BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) No. 31R-1019
ESTATE OF STEPHEN J. WOLF)

Appearances:

For Appellant: Ralph Mitzenmacher
Attorney at Law

For Respondent: Michael R. Kelly
Counsel

O P I N I O N

This appeal is made pursuant to section 19057, subdivision (a),[1/] of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of the Estate of Stephen J. Wolf for refund of personal income tax in the amount of $13,145[2/] for the year 1978.

1/ Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the year in issue.

2/ As explained in detail in footnote six, appellant has modified its claim for refund to $9,969. (App. Post-Hrg. Supp. Br. at 9.)

The central issue presented is whether appellant is entitled to a deduction for a loss due to the transfer of certain shares of a closely held corporation pursuant to the terms of a stock purchase agreement more commonly referred to as a "buy-sell" agreement.

The estate, appellant herein, was created on November 21, 1977, upon the death of Stephen J. Wolf. Among the assets of the estate were 400 shares of Wolf & Rissmiller Concerts and 400 shares of Wolf & Rissmiller Productions (collectively referred to as "Wolf & Rissmiller stock"). That stock was subject to an agreement dated May 29, 1975, entitled "Stock Purchase and Trust Agreement" (App. Br., Ex. I) which outlined the rights and obligations of each party. Briefly, the Agreement provided that Stephen Wolf and James Rissmiller[3/] would each own 400 shares of the corporation.[4/] The parties agreed "not to sell, assign, transfer, encumber, hypothecate, or make any other disposition of any Shares . . . except with the written consent of the Parties and in accordance with the terms of this Agreement." (App. Br., Ex. I, par. 2.) That same paragraph provided that the Agreement would be binding upon any executor or administrator of either party. Paragraph seven of the Agreement further provided as follows:

> Upon the death of either Shareholder, the surviving Shareholder shall purchase, and the estate of the decedent Shareholder shall sell, all of the Shares now owned or hereafter acquired by the decedent Shareholder. The purchase price of such Shares shall be the sum of Two Hundred Thousand Dollars ($200,000.00).

Each shareholder agreed to finance such a purchase by obtaining life insurance of not less than $200,000 upon the life of the other shareholder. (App. Br., Ex. I, par. 8.)[5/] Moreover, the Agreement provided that

3/ Stephen Wolf and James Rissmiller were not related in any way, but were business associates.

4/ An additional 100 shares were to be purchased by a partnership denoted as MPR Associates - W & R, the partners of which are not identified in the record.

5/ The record does not indicate whether the corporation owned any tangible assets.

each share certificate was to be endorsed with a legend indicating that such certificate was "transferable only upon compliance with provisions of a Stock Purchase and Trust Agreement dated May 29, 1975." (App. Br., Ex. I, par. 14.)

Appellant timely filed its fiduciary return for the year at issue reporting that its Wolf & Rissmiller stock had been sold in March of 1978 for $200,000. Since, pursuant to section 18044, the basis of property acquired from a decedent is deemed to be its fair market value at the time of its acquisition, appellant determined that its basis in the stock was $200,000 and concluded that no gain or loss was realized upon the transfer. (See Rev. & Tax. Code, § 18031.)

On January 5, 1981, the California Inheritance Tax Referee assigned to the estate filed an Amended Final Inventory and Appraisement which increased the valuation of the subject Wolf & Rissmiller stock from $200,000 to $347,054. As a result of that change in valuation, appellant filed an amended fiduciary income tax return for the year at issue claiming that the basis of the Wolf & Rissmiller stock transferred was $347,054 rather than $200,000, thereby producing a loss on sale of $147,054.[6/] (Rev. & Tax. Code, § 18031.) Respondent treated the amended return as a claim for refund which it disallowed because it concluded that the decedent was not the legal owner of the subject shares. (Resp. Br., Ex. G.) Appellant's protest led to this appeal.

On appeal, respondent abandoned its initial theory agreeing with appellant that section 17737 obviates the need to ascertain whether the trust or the decedent's estate had legal title to the stock. (See Resp. Nov. 14, 1984, letter.) However, respondent

6/ At the hearing before this board, appellant stated that it was successful in obtaining a $70,000 settlement from the prior executor due to certain improprieties including the sale of the subject stock for "only" $200,000. Appellant apportioned $35,000 of this settlement to sale proceeds from the stock thereby reducing its alleged loss by $35,000 and reducing its claim for refund as noted in footnote two above. Notwithstanding this allocation, for the sake of clarity in this appeal, sales proceeds from the subject stock will be noted as being $200,000 rather than $235,000.

respondent advanced an alternate theory as support for its disallowance of appellant's claim for refund.

