BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
MARY FRANCES SAYER)

Appearances:

For Appellant: Dan A. Emmett
Attorney at Law

For Respondent: Joseph W. Kegler
Supervising Counsel

O P I N I O N

These appeals are made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the protests of Mary Frances Sayer against proposed assessments of additional personal income tax in the amounts of $6,939.27 and $350.00 for the year 1961.

The issue presented is whether a $105,000 payment made to appellant by her late husband's employer was a gift to her or taxable income.

At the time of his death on September 19, 1960, appellant's husband John N. Sayer was employed as the head of the appraisal department of the Los Angeles office of Coldwell, Banker & Company (hereinafter referred to as "Coldwell"), a partnership engaged in the real estate brokerage business and related activities. Mr. Sayer did not receive a salary for his services but rather received a portion of the appraisal fees and sales commissions earned by Coldwell from transactions in which Mr. Sayer played a part. From 1958 to the time of his death, Mr. Sayer's gross compensation from Coldwell was in the neighborhood of $40,000 to $50,000 per year.

On December 28,1961, Coldwell paid $105,000 to appellant in her individual capacity. At the time she received this payment, appellant executed a "Release and Agreement" which released Coldwell from any and all claims arising out of the relationships between Coldwell and Mr. Sayer and between Coldwell and appellant. This agreement further provided that appellant would hold Coldwell harmless from any governmental assessments which might arise from Coldwell's failure to withhold any portion of the payment. To secure this obligation appellant placed $10,000 in the hands of a pledgeholder for a lo-year period.

Appellant did not report the $105,000 as income in her 1961 return. In its 1961 return, Coldwell treated this payment as additional compensation to Mr. Sayer and claimed a business expense deduction of $105,000. Initially,, respondent determined that the $105,000 was taxable income to appellant except for $5,000 excludible as a death benefit under Revenue and Taxation Code section 17132. An assessment was issued accordingly. After the protest hearing and as a result of information obtained from Coldwell respondent issued another assessment which disallowed'the $5,000 death benefit exclusion on the grounds that the $105,000 was income in respect of a decedent so that section 17132 was inapplicable. Appellant has appealed both assessments, contending that the payment was a gift which was properly excluded from her income by virtue of Revenue and Taxation Code section 17136, subsection..(a).. In view of our resolution of this issue in favor of appellant, we need not reach the further question of the applicability of the $5,000 death benefit exclusion.

Revenue and Taxation Code section 17136 provides, in part:

> (a) Gross income does not include the value of property acquired by gift,...

Since this. statute is based on and is substantially identical to section 10.2 of the Internal Revenue Code of 1954, judicial decisions interpreting the federal statute. are highly persuasive on the proper construction of the state law. (Rihn v. Franchise Tax Board, 131 Cal. App. 2d 356, 360 [280 P.2d 893]; Appeal of Paul Greening Trust, Jack W. and Robert Greening, Co-Trustees, Cal. St. Bd. of Equal ., Dec. 7, 1970.) The landmark case in the gift area is Commissioner v. Duberstein, 363 U.S. 278 [4 L. Ed. 2d 1218]. In that case the U.S. Supreme Court said that a gift in the statutory sense "proceeds from a 'detached and disinterested generosity',... 'out of affection, respect, admiration, charity or like impulses.'" (363 U.S. at 255.) The key factor is the transferor's intention; consequently, the proper object of inquiry is "the dominant reason that explains his action in making the transfer." (363 U.S. 286.) This question is principally one of fact to be determined on a case-by-case basis. (363 U.S. at 290.)

