

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
WILLIAM E. O'HAREN) No. **84A-81-GO**

For Appellant: Holmes F. **Crouch**
Tax Practitioner

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 William E. **O'Haren** against a proposed assessment of additional personal income tax in the amount of \$625.26 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.

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

In 1974, appellant invested \$3,000 in cash for a 3.91 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. Br., 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.) Appellant included the ratable share of the \$182,000 debt (i.e., 3.91 percent, **or \$7,116**) in his partnership basis for MIDCO for a total basis of \$10,116 (i.e., \$7,116 plus cash investment of \$3,000). On his 1974 personal income tax return, appellant deducted **\$9,166** in MIDCO partnership losses, \$175 in 1975, \$1,348 in 1976, and \$348 in 1977 for a total of \$11,037. In 1976, appellant reported \$1,557 in capital gain from the partnership.

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 appellant recaptured his 3.91 **percent** share of the debt in 1977 "because the debt was extinguished on **which** appellants [sic] had previously taken . . . deductions." (Resp. Br. at 2.) Accordingly, respondent increased appellant's ordinary income by his partnership share of the extinguished indebtedness. Denial of appellant's protest led to this appeal.

On appeal, respondent framed the issue as whether appellant had "shown that he did not realize income on the extinguishment of a debt for which he had previously taken deductions." (Resp. Br. at 1.) In essence, then, this case is **indistinguishable** from Appeal

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of John H. and Marie E. Norton, decided February 4, 1986, in which we noted that it is well settled that the forgiveness of a debt in **any manner**, outside of limited exceptions not at issue here, constitutes taxable income to the debtor. (Rev. & Tax. Code, §§ 17071, subd. **(a)(12)**, and 17142.)

Appellant does not appear to disagree with this general principle but states that in 1980, when he was notified of the additional assessment for 1977, he voluntarily amended, his 1976 and 1977 returns to delete all references to income or loss from the partnership. Any impropriety, appellant argues, took place in 1974, a year now closed by the statute of limitations. However, whether the original deduction is proper or improper is irrelevant in this matter. What is relevant is the subsequent recovery of that expenditure; any adjustment to income is properly made in the year of that recovery. (Unvert v. Commissioner, 656 F.2d 483 (9th Cir. 1981).) As indicated above, respondent has determined that appellant recaptured **his** share of debt in 1977 so that that year, rather than 1974, would be the proper **year for** the adjustment. Accordingly, appellant's contention that **1974** was the proper assessment year is incorrect.

Appellant also argues that the theory upon which respondent relies was not incorporated into the California statutes until 1983, after the year at issue. However, section 17071, subdivision **(a)(12)**, and section 17142 cited above were both added to the California statutes in 1955 and were in effect throughout the period at issue. Accordingly, appellant's second argument is also misplaced.

For the reasons cited above, respondent's action must, therefore, be sustained in full.

