80-SBE-157

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
CHARLES E. AND ADA E. CONNORS)

For Appellants: Kneeland H. Lobner
Attorney at Law

For Respondent: Mark McEvilly
Counsel

OPINION

This appeal is made pursuant to section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Charles E. and Ada E. Connors against a proposed assessment of additional personal income tax in the amount of $537.60 for the year 1976.

The primary issue for determination is whether a distribution, transmission, or other disposition of an installment obligation hasoccurred within the meaning of Revenue and Taxation Code section 17580, resulting in immediate gain to appellants. Charles E. Connors is included as an appellant solely because he and Mrs. Connors filed a joint return. "Appellant" herein shall refer to Ada E. Connors'.

Appellant was appointed executor of the estate of Ruth Burgess, who died testate on November 4, 1975. Except for some small cash bequests, appellant was also the legatee of all the decedent's property, including a piece of real property which was appraised by an inheritance tax referee at $22,500 as of the date of decedent's death. In October 1976 appellant, as executor, contracted to sell this property, obtaining a promissory note for the purchase price of $37,000. The sum of $10,500 was to be paid in cash upon confirmation of the sale in 1976, $9,500 was to be paid on January 2, 1977, and the balance of $17,000 was to be paid in monthly installments thereafter.- The sale was confirmed and the initial payment made as scheduled. Installment treatment apparently was properly elected by the estate for reporting the gain on the sale. The probate court entered a Decree of Distribution on December 29, 1976, distributing the promissory note and deed of trust to appellant as a beneficiary of the estate. Actual delivery of the estate assets to appellant apparently took place late in January 1977.

On their 1976 California personal income tax return, appellants reported the proportionate amount of profit received in 1976 as a capital gain from the above described installment sale, i.e., the amount which would be properly reportable under the installment method elect ion. Respondent, on examining appellants' return, determined that the distribution of the note to appellant as the estate beneficiary constituted a distribution within the meaning of section' 17580, requiring that the entire gain on the installment sale be reported in 1976. Since the installment obligation was distributed by the estate, a deduction for the reportable gain is allowed to the estate (Rev. & Tax. Code, §17761), and the entire unreported gain is taxable to appellant as distributee (Rev. & Tax. Code, §§ 17762, 17763.). Respondent issued a notice of proposed additional tax for 1976, which appellants protested. Respondent thereafter affirmed the proposed assessment, and appellants filed this timely appeal.

Revenue and Taxation Code section 17580 provides, in pertinent part:

> (a) If an installment obligation is satisfied at other than its face value or distributed, transmitted, sold, or otherwise disposed of, gain or loss shall result to the extent of the difference between the basis of the obligation and--
>
> (1) The amount realized, in the case of satisfaction at other than face value or a sale or exchange, or
>
> (2) The fair market value of the obligation at the time of distribution, transmission, or disposition, in the case of the distribution, transmission, or disposition otherwise than by sale or exchange.
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> Any gain or loss so resulting shall be considered as resulting from the sale or exchange of the property in respect of which the installment obligation was received.
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> (b) The basis of an installment obligation shall be the excess of the face value of the obligation over an amount equal to the income which would be returnable were the obligation satisfied in full.

Since the relevant part of section 17580 is based on and substantially the same as the Internal Revenue Code of 1954, section 453(d), and its predecessor, section 44(d) of the Revenue Act of 1936, federal case law and interpretations are highly persuasive in construing. the California section. (Rihn v. Franchise Tax Board, 131 Cal.App.2d 356, 360 [280 P.2d 893] (1955).)

Ordinarily, when one receives a note in payment for the sale of an asset, it will be deemed the equivalent of cash and the entire gain realized is recognized in the year of the sale, even though the amount is paid off in installments. (See, e.g., Appeal of Roe C. and Rhoda M. Hawkins, Cal. St. Bd. of Equal., Jan. 10, 1963.) However, the seller may elect to spread the reporting of the gain proportionately over the period during which he actually receives payments. (Rev. & Tax. Code, §§ 17577, 17578; Int. Rev. Code of 1954, § 453.) If the installment obligation is later

"distributed, transmitted, sold, or otherwise disposed Of," section 17580 makes this deferred reporting no longer available to the taxpayer, and the entire unreported gain must be reported in the year of the disposition of the obligation. Since the gain has already been considered as both realized and recognized, the disposition is not a "taxable event," as such, but merely requires the immediate reporting of the gain. (See, Emory, Disposition of Installment Obligations: Income Deferral, "Thou Art Lost and Gone Forever" (1969) 54 Iowa L.Rev. 945.)

