



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
)
'WEST VALLEY REALTY COMPANY, ET AL)

Appearances:

For Appellants: Loris V. Cady
Attorney at Law

For Respondent: Peter S. Pierson
Counsel

O P I N I O N

These appeals are made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of West Valley Realty Company, Moonridge Village, Inc., Moonridge Mountain Estates, Inc. and Vacation Lands, Inc., against proposed assessments of additional franchise tax in the amounts of \$55.00, \$164.97, \$82.50 and \$82.50, respectively, for the income year 1961.

Appellant corporations were created to develop 1200 acres of land in the Big Bear Lake area of San Bernardino county. Moonridge Mountain Estates, Inc., is the chief sub-division corporation. Moonridge Village, Inc., is the developer of a proposed business section, West Valley Realty Company, and Vacation Lands, Inc., are the building and sales corporations, respectively, for the area. Loris V. and Roberta F. Cady are the dominant shareholders and officers of these corporations.

During the early stages of this enterprise appellants used direct advertising in an attempt to attract customers to their development. This method proved unsatisfactory and was substantially replaced by a new promotional plan, the development of recreational facilities which would make the area more desirable. This plan was initiated in 1948 through the creation of a new corporation, Mooaridge Golf and Mountain Club, hereafter referred to as "Club." Its stock was mainly owned by appellant corporations which contributed capital of

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approximately \$500,000.

Club developed a golf course, fishing pond, club house, swimming pool, ski and toboggan area, and a winter chalet. In 1957 and 1958 Club's net earnings were \$679 and \$294, respectively. In 1959 it experienced a net loss of \$55.11 and in 1960 a net gain of \$2,083. At the hearing of this matter on March 21, 1967, Mr. Cady testified "we expect in another year or two that the Club will be doing \$200,000 a year. "

Appellants subdivide approximately 100 to 120 lots per year. However, in 1960 they subdivided 240 lots, enough for 2 years, and appellants were still selling them in 1962. Prior to the creation of Club, lot prices were \$1,995. By the date this matter was heard, March 21, 1967, they had risen to \$5,100, and sales commissions paid by Vacation Lands, Inc., had been reduced from 27 to 10 percent of the selling price.

In December of 1961 the four appellant corporations entered into an agreement with Club in respect to the latter corporation's recreation program. The relevant portions of the agreement state:

WHEREAS, it appears that the Club program as it is developing should eventually be quite an asset to each of the participating companies by payment of dividends and by furnishing facilities to help each of the participating companies in their own activities; and ...

WHEREAS, each of the participating companies has wanted to accelerate said program so far as possible so that their benefits would mature earlier, and have heretofore expressed the wish and desire to participate in expenses for 1961 and to participate in the expenses of certain future improvements ; and

WHEREAS, during 1961, the Club has expended considerable sums for tract payroll, for parking area and for runs; and

WHEREAS, a fair portion should be allocated to the participating companies;

...

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NOW, THEREFORE, in consideration of the mutual covenants and promises herein contained, it is agreed:

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That the participating companies will reimburse the Club for one-half of the sum of Ten Thousand (\$10,000.00) Dollars expended during 1961 for the above purposes, each participating company to pay its percentage of said one-half, namely:

Vacation Lands, Inc.	30%	- \$1,500.00
Moonridge Mountain Estates, Inc.	30%	- \$1,500.00
Moonridge Village, Inc.	20%	- \$1,000.00
West Valley Realty Co.	20%	- \$1,000.00

The agreement also stated that appellants would pay, in the above proportions, up to 50 percent of future ski area development expenses. Appellants met their obligation under the agreement by reimbursing Club during 1961 in the amount of \$5,000.00.

Club reported a net loss in 1961 of \$9,311. Appellants deducted their respective shares of the \$5,000 as ordinary and necessary business expenses under section 24343 of the Revenue and Taxation Code. Respondent disallowed these deductions and treated the expenditures as contributions to capital. Whether this determination was correct is the primary issue of this case. Appellants have the burden of clearly showing their right to the claimed deductions. (New Colonial Ice Co. v. Helvering, 292 U.S. 435 [78 L. Ed. 1348].)

Respondent contends that appellant cannot deduct these expenditures because they were business expenses of Club, and not of appellants. In the 1967 case of James L. Lohrke 48 T.C. 679, the Tax Court pointed out that although generally the payment by one taxpayer of the business expenses or obligations of another is not an ordinary and necessary business expense of the payor, deductions have been allowed when the expenditures were made to protect or promote his own business.

The court stated:

-The tests as established by all of these cases are that we must first

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ascertain the purpose or motive which caused the taxpayer to pay the obligations of the other person. Once we have identified that motive...is it an appropriate expenditure for the furtherance or promotion of that trade or business? ..

We must determine whether the [shareholder's] ultimate purpose in paying [the corporation's] obligation was to keep [the corporation] in existence, thereby perhaps realizing a return on his payment through corporate profits, or whether his purpose was to protect or promote his own business, realizing a return on his payment through continued profits in that business.

In view of these tests, appellants must show that their primary or ultimate purpose in paying Club's expenses was the promotion of appellants', rather than Club's, business activities. Attempting to carry this burden, appellants cite the increase in lot prices since the creation of Club. There are many factors, however, which have contributed to the rising real property values in the Southern California area, and it is difficult to determine which of these were crucial in the instant situation.

Other circumstances also militate against a holding that promotion of, appellants* business as their ultimate purpose. The agreement between Club and the appellants states two purposes, the payment of dividends by Club and the enhancement of appellants' business activities. Neither is emphasized more than the other. In fact these purposes are to a large extent complementary, the success of one contributing to the success of the other. Also Mr. Cady has testified that in another year or two Club will have a dividend payment potential of \$200,000 per year.

In light of the above circumstances, we must conclude that appellants have failed to carry their burden. Therefore respondent's determination must be upheld.

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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,

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 West Valley Realty Company, Moonridge Village, Inc., Moonridge Mountain Estates, Inc., and Vacation Lands, Inc. against proposed assessments of additional franchise tax in the amounts of \$55.00, \$164.97, \$82.50. and \$82.50, respectively, for the income year '1961 be and the same is hereby sustained.

Done at Sacramento, California, this 6th day of June, 1968, by the State Board of Equalization.

[Signature], Chairman
John W. Lynch, Member
Scott Sperry, Member
_____, Member
_____, Member

ATTEST: *[Signature]*, Secretary

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of }
WEST VALLEY REALTY COMPANY, ET AL. }

ORDER CORRECTING CLERICAL ERRORS

It is hereby ordered with respect to the opinion and order of the board in the matter of the Appeals of West Valley Realty Company, et al., issued on June 6, 1968, that the word "protect" be substituted for the word "protest" in the next-to-last line of the last full paragraph of the **third** page, and the word "was" be substituted for the word "as" in the second line of the next-to-last paragraph on the fourth page.

Done at Sacramento, California, this 5th day
of August, 1968, by the State Board of Equalization.

Paul R. Fagan Chairman
Paul R. Fagan Member
John W. Lynch Member
Walter J. ... Member
Walter J. ... Member

ATTEST: *Walter J. ...*, Secretary