



BEFORE THE STATE BOARD OF EQUALIZATION
'OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
RICHARD E. AND JUNE M. ECKENWEILER)

Appearances:

For Appellants: Gino Coppa
Certified Public Accountant

For Respondent: Richard A. Watson,,,))
Counsel

OPINION

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board -on- the protest of Richard E. and June M. Eckenweilek against a proposed assessment of additional personal income tax in the amount of \$16,322.05 for the year 1968.

Richard E. Eckenweiler, hereinafter referred to as appellant, entered into a limited partnership with Sunset International Petroleum Corporation on July 1, 1965. The partnership, Hacienda Hills, Limited, was formed to acquire, develop, and sell certain real property located in Hacienda Hills, Los Angeles County.

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Appellant, who was the general partner, contributed the following property, subject to notes secured by trust deeds, to the partnership:

Assets contributed at cost		
Improved real estate	\$ 441,734.74	
Improved subdivision lots	2,553,999.93	
Houses under construction	442,855.65	
Unimproved land	131,577.40	
Model home furniture	50,363.41	
Plan deposits	4,000.00	
	<u> </u>	
Total		\$3,624,531.13
Liabilities		
Notes payable (secured by trust, deeds)	\$3,600,838.75	
Contracts payable	25,508.18	
Accounts payable and customers' deposits	5,772.09	
	<u> </u>	
Total		\$3,632,119.02
Excess of liabilities over assets contributed		<u>\$ 7,587.89</u>

On March 1, 1966, pursuant to an appropriate amendment to the articles of limited partnership, appellant became the limited partner and Sunset International Petroleum Corporation became the general partner.

The partnership's operations for the years 1965 through 1967 resulted in the following losses:

<u>Year</u>	<u>Partnership's Total Loss"</u>	<u>Appellant's Distributive Share</u>
1965	\$ 49,040.00	\$ 20,620.00 ^{1/}
1966	511,837.00	255,919.00
1967	715,519.00	357,759.00
T o t a l	<u>\$1,276,396.00</u>	<u>\$634,298.00</u>

^{1/} This amount reflects appellant's withdrawals from the partnership in addition to his distributive share of the partnership loss for 1965.

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I however, for the year 1968 the partnership's net income was \$357,220.00. Appellant's distributive share was \$178,610.00. The income resulted from the excess of liabilities existing against the partnership's real property over the properties' basis at the time of foreclosure by California Federal Savings and Loan Association in that year.

Appellant did not include his distributive share of the partnership's income in his 1968 California personal income tax return. It is appellant's position that the inclusion of his share of the partnership's net losses for the years 1965 through 1967 did not result in any tax benefit since appellant's taxable income, without inclusion of the partnership's net losses, resulted in no tax liability for those years. Therefore, appellant concludes, those losses should be available to offset his distributive share of the 1968 partnership income.

Respondent determined that the income should properly have been included in appellant's 1968 income and issued the proposed assessment which forms the basis for this appeal.

The parties agree that the foreclosure constituted a sale and that a gain was realized to the extent that the liabilities exceeded the properties' basis in the hands of the partnership. They also agree that since the property was held primarily for sale in the ordinary course of the partnership's business the gain constituted ordinary income. Therefore, the sole issue for determination is whether appellant is taxable upon his distributive share of the partnership income for the year 1968.

Appellant relies on section 17858 of the Revenue and Taxation Code and the regulations which interpret that section. Section 17858 of the Revenue and Taxation Code states:

A partner's distributive share of partnership loss (including capital loss) shall be allowed only to the extent of the adjusted basis of such partner's interest in the partnership at the end of the partnership year in which such loss occurred. Any **excess** of such loss over such basis shall be allowed as a deduction at the end of the partnership year in which such excess is repaid to the partnership.