Respondent contends that the distribution of the installment obligation which is the subject of this appeal falls squarely within the plain meaning of section 17580. We agree with respondent's contention.

In Estate of Henry H. Rogers, 1 T.C. 629 (1943), affd., 143 F.2d 695 (2d Cir. 1944), cert. den., 323 U.S. 780 [89 L.Ed. 6231 (1944), executors sold assets of an estate, receiving an installment obligation in return and electing installment reporting for the gain. Subsequently, on distribution of the estate, the obligations were transferred by the executors to themselves as testamentary trustees. The tax court, saying that the word "distribution" must be accorded its ordinary meaning, held that a distribution had occurred within the meaning of section 44(d) of the Revenue Act of 1936, and therefore the reporting of the gain on the sale had to be accelerated. The tax court again found a distribution within the meaning of section 44(d) in. Harry F. Shannon, 29 T.C. 702 (1958), where executor-trustees sold certain real estate, received an installment note in return, and distributed undivided interests in the note to the beneficiaries under the decedent's will. In Appeal of Paul Greening Trust, Jack W. and Robert Greening, Co-Trustees, decided by this board on December 7, 1970, we found a distribution within Revenue and Taxation Code section 17580 on facts verv similar to those in Estate of Henry H. Roqers, supra. These cases establish that when, as in appellant's case, an installment obligation is distributed by an estate or trust to its beneficiaries, the obligation is "distributed, transmitted, ... or otherwise disposed of" within the meaning of section 17580 and its federal counterpart.

Appellant asserts that the result here should be different because her rights in the property became vested as of the decedent's death (Prob. Code, §§ 28 & 300), so there was no real transfer of ownership on

distribution of the estate. The court of appeals, however, in affirming the tax court's opinion in Estate of Henry H. Rogers, supra, rejected the same argument that appellant makes here (Estate of Henry H. Rogers, supra, 143 F.2d at 696), and we believe that is the correct result. Although, for the purposes of construing wills and estate administration, the distributee here may have had vested rights in the property as of the decedent's death, for tax purposes the estate and the distributee were two separate entities and there was a transfer from one to the other. Additionally, section 17580 of the Revenue and Taxation Code, by its terms, includes any distributions or dispositions. Specific exceptions are enumerated in the statute, but distributions from an estate to a distributee are not included among them. We must, therefore, decline to usurp the prerogative of the Legislature by adding exceptions to a statute which is clear and unambiguous.

Having decided that a distribution occurred within the meaning of section 17850, we now must consider a second issue raised by appellant. Her position is that the distribution did not take place on December 29, 1976, the date of the probate court's entry of the Decree of Distribution, but rather, in January 1977, when the actual delivery of the estate assets was made to her as distributee. Although the term "distribution" may be used loosely to indicate actual delivery, as used in relation to wills, it "means a decree of distribution, not physical delivery of the assets." (Estate of Newman, 230 Cal.App.2d 158, 162 [40 Cal.Rptr. 7851 (1964).) Therefore, we agree with respondent's determination that the distribution occurred in 1976, upon entry of, the decree.

There is one final matter with which we must deal. Respondent has apparently computed the reportable gain as the difference between the basis of the property and its selling price. This is clearly contrary to the explicit instruction of section 17580. In the case of a disposition other than a sale or exchange, the reportable gain is the difference between the basis of the installment obligation and its fair market value at the time of distribution. (Rev. & Tax. Code, § 17580, subd. (a); Cal. Admin. Code, tit. 18, reg. 17577-17580(i), subd. (2).) Of course, the burden is on appellant to show the fair market value of the obligation at the time of its distribution, but respondent cannot ignore the method of measuring gain clearly set out in the statute and explained in the regulations thereto.

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 Charles E. and Ada E. Connors against a proposed assessment of additional personal income tax in the amount of $537.60 for the year 1976, be and the same is hereby sustained, with the understanding that the amount of gain to be included in appellants' income for that year be redetermined in accordance with the views set forth in this opinion.

Done at Sacramento, California, this 9th day of December, 1980, by the State Board of Equalization. with Members Nevins, Bennett, Reilly and Dronenburg present.

Richard Nevins, Chairman

George R. Reilly, Member

Ernest J. Dronenburg, Jr., Member

William M. Bennett, Member

_____, Member