

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 295

April 23, 1965

DEDUCTION: EXPENSES IN A PARTIAL TAX-FREE EXCHANGE

Syllabus:

Taxpayers exchanged a twenty-three acre ranch for an industrial building. The mortgage on the property they transferred was greater than the mortgage on the property they received. They incurred expenses for title policy fee, for revenue stamps, for escrow fees and for attorney fees. All of these amounts except one-half of the escrow fees and a portion of the attorney fees are expenses not attributable to the property transferred are allocable to the property newly acquired by the taxpayers in the exchange.

What is the proper treatment of the expenses incurred by the taxpayers arising out of the exchange?

Under the law when the entire gain is recognized the expenses of sale are offset against the selling price of the property (Seletha O. Thompson, 9 BTA 1342) and when no gain is recognized these expenses are added to basis (Columbus Die, Tool and Machine Co., 11 TCM 1053).

There is an absence of authority regarding the treatment of selling expenses when boot is received in an otherwise tax-free exchange. In Gabe P. Allen, 10 T.C. 413 taxpayer exchanged improved realty for rental real estate and cash. The issue before the court was whether a mortgage on the improved realty was "other property or money" within the meaning of Section 112(c)(1) of the 1939 Code. In computing the actual amount of gain subject to tax the Service allowed taxpayer to deduct from the cash received as boot the selling expenses incurred on the exchange. There is no indication in the case whether the expenses were attributable in part to each of the exchanged properties. There appears to be no cases which deal specifically with this question.

It is argued with some logic that since the exchange is a package deal that all expenses should be applied against the boot to reduce the taxable gain. However, in view of the lack of specific authority in this area it is recommended that the selling expenses applicable to the property disposed of be applied against the boot and the balance be added to the basis of the acquired property.