



BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
JAY BRIGGS )

Appearances:

For Appellant: Sidney Rudy  
Attorney at Law

For Respondent: Tom T. Muraki  
Associate Tax Counsel

OPINION

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Jay Briggs against proposed assessments of additional franchise tax in the amounts of \$49.73, \$468.48, \$458.95 and \$432.50 for the income years ended March 31, 1959, 1960, 1961 and 1962, respectively,

The issues involved in this appeal are (1) whether certain monthly payments made to a seller of stock were non-deductible payments for the stock or were deductible either as payments for services or a covenant not to compete, (2) whether certain amounts claimed as entertainment expenses were deductible and (3) whether certain amounts claimed as customer parking expenses were deductible. The facts and arguments relating to each issue will be set forth and discussed separately,

1. Monthly payments to seller of stock.

Appellant Jay Briggs is a California corporation formed in 1955. In that year it began operating a men's clothing **store**, specializing in the sale of "Ivy League" clothes, in San Francisco. Appellant's president was Jack **Davis, who** owned two-thirds of its stock, and its vice

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president was Kurt Gronowski, who owned one-third of the stock, Both stockholders had extensive experience in the clothing business.

At the time of appellant's formation in 1955, Davis and Gronowski agreed that in the event of the death of either of them the survivor would purchase the decedent's stock at book value plus the decedent's share of the net profits for the year preceding his death, after deduction of corporate income tax,

Jack Davis owned, and spent most of his time operating another men's clothing store in San Francisco. This store, known as Jack Davis Clothing, sold primarily conservative business suits, Kurt Gronowski spent most of his time operating the Jay Briggs store,

Appellant's sales, the salaries paid to its officers and its net profits for the years ended in 1956 through 1959 were as follows;

<u>Year</u>	<u>Sales</u>	<u>Davis's salary</u>	<u>Gronowski's salary</u>	<u>Net profits</u>
1956	\$156,224	\$ 2,102	\$ 4,044	\$18,916
1957	3	8,471		63,072
1958	495,504	10,489	12,824	43,135
1959	436,008	13,945	17,039	32,760

In March 1959, Davis agreed to sell his stock in appellant to a partnership composed of Kurt and Hans Gronowski and their mother, Immediately after March 31, 1959, the book value of that stock was \$57,548. If Kurt Gronowski had purchased the stock at that time under the survivor agreement entered into in 1955, the price to him would have been \$71,744.

The pertinent provisions of the agreement between Davis and the partnership were as follows:

- (1) The price of the stock was stated to be \$65,000
- (2) Davis was to be employed by appellant for five years at a total, salary of \$50,000;
- (3) the partnership guaranteed payment of the \$50,000 salary;
- (4) Davis was given the right to declare all of the salary due in case of default in any payment of it;
- (5) the salary was to be paid regardless of any sale of appellant's stock or assets, a change in its officers or directors, or its dissolution;
- (6) Davis was to resign as a director and officer of appellant and
- (7) Davis agreed not to engage directly or indirectly in the operation of a retail store competitive with appellant's business within one city

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block of the intersection of Kearny and Post Streets in San Francisco, except that the agreement was not to affect or restrict Davis's right to operate the Jack Davis Clothing Store at 116 Kearny Street, San Francisco.

Contemporaneously with the above agreement, appellant and Davis entered into an "employment contract" to retain Davis as a "consultant and adviser" for five years at a sum of \$50,000, payable in monthly installments. The services were to be rendered only in San Francisco, for *no* more than an average of two hours a week. The contract provided that the payments were to be made regardless of Davis's inability to render services due to sickness or absence from San Francisco and regardless of any sale of appellant's stock or assets, a change in its directors or officers, or its dissolution.. In case of default in any monthly payment, Davis had the right to declare the balance immediately due and payable. In the event of Davis's death, the monthly payments were to be made to his estate,

After Davis sold his stock, Kurt and Hans Gronowski became appellant's president and vice president, respectively. In subsequent years the sales, salaries and profits were as follows:

<u>Year</u>	<u>Sales</u>	<u>Kurt's salary</u>	<u>Hans I s salary</u>	<u>Net profits</u>
1960	\$519,006	\$21,447	\$20,159	\$11,555
1961	543,366	535,836	21,057	19,412
1962			22,641	25,197
1963	543,533	18,172	17,592	14,252

Respondent determined that the monthly payments to Davis under the agreement of sale and employment contract were part of the purchase price of his stock, that the services actually rendered by him were worth \$3,000 a year and that the balance of \$7,000 a year was not deductible by appellant. Appellant contends that all of the payments were deductible, either as compensation for services or as consideration for a *covenant* not to compete,

Section 24343 of the Revenue and Taxation Code provides for the deduction of "a reasonable allowance for salaries or other compensation for personal services actually rendered, . . ." *Payments* intended as part of the purchase price of property acquired from the person-whose services are alleged desired, are not deductible as compensation regardless of the label placed upon the payments, (Brush-Moore Newspapers, Inc.