Prior to Duberstein the U.S. Tax Court looked primarily to five factors which, if present, were sufficient to result in the transfer being classified as a gift. Those five factors were: (1) the payment had been made to the wife of the deceased employee and not to his estate; (2) there was no obligation on the part of the employer to pay any additional compensation to the deceased employee; (3) the employer derived no benefit from the payment; (4) the wife of the deceased employee performed no services for the employer; and (5) the services of her husband had been fully compensated. (Estate of Arthur W. Hellstrom, 24 T. C. 916; Florence S. Luntz, 29 T. C. 647.) Subsequent to Duberstein, and as a result of the Court's mandate in that case, 1/ the scope of the inquiry has broadened to include consideration of all relevant factors in each case. Some of these additional factors are the existence of a practice or plan of making payments to the widows of employees, the employer's ignorance of or failure to investigate the financial circumstances of the widow, and the fact that the employer claimed a business expense deduction for the payment. (See Gaugler v. United States, 312 F.2d 681.)

The search for Coldwell's "dominant motive" for paying appellant $105,000 begins against a background of rather tragic circumstances. At the time of her husband's sudden and unexpected death, appellant had recently lost her father under similar circumstances and had herself been hospitalized with cancer. It is difficult to imagine a situation more likely to produce feelings of sympathy, charity, benevolence and the like among appellant's friends and acquaintances, and we think it is undisputed that these feelings were present to some extent among the Coldwell partners. The dispute is over the effect those feelings

1/ "Decision of the issue presented in these cases must be based ultimately on the application of the fact-finding tribunal's experience with the mainsprings of human conduct to the totality of the facts of each case." (363 U.S. at 289.)

may have had on the partner determination to make the payment to appellant.'

On this crucial issue of' the motivation for. the payment, we do not have the best evidence which could have been produced,; namely, the testimony of the six Coldwell partners who made the decision to pay the money. Respondent chose to rely almost exclusively on a letter written by one of those partners in 1966 in answer to respondent's request for information concerning the payment. This' letter tends to show that the $105,000 was compensation for services performed by Mr. Sayer in connection with a large sales. transaction completed after his death. In view of this letter indicating that Coldwell's position would be adverse to her gift theory, appellant elected to 'rely on the testimony of Mr. David B. Harriman, the attorney who handled the probate of Mr. Sayer's estate and who had discussed the. $105,000 payment with two Coldwell partners before the money was actually paid.

Respondent's position, based on the Coldwell letter, is that the $105,090 was Mr. Sayer's share of a $420,000 commission received by Coldwell from the Heller Estate transaction which Mr. Sayer was helping to put together at the time of his death. If the contents of that letter can be taken at face value, Coldwell paid the $105,000 pursuant to its established practice of allowing a terminated employee to share in the commission received from a transaction on which he was working at the time of his termination but which had not then been consummated. The letter flatly denies, that the circumstances surrounding Mr. Sayer's death or appellant's bad health or financial needs were considered when Coldwell decided to make the. payment.

The testimony of Mr. Harriman puts the payment in an entirely different light. He testified that appellant learned sometime during 1961 that Coldwell was intending to transfer to her a substantial sum of money. She told Leonard Janofsky, one of Mr. Harriman's' law partners, about the proposed payment, and after he had discussed-the matter with Mr. Harriman and Joseph White, who was one of. the firm's tax lawyers, it was decided that Harriman and White should get together with the Coldwell people in order to learn the circumstances behind the proposed payment. Mr. White subsequently arranged a meeting which was held on August 30, 1961, in Coldwell's Los Angeles- offices. The participants were two Coldwell partners, Mr. Evans and Mr. Mott, a Coldwell employee named James Thomas.; who- had been John Sayer's assistant in Coldwell's appraisal department, and Harriman and White.

Harriman said that he wanted to find out if the proposed payment was an asset which should be included in Mr. Sayer's estate and which could be sued for and recovered if Coldwell backed away without paying it. He testified that Mr. White's objective was to determine whether the payment would be taxable income to appellant.

