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BOARD OF EQUALIZATION

STATE OF CALIFORNIA

In the Matter of the Appeal of:	**HEARING SUMMARY**
	PERSONAL INCOME TAX APPEAL
PETER M. BUCKLIN AND	Case No. 450416
JOAN BUCKLIN[1]	

Year	Claim For Refund
2002	$30,028

Representing the Parties:

For Appellants: Harold Tisdale, Enrolled Agent

For Franchise Tax Board: Jenna Mayfield, Tax Counsel

QUESTION: Whether appellants have shown that the Franchise Tax Board's denial of their claim for refund for the 2002 tax year was in error.

HEARING SUMMARY

Background

Appellants filed a late 2002 California income tax return on October 27, 2003, reporting a federal adjusted gross income (AGI) of $1,057,540. After California adjustments (additions) of

[1] Appellants reside in Petaluma, Sonoma County, California.

$491,289, and itemized deductions of $23,244, appellants reported a California taxable income of $1,525,585, which resulted in a self-assessed tax liability of $138,129. On Schedule CA of the 2002 California return, appellants reported a capital gain of $1,756,671. This capital gain resulted from the sale of property described as Orchard Plaza Ukiah (the "property"). The details of the sales transaction were reported on a 2002 federal Form 4797, which reflected a gross sales price of $5,900,000, an adjusted basis of $3,941,884, and a total gain of $1,958,116, as set forth in the table below:

TABLE 1

Gross sales price	$5,900,000
Cost or other basis	4,087,983
Depreciation	146,099
Adjusted basis	,941,884
Total gain	$1,958,116

On or about October 15, 2006, appellants filed an amended 2002 California income tax return, seeking a refund of $30,028. In the amended California return, appellants stated that an Internal Revenue Service (IRS) audit determined that they sold 12 percent of the property on June 2, 1999, meaning that only the remaining 88 percent of the property was actually sold in 2002; thus, appellants filed the amended return. Included with the amended California return was an amended 2002 federal Form 4797, which showed the amounts set forth in Table 2 below:

TABLE 2

Gross sales price	$5,192,000
Cost or other basis	3,679,151
Depreciation	128,567
Adjusted basis	3,550,584
Total gain	$1,641,416

Upon audit, the Franchise Tax Board (respondent or FTB) agreed with appellants' calculation of the gross sales price of the property ($5,192,000), as set forth in Table 2 above. However, the FTB disagreed with appellants' calculation of the cost basis, depreciation, and adjusted basis, because the amounts did not agree with the documentation that appellants provided.[2] In an attempt to reconcile the figures, the FTB requested a detailed explanation of appellants' basis in the property, but

[2] We note that other than the gross sales price of $5,192,000, the amounts set forth in Table 2 do not equal 88 percent of the amounts set forth in Table 1. Appellants should be prepared to explain this apparent discrepancy at the hearing.

the FTB allegedly never received a detailed explanation, and on March 25, 2008, the FTB denied appellants' claim for refund. Appellants then filed this timely appeal.

Contentions

Appellants contend that their claim for refund should have been granted, and in their Opening Brief, appellants provided the following table (Table 3) in an effort to further breakdown their calculations:

TABLE 3

Item	Per Original Return (100% Ownership)	Per Amended Return (88% Ownership As Established by IRS)
Sales Price	$5,900,000	$5,192,000
Expenses of Sale	-668,516	-588,294
GROSS PROFIT	$5,231,484	$4,603,736
Original Cost	3,327,435	2,928,143
Improvements	184,904	162,716
Less Depreciation	-146,099	-128,567
ADJUSTED BASIS [3]	$3,366,240	$2,962,292
NET GAIN	$1,865,244	$1,641,415

On appeal, the FTB agrees with appellants' calculation of the gross sales price ($5,192,000), as set forth in the Table 3. However, the FTB disputes appellants' other calculations in the Table 3; specifically, the FTB asserts the following problems in relation to the numbers set forth in Table 3:

Expenses of Sale – Based on the settlement statements provided by appellants (which are set forth as Exhibits H and I to the FTB's Opening Brief), the FTB asserts that appellants have only provided proof of selling expenses totaling $207,000 (not the $588,294, as set forth in Table 3 above). The FTB calculated selling expenses of $207,000, based on the following:

- commission charges of $200,000;
- escrow and title charges of $315;
- recording and transfer charges of $5,771.75; and

[3] It is not clear why appellants are now asserting an adjusted basis of $2,962,292 for an 88 percent interest in the property (as set forth in Table 3) when they reported an adjusted basis of $3,550,584 in their amended federal Form 4797 (as set forth in Table 2).

- A portion of the property taxes reported (i.e., apparently $913.25).