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Commissioner, 95 F.2d 900, cert. denied, 305 U.S. 615 [83 L. Ed. 392]; Nicholas Co., 38 T.C. 348; Greene & Greene, 11 B.T.A. 643; Estate of McDevitt, T.C. Memo., Dkt. Nos. 34253-34255, Jan. 30, 1953, aff'd, 212 F.2d 439; Robert H. Heller, T.C. Memo., Dkt. No. 74301, Dec. 23, 1959.) In any event, the payments are not deductible to the extent they exceed a reasonable allowance for services actually rendered, (Nicholas Co., supra; Robert H. Heller, supra.)

The sum of \$65,000, designated in the agreement as the price of Davis' stock, was approximately equal to the book value of his stock plus his share of the profits for the year of the sale. If the stock had not been sold in March 1959 and if Davis had died immediately after the end of that month Kurt could have purchased the stock under the survivor agreement for \$71,744. In view of the substantial profits of the business and its increasing success, however, it is unlikely that Davis, while living, would have sold his stock at that low a price. The contractual provisions whereby the partnership guaranteed payment of the \$50,000 "salary," and whereby that sum was to be paid to Davis of his estate in any event, regardless of the amount of services he rendered and whether or not appellant's business continued or Davis survived, indicate that the payments were part of the purchase price to the partnership.

In support of its position, appellant cites Black River Sand Corp., 18 B.T.A. 490. The holding there, however, was based on a finding that the services actually rendered justified part of the payments and that the balance represented an appropriate deduction for the amortization of a covenant not to compete. There is no evidence that the services rendered by Davis had a reasonable value in excess of \$3,000 annually, the amount allowed by respondent as a deduction.

Although the Board of Tax Appeals in the case of Black River Sand Corp., supra, assigned a value to a covenant not to compete and allowed the amortization of it, other and more recent cases have not been so liberal. (Carl L. Daniels, 44 T.C. 549; Howard Construction Inc., 43 T.C. 343; Nicholas, 38 T.C. 348; Robert H. Heller, T.C. Memo., Dkt. No. 74301, Dec. 23, 1959.) The gist of the more recent cases is that no amortization of such a covenant will be allowed unless it appears that the parties realistically and in good faith attached an independent value to the covenant and that additional consideration was actually paid for it. In the case before us no particular value or consideration for the covenant was specified in the agreement nor does it appear that appellant assigned a value or consideration for the covenant as an amortizable item on its books. The significance of the covenant moreover, is diminished by the fact that no restriction was

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placed on Davis's right to compete through the store that he owned at the time of the sale,

Appellant, in our opinion, was not entitled to deduct any more than the amounts allowed by respondent,

2. Entertainment expenses.

Appellant deducted entertainment expenses in the amounts of \$1,331.97, \$2,036.67, \$1,886.47 and \$1,521.11 for the income years ended March 31, 1959, 1960, 1961 and 1962, respectively. The only records regarding these expenses are monthly billings by restaurants, showing the total due for each month. Respondent disallowed 50 percent of these deductions,

Section 24343 of the Revenue and Taxation Code allow the deduction of "ordinary and necessary" business expenses. In the absence of evidence that the expenditures in question were ordinary and necessary in appellant's business, respondent's determination must be accepted,

3. Customer parking expenses.

Deductions were also taken for "customer parking expenses" of \$626.95, \$655.47, \$593.09 and \$637.84 for the income years ended March 31, 1959, 1960, 1961 and 1962, respectively. These expenses included \$350 a year to maintain a parking place in a commercial garage for the personal cars of appellant's officers and the cost of operating a station wagon acquired in November 1961 to transport inventory to and from a newly opened store which was owned and operated by a separate corporation named Jay Briggs, Stonestown, Inc. Respondent disallowed the deduction of the costs related to the officers' personal cars and 50 percent of the cost of operating the station wagon,

As in the case of the entertainment expenses, appellant has not presented any evidence to establish that these disallowed costs were in fact deductible as expenses of its business. Accordingly, we have no basis for making any adjustments,

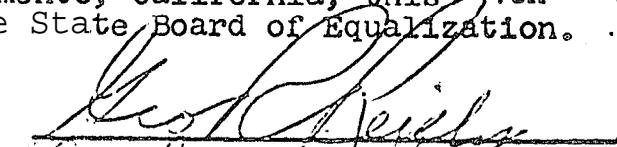
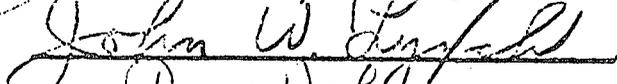
O R D E R

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

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IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board *on the* protests of Jay Briggs against proposed assessments of additional franchise tax in the amounts of \$49.73, \$468.48, \$458.95 and \$432.50 for the income years ended March 31, 1959, 1960, 1961 and 1962, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 4th day of January, 1966, by the State Board of Equalization.

	Chair
	Member
	Member
	Member
	Member

Attest:  Secretary