

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 127

June 20, 1958

CANCELLATION OF CONTRACTS

Syllabus:

Amounts paid by the seller to the buyer to obtain the cancellation of a contract of sale of income property are capital expenditures and must be added to the seller's cost basis.

Taxpayer, the owner of an out-of-state apartment house, entered into a contract to sell the property. Prior to the time of conveyance and complete performance by the buyer, taxpayer received a better offer for the property. Taxpayer entered into an agreement with the buyer under which he made a substantial payment to excuse performance. The property has not subsequently been sold. Advice is requested whether the payment to the buyer was a deductible loss or a capital expenditure.

The payment in question falls squarely within Regulation 17351(b), as the taxpayer perfected his title to property by eliminating the equitable interest of X. In Earl M. Palmer, 3 BTA 403, the court held a payment, which was analogous to the present payment, to be a capital expenditure as it secured the entire future business profits to Palmer. In the present case, taxpayer's payment secured not only future rentals from the property but also any additional amounts a sale of the property would bring over the agreed price to be paid by buyer. Such benefit extended to the future only, and accordingly, the payment should be added to taxpayer's cost basis for the property and be depreciated over its useful life.