

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 138

June 27, 1958

INVOLUNTARY CONVERSION

Syllabus:

Two vessels owned by taxpayer were requisitioned by the federal government in 1942 and were returned in 1945 in a miserable state of disrepair. As a result taxpayer could no longer use them for the purposes for which they were originally acquired and it was necessary for taxpayer to replace them. Taxpayer sold the vessels in July 1946 and placed the net proceeds in a replacement fund. In December 1946 the government paid taxpayer a sum of money in lieu of their obligation to restore the vessels, which was deposited in the replacement fund. In February 1947 taxpayer purchased another vessel and checks were drawn against the replacement fund in the exact amount of the two deposits. Advice is requested as to whether the proceeds of the sale of the two vessels come within the provisions of Section 29443 of the Bank and Corporation Tax Law (formerly Section 20(f) of the 1947 Bank and Corporation Tax Law).

T.B.R., 41, CB 1919 Pg. 78 was a parallel case. It was ruled that the ships could be sold and the restoration payment added to the proceeds of the sale to create a replacement fund which would qualify as a receipt of an involuntary conversion. The rationale of the ruling was that since the property returned to the shipowner was substantially different from the property taken, it may be wiser to replace the property than to restore it. The sale of the unseaworthy vessel was a part of the involuntary conversion process and the proceeds of the conversion consist of the cost restoration payment plus the price of the unusable property. This ruling is equally applicable under the present law.

It must be noted that a substantial change occurred in 1953. Prior to January 1, 1953, the effective date of Section 25035a (now Section 24944), the law was the same as under Section 20(f) of the 1947 Bank and Corporation Tax Law which required that the proceeds from the conversion must be forthwith and in good faith reinvested in replacement property. Whether the "forthwith" requirement was met was a question of fact. Twinbaro Corporation, 2 TCM 369. For determinations whether the facts showed the requirements was meant, see Buckhardt, 32, BTA 1272; Estate of Goodman, 199 Fed 2d 895; Herter v Helvering, 106 Fed 2d 153; Caldbeck Corporation, 36 BTA 452; Chickasha Cotton Gin Company, 18 BTA 1144.

Taxpayer expended the replacement fund within eight months of its creation, eight months after the sale of the ship and only two months after the

restoration payment. This period of time was not an unreasonable delay, considering the size of the investment (more than \$1,000,000), therefore, it would meet the "forthwith" requirement. Section 25035a (now Section 24944 of the 1957 Bank and Corporation Tax Law) was effective January 1, 1953, and abolished the "forthwith" test. It eliminated the requirement that the proceeds from involuntary converted property must be traced into replacement property in order to avoid recognition of gain. This requirement had the effect of denying relief to taxpayers who purchased replacement property in anticipation of seizure or condemnation or who used the proceeds of the conversion to pay off indebtedness on the converted property. In cases of involuntary conversion which occur after December 31, 1952, a specific time limit is provided for within which time replacement must be made, rather than the former requirement that it be made "forthwith".