



89-SBE-021

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
TISHMAN REALTY & CONSTRUCTION) No. 85A-1262-CD
CO., INC., AND TISHMAN DAVIS)
CORPORATION, ASSUMER AND/OR)
TRANSFeree)

For Appellant: Charles Sheldon
Certified Public Accountant

For Respondent: Donald C. McKenzie, Counsel

OP. I N I O N

This appeal is made pursuant to section 25666¹/ of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Tishman Realty & Construction Co., Inc., and Tishman Davis Corporation, Assumer and/or Transferee, against a proposed assessment of additional franchise tax in the amount of \$222,402 for the income year ended September 30, 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 **three** issues presented by this appeal are (1) whether appellant realized income in 1974, as a result of abandoning an uncompleted building, **or** in December 1976, as a result of the foreclosure of a mortgage securing the building; (2) whether any realized income was apportionable business **income**; and (3) whether the tax benefit rule applied to reduce the amount of realized income.

Appellant was in the business of constructing large office buildings. It had its own construction division, but would also serve as a construction manager for other entities. Appellant was engaged during the appeal period in a unitary business with at least ten subsidiaries which were also in the construction business.

In 1972, appellant began to construct a building in New York City. The construction of the building was financed by a nonrecourse mortgage, which was secured by the building itself, in the amount of approximately \$56 million. For its income year ended September 30, 1973, appellant deducted from income \$6,251,052 of real estate taxes and other carrying charges associated with the building. Appellant did not have sufficient income to permit it to deduct the remaining carrying charges in the amount of \$13,505,906, with the result that appellant did not receive a tax benefit for this amount in that year.

The shell of the building was completed in 1974. However, because of the energy crisis, high interest rates, inflation, and other adverse conditions that existed in the pertinent period, appellant determined that the expenditure of the funds which would be necessary to complete construction of the building would not be recaptured from reasonably anticipated future rents. Accordingly, in 1974, appellant stopped paying real estate taxes and other carrying charges, characterized the building as abandoned on its financial statements, and offered to reconvey the property to the mortgagee. The mortgagee began foreclosure proceedings which were completed in December 1976 after a foreclosure sale was held in which no bids for the underlying property were offered.

The Franchise Tax Board (FTB) issued a proposed assessment in connection with the foreclosure for appellant's income year ended September 30, 1977. When the FTB rejected appellant's protest, this timely appeal followed.

Respondent maintains that appellant constructively realized \$19,756,958 of apportionable-business income in December 1976 when foreclosure proceedings were completed. It

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further **maintains** that this amount may not be reduced, under the tax benefit rule, by that portion of the deductible carrying charges for which appellant has received no tax benefit for the year ended September 30, 1973.

Appellant contends that it abandoned the building in 1974 and that the abandonment was the pertinent taxable event rather than the completion of foreclosure proceedings in 1976. It also contends that the tax benefit rule applies to reduce the amount that the FTB maintains should be taken into income by an amount that is equal to the deductible carrying charges for which it received no tax benefit in 1973. Appellant maintains that any amount taken into income is nonbusiness income entirely allocable to its commercial domicile in New York.

We agree with the first of appellant's contentions and, as a result, do not find it necessary to consider the others.

Appellant has stated, without contradiction by respondent, that after determining that its continued participation in the building project was not financially feasible, it stopped paying real estate taxes and other carrying charges, and tendered the property to the mortgagee in 1974. In considering virtually identical actions by a partnership with regard to similarly troubled parcels of real property secured by nonrecourse mortgages, the United States Tax Court has held that the partnership's actions constituted abandonment. (Middleton v. Commissioner, 77 T.C. 310, 322-323 (1981), affd. per curiam, 693 F.2d 124 (11th Cir. 1982).) The tax court further held that the abandonments triggered realization of losses which were not deferred until the completion of foreclosure proceedings in later years, but were deductible in the years in which the abandonments occurred. (Middleton v. Commissioner, supra, 77 T.C. at 321.)

Because of the near identity of the material facts here with those discussed in Middleton, we find that appellant abandoned its uncompleted building in 1974, and any gain or loss on the transaction must be attributed to that year. Therefore, we conclude that appellant did not realize or recognize income in the matter at hand for the income year ended September 30, 1977, which is the only year before us. Accordingly, we must reverse the action of respondent.

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 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Tishman Realty & Construction Co., Inc., and Tishman Davis Corporation, Assumer and/or Transferee, against a proposed assessment of additional franchise tax in the amount of \$222,402 for the year ended September 30, 1977, be and the same is hereby reversed.

Done at Sacramento, California, this 2nd day of August, 1989, by the State Board of Equalization, with Board Members Mr. Carpenter, Mr. Collis, Mr. Bennett, Mr. Dronenburg, and Mr. Davies present.

<u>Paul Carpenter</u>	, Chairman
<u>Conway H. Collis</u>	, Member
<u>William M. Bennett</u>	, Member
<u>Ernest J. Dronenburg, Jr.</u>	, Member
<u>John Davies*</u>	, Member

*For Gray Davis, per Government Code section 7.9