



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)

A. J. WOOD

Appearances:

For Appellant: Cha's. W. Tye and N. Joseph Ross,
Attorneys at Law

For Respondent: W M. Walsh, Assistant Franchise Tax
C&missioner; James J. Arditto, Franchise
Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 18593 of the Revenue and Taxation Code (formerly Section 19 of the Personal Income Tax Act) from the action of the Franchise Tax Commissioner in overruling the protest of A. J. Wood to a proposed assessment of additional tax in the amount of \$871.83 for the taxable year ended December 31, 1936.

The principal question presented for decision relates to the cost basis of certain shares of stock of the Washington Furniture Company acquired by the Appellant from the widow of Phil C. Racine during the latter part of 1935. He acquired the stock pursuant to an agreement dated June 26, 1935, and under the following circumstances:

Prior to Mr. Racine's death in October, 1935, Appellant, Mr. Racine and their wives were the sole stockholders of the Washington Furniture Company. Mr. Racine, who with his wife owned 4/5 of the Company's stock, was its President and the Appellant, who with his wife owned the remaining 1/5 of the stock, was its Vice-President. The lives of both Phil C. Racine and A. J. Wood had been insured by the Company in the respective amounts of \$40,000.00 and \$10,000.00, both policies designating the Company as beneficiary. On June 26, 1935, the Appellant, his wife, and Mr. and Mrs. Racine entered into an agreement, which was consented to by the Washington Furniture Company, whereby the respective wives of A.J. Wood and Phil C. Racine were substituted as beneficiaries under the policies and whereby it was provided, in part:

"All the above mentioned parties being interested in the Washington Furniture Company, it is our desire and wish that should either Phil Racine or A. J. Wood die, the surviving member is to purchase the interest of the widow in said furniture company and to make this possible, \$40,000.00 of life insurance has been taken out on the life of Phil Racine and \$10,000.00 on the life of A. J. Wood.

Appeal of A. J. Wood

"Now, in the case of the death of either party the surviving member will be given credit for the amount of insurance paid the widow of the deceased in the purchase of the deceased member and the widow's interest.

"In the event that Phil Racine and A. J. Wood are actively engaged in the management and operation of the Washington Furniture Company, this agreement will be in force. Should either of them leave the firm, this agreement will be null, and void ...

"It is further understood that in the purchase of the interests of Mrs. Racine, the \$40,000.00 will be used as first payment on her interest, but that none of her interest will pass from her ownership until the final payment has been made on the total of her interest,, the value of her interest to be book value at the time the sale is made, but in no event shall it be less than the amount of insurance involved. The same arrangement will apply to the interest of A. J. Wood and his wife."

Mr. Racine died during October, 1935, and his widow received the proceeds of the aforesaid \$40,000.00 policy. Thereafter, Appellant purchased Mrs. Racine's interest in the Washington Furniture Company and the consideration actually passing from Appellant to Mrs. Racine, for the shares representing said interest, was equal to the difference between book value of said shares (approximately \$75,000.00) and the insurance proceeds, or approximately \$35,000.00. In June, 1936, the Washington Furniture Company was liquidated and all its stock retired.

Appellant filed a return for 1936 and reported a loss upon the retirement of the shares purchased from Mrs. Racine. The loss so reported was computed pursuant to Appellant's contention that his cost basis for the shares was book value at the time of purchase or approximately \$75,000.00. The Commissioner contends however, that the insurance proceeds received by Mrs. Racine cannot be included in Appellant's cost basis for the shares acquired from her and that the basis to be used for the purpose of determining gain or loss should be limited to the amount actually passing from Appellant to Mrs. Racine, or approximately \$35,000.00.

The Commissioner's position is sustained by the decision in Paul Legallet v. Commissioner of Internal Revenue, 41 B.T.A. 294, wherein the arguments presented by the Appellant on this appeal were fully considered and discussed in connection with a factual situation almost identical with the one here under consideration. Appellant's position with respect to the tax aspects of the factual situation under consideration does not, however, find support in reported decisions. It must be held, therefore, on the authority

Appeal of A. J. Wood

of the Legallet case, and the decisions therein cited, that the insurance proceeds receive&by Mrs. Racine are not properly includible in Appellant's cost basis for the shares of stock acquired by the Appellant from Mrs. Racine pursuant to the agreement of June 26, 1935.

The Appellant also contends that the Commissioner's proposed deficiency assessment is uncollectible inasmuch as notice thereof was not mailed within the three year period provided by Section 19 of the Personal Income Tax Act as in effect during the taxable year in question. Prior to the termination of that period, however, the Section was amended (Stats. 1939, p. 2557) to provide a four year period for mailing of the notice and the notice of the assessment involved herein was mailed within that four year period. The California Supreme Court has rejected the Appellant's position in Mudd v. McColgan, 30 A.C. 463, and held the four year period prescribed by the 1939 amendment to be controlling in this situation. The Commissioner's notice of proposed assessment was, accordingly, mailed within the time required by the Act.

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 Chas. J. McColgan, Franchise Tax Commission&, in overruling the protest of A. J. Wood to a proposed assessment of additional personal income tax in the amount of \$871.83 for the taxable year ended December 31, 1936, be and the same is hereby sustained.

Done at Sacramento, California, this 21st day of August, 1947, by the State Board of Equalization.

William G. Bonelli, Chairman
Geo. R. Reilly, Member
J. H. Quinn, Member
Jerrold I. Seawell, Member
Thomas H. Huchel, Member

ATTEST: Dixwell L. Pierce, Secretary