Respondent now argues that the Inheritance Tax Referee valued the Wolf & Rissmiller stock at $347,054 pursuant to the authority of Estate of Bielec, 8 Cal.3d 213 [502 P.2d 12] (1972).[7] Based upon its reading of Bielec, respondent concludes that in the instant situation, the excess of value transferred (i.e., $347,054 less $200,000 or $147,054) by appellant was actually a donative transfer. Accordingly, respondent argues that a consistent finding for income tax purposes requires a conclusion that the transfer[8] was part sale and part gift and to the extent it was a gift, (i.e., to the extent of the excess value conferred), no loss occurred. (Resp. Reply to App. Post-Hrg. Supp. Br. at 4.)[9]

7/ On page 7 of its brief, respondent states that it "is certain the referee valued the shares . . . at greater than $200,000 pursuant to the authority of Estate of Bielec, supra." However, the only documentation even peripherally related to this conclusion is the notation on a copy of the subject Stock Purchase Agreement stating "Not Binding" purportedly made by an inheritance tax attorney.

8/ Since this issue was not subject to any litigation, respondent does not argue that the rule of res adjudicata applies. (See Mallery v. Commissioner, 42 B.T.A. 793 (1940).)

9/ While not stated, the root of respondent's theory appears to be that in order for a loss to be deductible under section 18031, a "sale" must have occurred. Section 18031 is substantially similar to Internal Revenue Code Section 1001. Treasury Regulation section 1.1001-1 (e)(1), provides:

> Where a transfer of property is in part a sale and in part a gift, the transferor has a gain to the extent that the amount realized by him exceeds his adjusted basis in the property. However, no loss is sustained on such a transfer if the amount realized is less than the adjusted basis.

* * *

(9/ Continued on next page)

In Bielec, two brothers who were the sole shareholders of a corporation entered into an agreement which provided that the corporate stock of the first brother to die would be sold back to the corporation for either $100,000 or some other amount to be set in the interim. Ten years after entering into the agreement, one of the brothers died at a time when the fair market value of his stock was $454,127. The inheritance tax referee computed the tax on the basis of that fair market value. The surviving brother objected to that report, contending that the buy-sell agreement conclusively established $100,000 as the value of the stock for inheritance tax purposes. The California Supreme Court upheld the inheritance tax report, concluding that where the agreement contained no restriction on an inter vivos sale, the proper time for measuring the adequacy of consideration for the transfer was at the time of death rather than at the time the agreement was entered into. Based upon that conclusion and the fact that the fair market value of stock at that time was $454,127, the court held that the excess of the value received for the stock (i.e., $454,127 less $100,000 or $354,127) "is tantamount to a testamentary gift . . ." (Estate of Bielec, supra, 8 Cal.3d at 223) and subjected the excess to inheritance tax pursuant to section 13641.

It is well settled that a taxpayer who claims a deduction has the burden of proving that he is entitled to that deduction. (New Colonial Ice Co. v. Helvering, 292 U.S. 435 [78 L.Ed. 1348] (1934); Appeal of Crystal Ice and Cold Storage Company, Cal. St. Bd. of Equal., Mar. 7, 1979.) In order to claim a loss on a sale, ordinarily a taxpayer must establish that the adjusted basis of the property transferred is greater than the price obtained from the "sale or other disposition" of

9/ (Continued)

The provisions of subparagraph (1) may be illustrated by the following examples:

* * *

A transfers property to his son for $30,000. Such property in the hands of A has an adjusted basis of $60,000 (and a fair market value of $90,000). A has no gain or loss and has made a gift of $60,000, the excess of $90,000, the fair market value, over the amount realized, $30,000.

that property. (Rev. & Tax. Code, § 18031.) In the instant matter, appellant has clearly established that such a prima facie loss occurred.[10/] The values assigned to assets for inheritance tax purposes establish the prima facie fair market value for the adjusted basis of property acquired from a decedent. (Rev. & Tax. Code, § 18044; Appeal of William S. and Helen L. Meyer, Cal. St. Bd. of Equal., July 11, 1963.) As indicated above, the inheritance tax referee established that the value of the subject stock was $347,054, at the time of the decedent's death. Moreover, the record indicates that in March of 1978, appellant transferred the stock for $200,000.

Nevertheless, respondent, relying upon Bielec, argues that the transfer was part sale and part gift. Appellant counters that no gift took place since there was no donative intent to make a gratuitous transfer to Wolf's business associate Rissmiller. In addition, appellant contends that for income tax purposes, sections 17287 and 17288, prohibiting the deduction of losses between certain related persons (none of which apply to Rissmiller) are the exclusive statutory provisions available to respondent in this matter to disallow the subject loss. Respondent, of course, disagrees with each of appellant's contentions.