At the start of the meeting, there were expressions of sadness at Mr. Sayer's death and of sympathy for his widow. There also were some general comments concerning the fact that the Sayer estate was not large and that appellant was not very secure financially. As the meeting got down to business, Mr. White asked Mr. Evans and Mr. Mott if they would be kind enough to explain the circumstances behind the proposed payment to appellant. They answered that John Sayer had been working on the sale of a large parcel of land for the Heller Estate and that the sale had been completed after Mr. Sayer's death, resulting in a $420,000 commission to Coldwell. The sale was then described in some detail, revealing that Mr. Sayer's role in the transaction had been relatively minor. After relating this background information the partners said that, although Coldwell had absolutely no obligation to pay John Sayer or his widow anything, the partnership had nevertheless decided to pay $105,000 of the Heller Estate commission to appellant because they wanted to do something for her. In response to specific questions put to them by Mr. White, the partners said that Coldwell had no fixed policy regarding the sharing of commissions with employees who died, quit or were fired while a transaction was still pending; that John Sayer would not have been paid anything had he quit or been fired before the Heller Estate sale was consummated; that nothing would have been paid to John Sayer or anyone else had the sale not been completed; 2/ and that no representation was made to newly hired employees that Coldwell had a policy of sharing commissions with employees who terminated their employment while working on uncompleted transactions. 3/

2/ It thus appears that at the time of his death John Sayer had no right to any compensation for his services in connection with this sale. Any such right could arise only upon the completion of the sale, and the realization of a sales commission.

3/ We note that there is no evidence indicating that John Sayer himself was aware of the existence of any such policy.

Mr. Harriman's testimony concerning these matters was corroborated by Mr. White's sworn affidavit and by his handwritten memorandum summarizing the meeting, prepared within an hour after the meeting and signed by him and Mr. Harriman.

Mr. Harriman was an impressive and very credible witness for appellant. His explanation of the circumstances surrounding the payment was npt only inherently reasonable and credible,' when measured against the undisputed facts contained in the record, but also assumed compelling pursuasiveness after emerging unshaken from exceptionally vigorous and prolonged cross-examination; Although his testimony concerning the statements made by the two Coldwell partners is not the strongest evidence imaginable on the motives which gave rise to the payment, we think it is entitled to greater weight than the Coldwell letter.on which respondent relies so heavily. That letter was in response to an inquiry from respondent and was written almost five years after the payment to appellant. In contrast to Mr. Harriman's testimony, the contents of the letter were not given under oath and were not subjected to the fundamental test of cross-examination. Moreover, since.- the Coldwell partners had taken'a business expense deduction for this $105,000 payment, it was in their interest to describe the transaction in language calculated to protect the integrity of that deduction. While these weaknesses are serious ones, we find even more important respondent's failure to call anyone from Coldwell as a witness. Since everything in the record indicates that a witness from Coldwell would, if called, have given testimony highly favorable to respondent, respondent's manifest reluctance to put even the author of the letter (Mr. Evans) on the stand is very damaging. Under these circumstances we cannot give the letter the significance which respondent. would have us attach to it.

Even if we were inclined to take the letter at face value, however, we are not at all convinced that it proves the $105,000 was paid pursuant to an established policy on dividing commissions. The policy described in the letter calls for the payments to be made to <u>the estate</u> of the -deceased Coldwell employee. This is significant wording for two reasons. First, there is not a shred of evidence in the record to indicate that Coldwell has ever made "a similar payment directly to any employee's widow other than appellant. Second Coldwell in fact made 14 separate payments (totaling $8,900) to Mr. Sayer's estate, representing fees arid commissions earned by him before his death. Everyone agrees that these payments were compensation income and they were reported as such by the estate. In addition, appellant paid income, tax on them when she received them pursuant to distribution of the estate. The fact that Coldwell made these payments to the estate but paid the $105,000 directly to appellant indicates to us, as similar facts did to the court, in Bounds v. United States, 262 F.2d 876, that Coldwell viewed the payment- to appellant as different in nature from the payments to the estate. It is true, as respondent points out, that the estate was closed before the payment was made. But -it was closed only eight days prior to the payment, and Coldwell had been planning to pay it for months before that' time. The record shows beyond question that Coldwell always 'intended to make the payment directly to appellant, and it is clear that the payment would have been made to appellant before the estate closed had there not been the delay occasioned by Coldwell's deliberation over whether it wanted to protect itself by withholding part of the payment for tax purposes.

