

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 224

June 27, 1958

CANCELLATION OF INDEBTEDNESS: TAXABLE GAIN

Syllabus:

Under the peculiar facts herein, cancellation of indebtedness results in taxable gain to the taxpayer.

In 1950, taxpayer, a California production corporation, entered into a loan agreement with a corporate foundation for a loan to be used in connection with the production of a certain photoplay. The loan was evidenced by four promissory notes in favor of said foundation and as security for repayment of the loan taxpayer executed a Mortgage of Chattels, Pledge and Assignment and various other documents in favor of said foundation. The photoplay was completed in 1950 and was released in 1951 with disappointing results. Taxpayer amortized the cost of the photoplay under the estimated gross receipts method and by the end of March 1953 it had recovered \$129,406.36 of its basis. The remaining unamortized basis being \$2,372.04. The loan, as evidenced by said promissory agreement taxpayer sold, assigned, transferred and set over to said foundation its right, title and interest in the photoplay etc., and the foundation released and discharged taxpayer from its remaining indebtedness. The agreement transferring the photoplay etc., to said foundation sets out that its purpose was to give to taxpayer releases in exchange for taxpayer's surrender of the photoplay etc. For Federal tax purposes, taxpayer reported the release and transfer amount as gross income against which was applied the unamortized tax basis of \$2,372.04. For state tax purposes taxpayer treated same as nontaxable cancellation of indebtedness under former section 23852 of the Bank and Corporation Tax Law.

Advice is requested as to whether, under the circumstances of this case, taxpayer realized a taxable gain.

The question is not whether taxpayer realized income from a cancellation of indebtedness, but is rather whether it realized gain from the disposition of its property (photoplay etc.) to the foundation pursuant to the agreements.

There appears to be no question of the fact that the taxpayer received and used for its own benefit the amount of the loan and the only repayment it made on the remaining balance of the loan was the transfer of the property. The debt was finally satisfied by that transfer. Since the debt was discharged with property the transaction would be regarded as a sale of the property for the total amount of the debt.

The facts herein fail to demonstrate that taxpayer did not realize a taxable gain.