

# CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 096

June 26, 1958

## CAPITAL GAINS: REDUCTION OF GAIN PREVIOUSLY REPORTED

### Syllabus:

The reduction of a previously reported capital gain is a capital loss and subject to the same limitations as other capital losses.

Taxpayer, a principal officer of a corporation, received options to purchase stock in the corporation. They were later sold and the resulting gain reported as a capital gain. Subsequently a minority shareholder threatened a suit, claiming the sale to be illegal. Taxpayer settled the claim and deducted the amount paid in settlement in his return. Advice is requested whether such "diminution of capital gains" are subject to the same limitations as capital losses for purposes of the maximum loss deduction limitation of \$2,000.

The courts make no tax distinctions between payments labeled "diminution of capital gains" and those described as capital losses. In Arrowsmith v. Comm., 344 US 6, the Supreme Court did not describe the transaction as the "diminution of capital gain", but the Circuit Court opinion which it affirmed (Comm. v. Bauer, 183 F2d 734) did so characterize it. The payments served to reduce the previous capital gain realized. The court held that these reductions were capital losses rather than ordinary loss, and as capital losses subject to all the limitations provided in the code. Duveen Brothers, Inc., 17 TC 124, aff'd per curiam, 197 F2d 118, cert. den., 73 U.S. 182, gives further weight to the conclusion that reductions of a previous capital gain or loss are also capital gain or loss transactions subject to the same limitations as other capital gains or losses. It is concluded that the payment herein is a reduction in the gain from the original sale of the options and assumes the same nature as the original transaction. Since the original transaction was taxed as a capital gain, the subsequent payment was a taxable loss, and subject to the same limitations as other capital losses.