



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

Paul

In the Matter of the Appeal of)
H. C. FRYMAN HOTEL COMPANY)

Appearances:

For Appellant : Verne H. Wright, Certified Public Accountant

For Respondent: W. M. Walsh, Assistant Franchise Tax Commissioner; Burl D. Lack, Chief Counsel; Crawford H. Thomas, Associate Tax Counsel

OPINION

This appeal is made pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes of 1929, as amended) from the action of the Franchise Tax Commissioner on the protest of H. C. Fryman Hotel Company to a proposed assessment of additional tax in the amount of \$6,521.91 for the income year ended December 31, 1943.

The Appellant now questions only one of several adjustments made by the Commissioner in his determination of its net income, this remaining issue relating to a reduction in the adjusted basis of Appellant's interest as lessee in a lease sold by it in 1943, the subject of the lease being certain hotel property which Appellant had operated. The adjustment was made in reliance on Section 6(d) of the Act upon the ground that the Appellant was insolvent after the cancellation in 1941 of an indebtedness for rent in the amount of \$90,092.33 owed to its lessor and that, accordingly, the basis of the lease interest should be reduced by the amount of the cancelled indebtedness,

Section 6(d), as enacted in 1939 and in effect throughout 1941 and 1943, read in part as follows:

"If the indebtedness of a bank or corporation is canceled or forgiven in whole or in part without payment, the amount so canceled or forgiven shall constitute income to the extent the value of the property (including franchises) of the bank or corporation exceeds its liabilities immediately after the cancellation or forgiveness. The remainder of the amount of indebtedness so canceled or forgiven, if any, shall be applied in reduction of the basis of the assets to the extent the basis thereof exceeds

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"the value thereof immediately after the cancellation or forgiveness, such reduction to be made in accordance with regulations prescribed by the commissioner."

The Appellant agrees that the sole question is that of its solvency at the time of the cancellation, but contends that it was solvent after the cancellation and, accordingly, that the Commissioner was not warranted in reducing the basis of the asset in question. It points to its balance sheets of January 1, 1941, and December 31, 1941, wherein the lease (designated "Buildings, Furniture and Fixtures--Less Reserves for Depreciation"), its major asset, is valued at \$472,572.66 and \$459,049.83, respectively. The balance sheets indicated that Appellant had a net worth of \$31,994.85 at the start of 1941 and of \$95,057.67 at the end of that year. The sale of all the stock of Appellant as of June 1, 1944, for \$595,000 is also referred to as evidence of its solvency.

We are of the opinion, however, that the action of the Commissioner must be sustained. He concluded that the fair market value of the lease at the end of 1941 was not in excess of \$300,000. This conclusion was based on the fact that the asset was sold in 1943 for \$290,000, the purchaser also assuming a contingent liability of \$35,826.47, and the assumption that the market value of the property increased from 1941 to 1943. If the \$300,000 value be accepted, it is not to be denied that the Appellant was insolvent even after the cancellation.

Appellant has not submitted any evidence, establishing the incorrectness of the Commissioner's \$300,000 value. The reference to the price at which its stock was sold in 1944, without other evidence, certainly does not establish its solvency in 1941. It seeks to avoid the conclusion drawn by the Commissioner from the price at which its lease was sold in 1943 by asserting that that price was due in part to a low Federal excess profits tax basis for the property, in the absence of which the price would have been higher and reflected solvency. Here, again, the lack of evidence renders Appellant's contention unavailing as a means of proving its solvency in 1941,

Furthermore, it may be observed that doubt is cast on the correctness of the values set forth for the lease in Appellant's balance sheets of January 1, and December 31, 1941, by a protest which it filed with the Commissioner in 1941 to a proposed assessment of additional franchise tax for the income year 1936. That assessment involved the question of the effect of a cancellation of rent indebtedness in 1936 and in arguing that it was insolvent both before and after the cancellation, despite a balance sheet showing of solvency, Appellant stated that its net worth could be determined only after first eliminating the lease from its balance sheets inasmuch as the amounts set forth therein represented not the value of Appellant's interest in the lease, but rather the unamortized cost of the leased building, which though erected by Appellant was owned by its lessor. In the case of both the 1936 and the 1941 rent cancellations the Commissioner accepted the Appellant's position that the cancellations had not resulted in income in either of those years under Section 6(d) or Section 8(o).

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In view of these considerations we believe that the Appellant has not established the fact of its solvency after the 1941 rent cancellation and, accordingly, that the action of the Commissioner in reducing the basis of the lease and thereby increasing Appellant's net income for 1943 must be upheld.

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 25 of the Bank and Corporation Franchise Tax Act, that the action of Chas. J. McColgan, Franchise Tax Commissioner, on the protest of H. C. Fryman Hotel Company to a proposed assessment of additional tax in the amount of \$6,521.91 for the income year ended December 31, 1943, be and the same is hereby sustained.

Done at Sacramento, California, this 18th day of November, 1949, by the State Board of Equalization.

Geo. R. Reilly, Chairman
J. H. Quinn, Member
Thomas H. Kuchel, Member

ATTEST: Dixwell L. Pierce, Secretary