Original Cost – The FTB notes that the federal audit report (attached as Exhibit G to the FTB's Opening Brief) shows a cost basis of 100 percent of the property in 1999 as $3,328,057, and based on this report, the FTB asserts that the original cost of the property in 2002 should be $2,928,690 (i.e., 88 percent of $3,328,057) **–** not the $2,928,143 as set forth by appellants in Table 3.

Improvements – The FTB claims that the depreciation schedule provided by appellants (attached as Exhibit J to the FTB's Opening Brief) shows improvements totaling $184,904 on or after July 1, 1999, but the FTB notes that appellants claimed only 88 percent of these improvements for the 2002 tax year. The FTB contends that since all improvements appear to have occurred subsequent to June of 1999, the 2002 adjusted basis should include 100 percent of the improvements claimed on the depreciation schedule; thus, the FTB claims that the improvements should be listed as $184,904 for the sale in 2002, and not $162,716 as set forth by appellants in the Table 3.

Depreciation – The FTB notes that appellants reported accumulated depreciation of $128,567, which represents 88 percent of the $146,099 total accumulated depreciation originally reported. However, the FTB states that on December 3, 2007, appellants provided a copy of a revised federal 2002 Form 4797 (attached as Exhibit K to the FTB's Opening Brief), which reflects total accumulated depreciation of $158,749.[4] Thus, the FTB contends that appellants should have listed the amount of depreciation as $139,699 (i.e., 88 percent of $158,749).

In summary, the FTB alleges in its Opening Brief that "the cost basis of $2,928,690.00, plus improvements of $184,904.00 and selling expenses of $207,000.00, less depreciation of $128,567.00, results in an adjusted basis of $3,192,027.00."[5] Next, the FTB states that when the adjusted basis of $3,192,027 is subtracted from the amount realized of $5,192,000, a gain of $1,999,973 results, and since this gain of $1,999,973 is higher than the gain originally reported by appellants ($1,958,116), it appears that appellant actually underreported gain from the sale of the property by

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[4] Appellants reported total accumulated depreciation of $158,749; however, in its Opening Brief, the FTB apparently reversed the last two digits and stated that appellants reported total accumulated depreciation as $158,794.

[5] As stated above, the FTB asserts that the actual depreciation should be $139,699, which is greater than $128,567. However, the FTB calculates that no refund is due even if one uses the $128,567 amount.

$41,857, such that the FTB properly denied appellants' claim for refund.

Applicable Law

Internal Revenue Code (IRC) section 1001 provides that the gain on the sale of property shall be the excess of the amount realized over the adjusted basis provided for in IRC section 1011.[6] IRC section 1011 provides that the adjusted basis for determining gain from the sale of property shall be the property's initial basis (determined under section 1012 or other applicable sections of that subchapter) adjusted as provided for in IRC section 1016.

Under IRC section 1016, the property's initial basis must be adjusted for capital additions and capital recoveries. Capital additions increase the initial basis and capital recoveries decrease the initial basis so that on the date of disposition the adjusted basis reflects the unrecovered cost or other basis of the property. (Int.Rev. Code § 1016(a).) Capital additions include the cost of capital improvements and betterments made to the property by the taxpayer. (*Ibid*.) These expenditures are distinguishable from expenditures for the ordinary repair and maintenance of the property, which are neither capitalized nor added to the initial basis. The latter expenditures are deductible in the current taxable year if they are related to business or income-producing property. (Int.Rev. Code §§ 162 and 212; Rev. & Tax Code, § 17201.) Capital recoveries (such as depreciation) decrease the initial basis. (Int.Rev. Code, § 1016(a)(2).)

Respondent's determination of tax is presumed to be correct, and a taxpayer has the burden of proving error. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Michael E. Myers*, 2001-SBE-001, May 31, 2001.)[7]

STAFF COMMENTS

At the hearing, appellants should be prepared to substantiate the following amounts, which are set forth by appellants in Table 3 above: (1) selling expenses totaling $588,294, (2) an original cost of $2,928,143, (3) improvements of $162,716, (4) depreciation of $128,567,[8] and (5) an adjusted

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[6] California conforms to IRC sections 1001 and 1011-1016 at California Revenue and Taxation Code section 18031.

[7] Board of Equalization cases are generally available for viewing on the Board's website (www.boe.ca.gov).

[8] As stated above, the FTB asserts that the actual depreciation should be $139,699, which is greater than $128,567. However, it asserts that no refund is owed even if one uses the $128,567 amount to calculate gain.

basis of $2,962,292. As stated above, the FTB concedes that the sales price of an 88 percent interest in the property in 2002 was $5,192,000 (as set forth in Table 3 above). Pursuant to California Code of Regulations, title 18, section 5523.6, appellants should provide any evidence to the Board Proceedings Division at least 14 days prior to the oral hearing.[9]

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[9] Evidence exhibits should be sent to: Mira Tonis, Appeals Analyst, Board Proceedings Division, State Board of Equalization, P.O. Box 942879, Sacramento, California, 94279-0081.