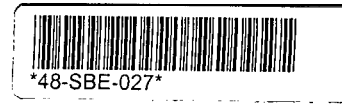


BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA



In the Matter of the Appeal of)
G. H. WHITNEY)

Appearances:

For Appellant: Raymond M. Wansley, Certified Public Accountant

For Respondent: Wm. M. Walsh, Assistant Franchise Tax Commissioner, and James J. Arditto, Franchise Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 19059 of the Revenue and Taxation Code (formerly Section 20 of the Personal Income Tax Act) from the action of the Franchise Tax Commissioner in denying the claim of G. H. Whitney for refund of personal income tax in the amount of \$2,138.22 for the year ended December 31, 1937.

There is no dispute as to the facts. The Corte Madera Corporation was organized under the laws of this State in 1930, and although the corporate articles empowered the directors to levy assessments upon the shares of the corporation, personal liability for such assessments was not imposed upon the shareholders. Appellant acquired one share of Corte Madera stock during that year and the total sum paid therefor, either as initial purchase price or subsequently duly levied assessments, amounted to \$19,250.00. In May, 1937, a further assessment in the amount of \$3,000.00 was duly levied on that share and, upon Appellant's failure to pay the assessment, his share was sold for \$5.00 to the highest bidder at a public sale held on July 14, 1937, pursuant to notice given and published in conformity with pertinent statutory provisions. The Corte Madera Corporation's Secretary issued a certificate of sale to the successful bidder on July 15, 1937, and Appellant neither objected thereto nor took any action which might possibly be construed as being designed to have the sale set aside. In the latter part of 1937 all the Corte Madera Corporation's assets were sold at foreclosure and the share of stock became worthless.

It is Appellant's contention that the sale on July 14, 1937, was void for lack of compliance with an essential statutory requirement; that the ownership of his share was, accordingly, not terminated by that sale; and that either the share was forfeited to the Corporation in accordance with the pertinent statutory provisions or he retained his ownership of the share until it became worthless in the latter part of 1937, in either case a fully deductible loss being sustained pursuant to the law then in effect in an amount equal to the cost basis of the share. The Commissioner, however,

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maintains that Appellant's ownership of the share was terminated by the sale on July 14, 1937, and that the loss sustained thereby was subject to the capital loss limitations provided for by Section 7(e) of the Personal Income Tax Act as amended in that year.

The sale of the stock for a delinquent assessment is governed by the pertinent provisions of the California Civil Code, Section 336 of that Code, as in force and effect during the year 1937, provided in part as follows:

"At the place and time appointed in the notice of levy and sale, the . . . secretary . . . of the corporation . . . shall sell or cause to be sold to the highest bidder for cash as many shares of each delinquent holder of the assessed shares of stock as may be necessary to pay the assessment and charges thereon according to the notice. . . . The person offering at such sale to pay the assessment and penalty for the smallest number of shares is the highest bidder, and the shares purchased must be transferred to him on the share register of the corporation on the payment of the assessment and penalty and a new certificate thereof or issued to such purchaser. . . . If no bidder offer to pay the amount due on the shares, together with the penalty of five per cent thereof, the shares shall be declared forfeited to the corporation in satisfaction of the assessment and penalty thereon. . . ."

Section 336 was not complied with in that the price paid by the purchaser of Appellant's share of Corte Madera stock was but a mere fraction of the amount assessed against that share. In the case of a defect such as this arising after a valid assessment of the share Section 338 of said Code provides:

"No assessment is invalidated by a failure to make publication of the notice hereinbefore provided for, nor by the nonperformance of any act required in order to enforce the payment of the same; but in case of any substantial error or omission in the course of proceedings for collection, all previous proceedings, except the levying of the assessment, are void, and publication must be begun anew. "

The California Supreme Court, however, has found that the word "void" as used in this Section merely means that the irregular proceedings are inoperative to confer an indefeasible title to the stock as against the owner who makes tender of the assessment and brings suit for its recovery within the time specified in Civil Code Section 339. Burham v. San Francisco Fuse and Manufacturing Company, 76 Cal. 26:

Section 339 of the Civil Code provides:

"No action shall be sustained to recover stock sold

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"for delinquent assessments, upon the ground of irregularity in the assessments, irregularity or defect of the notice of sale, or defect or irregularity in the sale unless the party seeking to maintain such action first pays or tenders to the corporation, or the party holding the stock sold, the sum for which the same was sold, together with all subsequent assessments which may have been paid thereon and interest on such sums from the time they were paid; and no such action shall be sustained unless the same is commenced by the filing of a complaint and the issuing of a summons thereon within six months after such sale was made."

It has been held that this Section does not apply to totally void assessments. Cheney v. Canfield, 158 Cal. 342. If, however, the invalidity does not affect the assessment itself it is a mere irregularity or defect and the Section applies. Whitcomb v. Gianini, 43 Cal. App. 229. In reality, in the present case there was at most an irregular sale. The seller could recover the share of stock upon payment of the sum for which it was sold, as provided in Section 339, and it was not under these circumstances a completely void sale but at most it was a voidable sale that terminated Appellant's ownership of said share of stock although he could have commenced proceedings pursuant to Section 339 to set the sale aside. See Newhall v. Hunsaker, 36 Cal. App. 399.

Appellant's position is similar to the position of the petitioner in Ripley Realty Company, 23 B.T.A. 1247, affirmed 61 Fed. 2d 1038, wherein the Board of Tax Appeals held that the profit realized from a sale in 1926 is taxable income for that year although the sale may have been voidable, and there was a later settlement of a claim of fraud made by the purchaser in which the petitioner took back some of the property and to some extent placed the purchaser in the position he was in before the sale. Also see: Gregg Company, Ltd., 25 B.T.A. 81, in which the Board states that a voidable declaration and payment of a dividend reduces invested capital at least until the dividend is restored, thus treating the voidable act as valid until something is done to void it.

On the basis of these authorities it may be said that a voidable sale is properly considered a sale for income tax purposes in the year it is made, at least in the absence of any later attack on the sale. As a result the Appellant here suffered a capital loss at the time of the sale of the stock and is subject to the capital loss limitations of the Act.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefore,

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IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 19060 of the Revenue and Taxation Code, that the action of Chas. J. McColgan, Franchise Tax Commissioner, in denying the claim of G. H. Whitney for a refund of personal income tax in the amount of \$2,138.22 For the year ended December 31, 1937, be and the same is hereby sustained.

Done at Sacramento, California, this 17th day of November, 1948, by the State Board of Equalization.

Wm. G. Bonelli, Chairman
J. H. Quinn, Member
Geo. R. Reilly, Member
J. L. Seawell, Member

ATTEST: DIXWELL L. PIERCE, Secretary