While respondent's main argument may be plausible in a true Bielec situation, we believe that, factually, this appeal is distinguishable from Bielec. First, nothing in the record establishes that the Controller's office actually relied upon Bielec to value the subject shares at $347,054. The only documentation offered to establish such reliance is a notation on a copy of the Stock Purchase Agreement purportedly made by an inheritance tax attorney stating that the Agreement was "Not Binding." (See fn. 7/ above.) Pursuant to section 14814, respondent was entitled to examine all relevant inheritance tax records. However, apparently relying upon section 14813, the Controller's office determined that the disclosure of such records would violate

10/ Indeed, appellant has clearly suffered an economic loss since inheritance tax was paid based upon the inheritance tax referee's value of $347,054 for the stock, but appellant received only $200,000 for that stock.

appellant's right to confidentiality. (See Resp. Reply Br., Ex. AA.)[11]

This lack of evidence creates a two-fold problem for this board. Not only are we unable to ascertain whether the Controller's office actually relied upon Bielec, we are also unable to ascertain that if it did, it did so properly. Indeed, the instant record appears to be easily distinguishable from Bielec. First, the surviving shareholder in this appeal was of no blood relation to the decedent, but was merely decedent's business associate. In Bielec, the surviving shareholder was the decedent's brother. Second, in this appeal, the surviving shareholder took nothing from the estate. In Bielec, the surviving brother was the principal beneficiary of his brother's will. Accordingly, unlike the instant situation, Bielec presented a classic case of inheritance tax avoidance by related parties. Third, in Bielec, the court found that the buy-sell agreement contained no provision restricting an inter vivos sale by either brother. (Estate of Bielec, supra, 8 Cal.3d at 218, fn. 4.) In the instant appeal, the agreement provided that an inter vivos sale was prohibited except with the written consent of the parties and all stock certificates were endorsed with a legend indicating that such stock was only transferable in compliance with the Stock Purchase Agreement. (App. Br., Ex. I.) Many other factors in the instant appeal (e.g., length of time between the agreement and date of death; ratio of buy-sell valuation versus inventory valuation; type of corporate assets) also distinguish this appeal from Bielec.

Accordingly, based upon the record before us, there appears to be no solid basis for us to conclude that the Controller's office actually relied upon Bielec. Moreoever, we don't find appellant's failure to formally object to the inheritance tax referee's report to be determinative in this appeal. That is, the initial executor of decedent's will was discharged due to various improprieties (including the sale of the subject stock for "only" $200,000), and he and his insurers ultimately paid appellant $70,000 in settlement of those claims. When the inheritance tax referee valued the subject stock at $347,054, it seems to us that as a practical matter,

11/ Since section 14814 allows disclosure to any state official charged with the administration of any tax, including this board, it is at least arguable that such records could be disclosed in this appeal.

appellant could either formally object to that value and weaken or compromise its claim against the initial executor for malfeasance involving that sale or not object and solidify its claim against that executor. In this light, contrary to repondent's contention, we do not find appellant's failure to formally object to the inheritance tax referee's value to be controlling in this appeal.

At this point then, the question is whether any part of the instant transfer of stock to Rissmiller involved a gift. Respondent correctly states that "[i]f a gift was made, any donative intent would have to come from decedent, not from appellant." (Resp. Reply to App. Post-Hrg. Supp. Br., at 3.) After the donor is dead, it is "but a salutary precaution [to require] explicit and convincing evidence of every element that constitutes a valid gift. . . ." (Blonde v. Estate of Jenkins, 131 Cal.App.2d 682, 685 [281 P.2d 14] (1955).) One of the essential elements of a gift is donative intent which has been defined as a "clear intention on the part of the donor to make a gift. . . ." (Turnbull v. Thomsen, 171 Cal.App.2d 779, 784 [341 P.2d 69] (1959).) In this appeal, we cannot conclude that there is such explicit and convincing evidence of decedent's intent to make a gift of the subject stock. We note that the transferee, Rissmiller, was not a blood relative of decedent and was merely his business associate. Moreover, Rissmiller was not a beneficiary under decedent's will but the bulk of the estate passed to decedent's son. The weight of the record indicates that decedent and Rissmiller were dealing with each other at arm's length and not with donative intent. Accordingly, based upon the record presented us, we cannot find that any part of the transfer of stock to Rissmiller involved a gift. Therefore, subject to appellant's modifications to its claim noted above, we must reverse respondent's action here.[12]

12/ Because of this finding, we do not have to address appellant's arguments based upon sections 17287 and 17288.

Appeal of Estate of Stephen J. Wolf

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 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of the Estate of Stephen J. Wolf for refund of personal income tax in the amount of $13,145 as reduced by appellant's concession for the year 1978, be and the same is hereby reversed.

Done at Sacramento, California, this 9th day of October, 1985, by the State Board of Equalization, with Board Members Mr. Dronenburg, Mr. Collis, Mr. Bennett, Mr. Nevins and Mr. Harvey present.

Ernest J. Dronenburg, Jr., Chairman

Conway H. Collis, Member

William M. Bennett, Member

Richard Nevins, Member

Walter Harvey*, Member

*For Kenneth Cory, per Government Code section 7.9