

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 135

June 23, 1958

CANCELLATION OF INDEBTEDNESS: BANKRUPTCY

Syllabus:

The discharge of indebtedness under Chapter X through XIII of the National Bankruptcy Act does not give rise to taxable income.

Taxpayer, a corporation, filed a voluntary petition in bankruptcy under Chapter X of the National Bankruptcy Act. Claims for taxes were not filed by the closing date for filing claims and the court refused a petition for the late filing of the claims. Subsequently, a lien for those taxes was filed, however, it was ordered removed. An administrative claim was filed later for taxes arising out of the discharge of indebtedness from the Chapter X proceedings. Advice is requested whether taxpayer realizes taxable income as a result of the cancellation of indebtedness resulting from Chapter X proceedings.

Chapters X, XI, XII and XIII of the Bankruptcy Act contain sections which provide that no taxable income (either Federal or State) can arise out of a discharge of a debtor's obligation under those chapters. In the instant case Section 268 of Chapter X directly forbids such an assessment. Our Regulation 23852-23852a in its provisions recognizes the exclusive Federal authority in this field. The only exception to the conclusion that income cannot arise from a discharge of indebtedness under Chapter X through XII appears in Sections 269, 395, 521 and 679, which provide that the plan of discharge may be refused confirmation if it has as one of its principal purposes the avoidance of taxes.