the indebtedness. As of November 30, 1945, the principal of the indebtedness amounted to approximately $333,000. All or substantially all of the interest due on the notes had been paid up to that date.

Sometime prior to November 30, 1945, Transamerica Corporation, the principal pledgee, offered to reduce the interest rate on the notes for the period from January 1, 1940, to November 30, 1945, to 2%, and to credit Appellant's account with the difference between the interest computed at that rate and the amount actually

paid by him, if Appellant would sell sufficient collateral to pay off the notes. Appellant accepted the proposal and directed that collateral be sold in an amount which, with the credit due to recomputation of the interest, would be sufficient to liquidate the notes. As a result of the recomputation of the interest rate, the amount of $26,436.92 was credited on November 27, 1945, to Appellant's loan account. The remaining balance due on the notes was liquidated as of November 30, 1945, and the remaining collateral consisting of 3,318 shares of Transamerica Corporation stock and 71 shares of Bancamerica-Blair Corporation stock, was returned to Appellant.

During the years 1941 to 1944, inclusive, Appellant filed personal income tax returns on the accrual basis, including in his income, among other items, dividends paid on stock held by Transamerica and Bank of America as collateral on his indebtedness. He claimed as deductions for those years the amount of interest accrued on these loans at the rate of 4½% per annum. Because of offsetting losses, deductions and personal exemptions during the years 1941 to 1943, inclusive, Appellant did not receive any tax benefit from the interest deduction for those years. For the year 1944 he received a tax benefit in the amount of $3,978.51.

It is the position of the Franchise Tax Board that pursuant to Section 17191 of the Revenue and Taxation Code the amount of $26,436.92 credited against the notes constituted community income to Appellant and his wife, Since Appellant and his wife filed separate returns for the year 1945, the Franchise Tax Board has included one-half of this amount in the income of each. Appellant contends that the cancellation of $26,436.92 of the indebtedness by the corporations was a gift and not taxable as income., His sole support for this contention is Helvering v. American Dental Company, 318 U.S. 322. Appellant aiso alleges that the interest paid on the notes was never accrued nor taken as a deduction from income. He contends that only if it had been so accrued and deducted could the forgiveness of the interest be considered income Although it appears that Appellant did claim as deductions the interest accrued on the loans and that he received a tax benefit of $3,978.51 from the interest deduction for the year 1944, for the reasons hereinafter stated, we do not consider these facts as material to the determination of this appeal.

During the period in question Section 17191 of the Revenue and Taxation Code provided as follows:

> "If the indebtedness of a taxpayer is canceled or forgiven in whole or in part without payment, the amount so cnaceled or forgiven constitutes income to the extent the value of the property of the taxpayer exceeds his liabilities immediately after the cancellation or forgiveness. The remainder of the

> amount of indebtedness so canceled or forgiaen, if any, shall be applied in reduction of the basis of the assets to the extent the basis thereof exceeds the value thereof immediately after the cancellation or forgiveness. The reduction shall be made in accordance with regulations prescribed by the commissioner."

Section 17191 of the Code as it then read was identical to Section 6(d) of the Bank and Corporation Franchise Tax Act which was construed in Edward McRoskey Mattress Company v. Franchise Tax Board, 97 Cal. App. 2d 478. All of the contentions of Appellant are, we believe, answered by that decision.

As respects the ouestion of forgiveness versus gift, the McRoskey opinion states:

> "The words 'without payment' as used in Section 6(d) serve no purpose other than to emphasize the idea that cancellation or forgiveness, to result in a taxable gain, must be gratuitous - a gain for which no direct consideration passed from the taxpayer. Certainly there could be no forgiveness with payment." 97 Cal. App. 2d 478, 481.

Similarly, under the McRoskey case, no weight can be accorded Appellant's contention that the operation of Section 17191 of the Code is contingent upon the taxpayer having received a tax benefit from the indebtedness, as the Court stated:

> "The statute is plain. Whenever the indebtedness of a bank or corporation is canceled or forgiven by the creditor without payment, the amount so canceled or forgiven constitutes a taxable gain ... There are no exceptions. Whenever and however the event occurs, liability for the tax arises."

Since Section 17191 of the Revenue and Taxation Code had no counterpart in the Internal Revenue Code. we do not regard the decision in Helvering v. American Dental-Company, supra, as applicable to the transaction in ouestion in this appeal. We are of the opinion, accordingly, that we must uphold the action of the Franchise Tax Board in treating the transaction as a cancellation or forgiveness of indebtedness resulting in income to Appellant and his wife, no auestion having been raised as to their solvency before or after the transaction.

Appeal of Rocco M. Matteucci and Josephine M. Matteucci.

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 protests of Rocco M. Matteucci and Josephine M. Matteucci to proposed assessments of additional personal income tax against each of them in the amount of $621.52 for the year 1945 be and the same is hereby sustained.

Done at Sacramento, California, this 8th day of October, 1954, by the State Board of Equalization.

Geo. R. Reilly, Chairman

Robert C. Kirkwood, Member

Paul R. Leake, Member

J. H. Quinn, Member

Wm. G. Bonelli, Member

ATTEST: Dixwell L. Pierce, Secretary