



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
HARRY A. AND SELMA CHERROFF)

Appearances:

For Appellants: Harry Valentine and
Harry A. Cherroff, in pro. per.

For Respondent: Peter S. Pierson
Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to section 19059 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of Harry A, and Selma Cherroff for refund of personal income tax in the amount of \$982.97 for the year 1958.

The sole issue raised by this appeal concerns the fair market value, for purposes of determining gain realized, of a promissory note containing a contingency provision.

Prior to August 26, 1956, appellant Harry A. Cherroff owned all the stock of Meddock Truck Line (hereafter "Meddock"), a California corporation engaged in the freight transportation business. On that date Santa Fe Trail Transportation Company (hereafter "Santa Fe") agreed to purchase all of Meddock's trucking rights and operating assets. Under the agreement of sale Santa Fe was to file appropriate applications with the Interstate Commerce Commission (the ICC) and other governmental agencies for a transfer of Meddock's operating rights. The sale was not to be consummated until such applications had been approved, and failure to obtain the full approval of those agencies would give Santa Fe a right to terminate the sale agreement. The sale price was to be the sum of (1) \$139,460.82 in cash, (2) the balance on the date the sale was consummated of Meddock's existing long term equipment obligations, and (3) the depreciated book value as of the consummation date of any new tangible personal property which was acquired by Meddock.

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Other carriers serving the same area opposed this sale to Santa Fe, and in 1958 the transaction had not yet been approved by the ICC.

On December 5, 1958, appellant sold all his Meddock stock to a Mr. Digby for \$126,358.44. Mr. Digby made a down payment of \$36,643.94 cash on the date of sale, and gave appellant his promissory note for the balance. Dated December 5, 1958, the note contained Digby's promise to pay appellant \$89,714.50, and provided that this amount was payable in monthly installments of \$1,000. Interest on the unpaid balance was due at the rate of 5 percent, also payable monthly. If the Meddock sale to Santa Fe was completed, the unpaid balance **on** this note was to become due at an earlier date, The last sentence of Mr. Digby's note provided:

In the event of the consummation of said contract [between Meddock and Santa Fe] the balance due at the accelerated maturity date shall be reduced by an amount equivalent to any capital gains taxes paid by said Meddock Truck Line as the result of the consummation of said contract with Santa Fe Trail Transportation Company.

The transaction was secured by a pledge of the Meddock stock.

Mr. Digby made all payments of principal and interest as agreed until January 1962. In that month the ICC approved the sale of Meddock's trucking rights and equipment to Santa Fe. The amount due on Mr. Digby's promissory date was thereupon reduced by \$25,430.36, the amount of the federal capital gains tax due from Meddock on the Santa Fe sale, and on January 31, 1962, Mr. Digby paid the adjusted balance due on the note. A prior reduction in the balance due under the note had been made in February 1959 in the amount of \$2,388.98, as a result of a sale price formula miscalculation.

In his 1958 return appellant-reported gain from the sale of his Meddock stock to Digby on the basis of the receipt of the **entire** purchase price (\$126,358.44). In 1962, following the ICC's approval of the Meddock-Santa Fe transaction and a determination of Meddock's federal capital gains tax liability, appellant filed an amended return for 1958 in which he reported a purchase price of \$98,539.10, the amount of cash actually received from Mr. Digby (\$126,358.44, less 1959 adjustment of \$2,388.98 and 1962 adjustment of \$25,430.36). Respondent's disallowance of appellant's claim for refund gave rise to this appeal,

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Respondent states that the gain realized by appellant in 1958 on the sale of his Meddock stock was measurable by the cash down payment he received plus the fair market value of the note taken for the balance. Respondent urges that appellant has failed to sustain his burden of proving what the value of that note was in 1958, and that it was therefore proper for him to report the entire unadjusted purchase price in 1958, as he did, and then to take a loss deduction in 1962 in the amount of the adjustment.

Appellant argues that the contingency provision in the note made it impossible in 1958 to tell what the final selling price of the stock would be. Appellant contends that he therefore properly filed a timely amended return for 1958 in 1962, when the amount of the purchase price was finally settled.

Gain from a sale or other disposition of property is the excess of the amount realized therefrom over the adjusted basis of the property. (Rev. & Tax. Code, § 18031, subd. (a).) The "amount realized" from an exchange of property is the sum of money received, plus the fair market value of the property, other than money, which is received. (Rev. & Tax. Code, § 18031, subd. (b).) A determination of the total gain realized by appellant in 1958 upon the sale of his Meddock stock therefore turns upon the fair market value of Mr. Digby's note at the time of the sale,

The amount payable on the note was subject to reduction by the amount of any federal capital gains tax due from Meddock if the sale of its trucking rights and equipment to Santa Fe was consummated. The completion of that sale, in turn, was conditioned upon approval of the transaction by the ICC and other governmental agencies. The amount of capital gains tax due from Meddock would depend upon the sale price of Meddock's operating rights and assets. That price, as provided in the contract between Meddock and Santa Fe, was to be \$139,460.82 cash, plus the amount of two variables on the date of consummation.

The above contingencies made the amount which would be paid on the note speculative and uncertain. Similar uncertainties with respect to the payment of promissory notes have been held to require a finding that the notes had no fair market value at all. (Carling Dinkler, Executor, 22 B.T.A. 329; Edward J. Hudson, 11 T.C. 1042, aff'd, 183 F.2d 180, 184 F.2d 518.) Assuming that the note in question did have a fair market value, we do not believe the value exceeded the amount which appellant ultimately did in fact receive on the note. Since his refund claim for 1958 is based on that amount, we conclude that the refund should be granted,