In sum, the following facts tend to show that the $105,000 was a gift: (1) the payment was made to appellant and not to her husband's estate; (2) Coldwell had no discernible obligation to make the payment; (3)' Coldwell does not appear to have derived any particular benefit from the payment; (4) appellant performed no services for Coldwell; (5) the payment was not made pursuant to a practice or policy of making such payment's to the widows of Coldwell employees; (6) the Coldwell partners were aware that John Sayer's estate was rather small for a man in his income bracket, although they did not know the exact amount of the estate or what assets. appellant would receive from it (see Corasaniti v. U.S., 212 F. Supp. 229); and (7) there is no showing that John Sayer had not been fully and adequately compensated for all his compensable services. (See Bounds v. United States, supra; Kuntz' Estate v. Commissioner, 300 F.2d 849; Packard v. United States, 179 F. Supp. 508.)

To counter this fairly strong circumstantial case for appellant, respondent puts considerable emphasis on the "Release and Agreement" which appellant had to sign in order to get the $105,000. Respondent contends that the'fact that appellant was required to release Coldwell from any and all claims-.arising out of the employment relationship between Coldwell and her husband shows that Coldwell had no donative intent when it- transferred the $105,000. We do not agree. The principal reason for the agreement was that Coldwell's lawyers wanted their client to be protected in case the

$105,000 was ultimately judged to be taxable income to appellant, who might at that time be unable to pay the taxes on such a large sum. In such case the government might have proceeded against Coldwell on the theory that a portion of the payment should have been withheld and remitted to the government. To protect Coldwell, it was decided to have appellant put $10,000 in the hands of a pledge-holder and agree to hold Coldwell harmless from its failure to withhold a part of the $105,000. The "Release and Agreement" was drafted to accomplish this purpose, and the paragraph releasing Coldwell from any further claims by appellant was not a major part of the transaction. That paragraph seems rather to have been largely a legal formality to put the finishing touches on the Sayer-Coldwell relationship.

Respondent correctly notes that Coldwell deducted the $105,000 as a business expense and that this tends to negate an intent to make a gift. The propriety of that deduction is not in issue here, however, and the Court in Duberstein pointed out that "[t]he taxing statute does not make nondeductibility by the transferor a condition on the 'gift' exclusion; . . ." (363 U.S. at 287.)

Finally, respondent suggests that the $105,000 may have been compensation for the appraisal services which John Sayer rendered, a year before his death, on the land ultimately involved in the Heller Estate sale. Respondent did not, however, offer any evidence to support its suggestion. The only evidence on this point indicates that Mr. Sayer had been paid for these services before his death, and from what we know of how Coldwell billed its clients for appraisal services, we can see no reason why the appraisal fee would not have been billed at the time of the appraisal rather than two years later when the property was finally sold. Likewise, we do not believe that the appraisal fee would have been submerged in the sales commission, or that Coldwell's right to that fee was dependent on its effecting a sale of the appraised property.

On the basis of this record, we think appellant has shown by a preponderance of the evidence that the "dominant reason" for the payment was the Coldwell partners' desire to give tangible expression to their sympathy for her loss. The payment proceeded primarily "out of affection, respect, admiration, charity or like impulses" and thus was a gift within the meaning of Revenue and Taxation Code section 17136. Accordingly, respondent's determination cannot stand.

Appeals of Mary Frances Sayer

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 Mary Frances Sayer against proposed assessments of additional personal income tax in the amounts of $6,939.27 and $350.00 for the year 1961, be and the same is hereby reversed.

Done at Sacramento, California, this 27th day of October , 1971, by the State Board of Equalization.

_______________, Chairman

Scott Keene, Member

John W. Lynch, Member

_______________, Member

_______________, Member

ATTEST: _______________, Secretary