BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
)
EDWIN J. AND ADA THOMPSON)

Appearances:

For Appellants: Willard C. Mills, Attorney at Law

For Respondent: Jack Rubin, Assistant Counsel

OPINION

These appeals are made pursuant to Section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Edwin J. Thompson and Ada Thompson to proposed assessments of additional personal income tax for the year 1947 in the amounts of $801.03 against Edwin J. Thompson and $805.86 against Ada Thompson.

Appellants are husband and wife, In 1943 they moved from San Francisco to Los Angeles. For the purpose of acquiring a residence in Los Angeles they contracted to purchase a furnished home in that city at an agreed price of $65,000, which sum they placed in escrow. Under the terms of the contract they were to be given possession on September 8, 1943. On that date, however, the seller refused to perform the contract and remained in possession of the premises.,

The Appellants brought suit against the seller and in September, 1946, secured a final judgment ordering specific performance of the contract and awarding damages computed at the rate of $750 per month while the real and personal property was wrongfully withheld. The judgment provided that the escrow agent was to deduct and offset the amount of the damages against "the total purchase price of $65,000" and to pay the balance, less escrow charges to the seller. In January, 1947, the escrow was closed and the property was formally transferred to Appellants. At the same time, pursuant to the judgment, the sum of $29,250, less certain escrow charges, was remitted to Appellants from the amount they had initially placed in escrow.

Upon taking possession of the property Appellants discovered that the seller's abuse and neglect had extensively damaged the furnishings, house and grounds. Leaky plumbing in upstairs bathrooms had not been repaired and caused plaster to fall off from downstairs walls; rugs and carpets were damaged, in many cases beyond repair; upholstering on furniture was damaged and many pieces of valuable furniture were broken beyond repair; pet dogs had been allowed in the house and had contributed to the damage by leaving stains and an offensive odor; cleaning and painting had been neglected and exterior walls, outside walks and garden were all badly deteriorated. In 1947, before moving in, Appellants expended in excess of $30,000 on repairs and replacements needed to restore the property to the condition it was in as of the date of the contract of sale.

The property was resold in 1951. In reporting gain on the sale of the premises the damage award was treated as a reduction of the cost price of the property, thus reducing the basis and increasing the realized gain subject to tax.

The Franchise Tax Board determined that the damages awarded to Appellants are includible in their gross income under the residual clause of Section 17101 of the Personal Income Tax Law of 1947 (now Section-17071 of the Revenue and Taxation Code), which provided that gross income includes "gains or profits and income derived from any source whatever." In its recomputation of income the Franchise Tax Board has disallowed any deductions from gross income on account of Appellants' expenditures for replacements and repairs required to restore the property to its former condition.

The Franchise Tax Board takes the position that during the period of wrongful withholding the property was not owned by Appellants and has specifically disclaimed any contention that the amount awarded as damages constituted the equivalent of "rents." It is on this premise that the Franchise Tax Board has denied deductions for any part of the expenses incurred by Appellants in rehabilitating the property.

The gist of the Franchise Tax Board's argument appears to be that the damages in question constituted an addition to Appellants' wealth, something in the nature of a windfall. In accord with this view it relies upon Commissioner v. Glenshaw Glass Company, 348 U. S. 426, as support for the inclusion of the amount of the damages in gross income under the residual clause of Section 17101.

In Commissioner v. Glenshaw Glass Company the court was concerned with punitive damages, for fraud and antitrust violations, which had been recovered by the taxpayer as an addition to its recovery of actual damages. In deciding that punitive damages are includible in gross income under the residual clause of Section 22(a) of the Internal Revenue Code of 1939, the court stated that such damages constituted "undeniable accessions to wealth, clearly realized." The damages in question in this appeal are, however, clearly compensatory in nature and Appellants realized no gain or "accession to wealth" by their receipt.

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In August, 1943, when Appellants contracted to purchase the property in question it was well maintained and in good condition. When they acquired the property in 1947 it was badly run down and deteriorated. To the extent of the decrease in value of the property the Appellants incurred a a loss of capital. Since Appellants did not receive damages in excess of their capital loss they made no gain which could be characterized as income. (Henri Chouteau, 22 B.T.A. 850; Drier v. Helvering, 72 Fed. 2d 76.)

ORDER

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 the Franchise Tax Board on the protests of Edwin J. Thompson and Ada Thompson to proposed assessments of additional personal income tax for the year 1947 in the amounts of $801.03 against Edwin J. Thompson and $805.86 against Ada Thompson be, and the same is hereby, reversed.

Done at Los Angeles, California, this 19th day of October, 1960, by the State Board of Equalization.

John W. Lynch, Chairman

Geo. R. Reilly, Member

Paul R. Leake, Member

Richard Nevins., Member

__________, Member

ATTEST: Dixwell L. Pierce, Secretary