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The regulation interpreting section 17858 provides, in part:

A partner's distributive share of partnership loss will be allowed only to the extent of the adjusted basis (before reduction by current year's losses) of such partner's interest in the partnership at the end of the partnership taxable year in which such loss occurred. A partner's share of loss in excess of his adjusted basis at the end of the partnership taxable year will not be allowed for that year. However, any loss so disallowed shall be allowed as a deduction at the end of the first succeeding partnership taxable year, and subsequent partnership taxable years, to the extent that the partner's adjusted basis for his partnership interest at the end of any such year exceeds zero (before reduction by such loss for such year). (Cal. Admin. Code, tit. 18, reg. 17855-17859, subd. (d)(1); see also Cal. Admin. Code, tit. 18, reg. 17855-17859, subd. (d)(4), Example (1).)

Appellant maintains that when the above principles are applied the result is that the \$178,610.00 in income realized as a result of the foreclosure in 1968 increased the basis of his partnership interest, which prior to the foreclosure was zero, to \$178,610.00, thus permitting the deduction of losses disallowed in prior years up to that amount. Since the \$634,298.00 in partnership losses allocated to him for the years 1965 through 1967 exceeded the \$178,610.00 in income realized in 1968, a loss in an equivalent amount is allowable in 1968, thus offsetting the entire amount of income. Therefore, appellant concludes, he was correct in not reporting any partnership income for 1968.

Critical to appellant's argument is the supposition that his initial basis in the partnership was zero. However, the record, the applicable regulations, and case law do not support such a conclusion. (Cal. Admin. Code, tit. 18, regs. 17860, subd. (a), 17882, and 17915; see also Frank A. Logan, 51 T. C. 482; Streuling and Boley, The Assumption of a New Partner's Debts by a Partnership: How Does It Offset His Basis? 1974-10 J. Tax. 240; Treas. Regs. §§ 1.705-1, 1.722-1, and 1.752-1.)

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The basis to a partner of his partnership interest acquired by a contribution of property to the partnership shall be the adjusted basis of the property at the time of contribution. If the contributed property is subject to indebtedness the basis of the contributing partner's interest shall be reduced by the portion of the indebtedness assumed by the other partners, since the partnership's assumption of his indebtedness is treated as a distribution of money to the contributing partner. (Cal. Admin. Code, tit., 18, reg. 17882.)

In a similar vein, the regulations also provide that where a partnership assumes the separate liabilities of a partner or a liability to which property owned by such partner is subject, the amount of the decrease in such partner's liabilities is treated as a distribution of money by the partnership to such partner. It is immaterial whether the mortgage is assumed by the partnership. (Cal. Admin. Code, tit. 18, regs. 17915, subd. (b)(2) and (c).)

Appellant's original basis in the partnership, when computed in accordance with the principles set out above, is \$1,808,471.62.^{2/} This amount was more than sufficient to allow appellant to utilize his one-half share of the partnership's losses for the years 1965 through 1967, which totaled \$634,298.00. Consequently, appellant was not precluded by the provisions of section 178.58 of the Revenue and Taxation Code and the applicable regulations from utilizing any partnership loss during the years 1965 through 1967. Therefore, appellant had no unusable loss available in 1968 to offset the income realized in that year.

In conclusion it is our opinion that appellant's distributive share of partnership income resulting from the foreclosure of partnership property which was subject to liabilities in excess of basis was properly includible in his 1968 income. Accordingly, respondent's action in this matter must be sustained.

<u>2/</u> Appellant's cost basis of assets	
contributed to the partnership	\$3,624,531.13
Less:	
Portion of indebtedness assumed by other partner (1/2 x \$3,632,119.02)	<u>1,816,059.51</u>
Appellant's original basis in the partnership	<u><u>\$1,808,471.62</u></u>

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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 protest of, Richard E. and June M. Eckenweiler against a proposed assessment of additional personal income, tax in the amount of \$16,322.05 for the year 1968, be and the same is hereby sustained.

Done at Sacramento, California, this 7th day of October, 1974, by the State Board of Equalization,

Edo J. Beech, Chairman
Stan G. Lynch, Member
Chub H. Hays, Member
William B. Burnett, Member
_____, Member

ATTEST: *W. W. Denlop*, Secretary