BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
)
WALTER E. AND PEARL ROBERTSON)
AND MAX AND SADYE MALTZMAN)

Appearances:

For Appellants: W. E. Guthner, Jr.
Attorney at Law

George S. Brotemarkel
Certified Public Accountant

For Respondent: Gary Paul Kane
Counsel.

O P I N I O N

These appeals are made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Walter E. and Pearl Robertson and on the protest of Max and Sadye Maltzman against proposed assessments of additional personal income taxes in the amounts of $2,502.47 and $1,263.15 (including penalty), respectively, for the year 1961.

The issue presented is whether certain bad debt losses sustained by appellants were bad debt losses incurred in their trade or business.

For more than 20 years appellant Walter E. Robertson, a building contractor licensed in this state, and appellant Max Maltzman, a licensed architect and also a building contractor licensed in this state, have sought out business opportunities in the building construction field usually using as a medium for this purpose their principal partnership, the W. E. Robertson Company.

Thereafter, appellants have created the most appropriate business organization or organizations to carry out; the particular project, Through the years 40 corporations, and 34 partnerships and joint ventures were created. Appellants have owned directly, or indirectly as stockholders, part or all of the entity or entities chosen to, carry out the particular construction jobs. Thousands of individual dwelling units, hundreds of multiple dwelling units, and dozens of commercial buildings have been built.

Management fees were received by W. E. Robertson Company as a result of some of the projects, although such revenue was substantially less than the amounts received by the. appellants in long-term capital gains upon sale or liquidation of the corporations. The principal management fee received in 1961 was earned through services performed for Consolidated Builders, a corporation in which appellants did not hold any stock. Small. salaries were also earned by appellants from a minority of the entities carrying out the projects. Appellants have personally guaranteed bonds, made advances, or paid debts of the corporate entities in connection with many of these projects.

All the bad debt losses under consideration' occurred in connection with a joint venture project to construct military housing at Fort Hood, Texas. This joint venture was comprised of several corporations including three controlled by appellant Robertson, four by appellant Maltzman, and a few corporations controlled by an entity called the Miller Estate. Appellants managed the operation. In this project the buildings became the property of the United States. In connection with this venture appellants executed personal guarantee-s and lent money to their corporations, The personal guarantees were required in order to obtain necessary. bonds. In view of many unexpected costs appellants lent money and paid money on their guarantees far beyond what was originally anticipated. As a result, insolvency of the corporations was avoided. Appellants did not receive, or expect to receive salaries for their individual services with respect to this particular project. Nor did the W. E. Robertson Company partnership receive management fees for services performed by the appellants. Appellants did not sell the joint venture any materials or supplies.; All but one of the seven corporation8 continued to exist after the project's completion.

Appellants deducted the bad debt losses from this project *on* their 1961 personal income tax returns as business bad debts. Respondent concluded that the losses were nonbusiness bad debt losses and thereby partially disallowed the deductions.

Business bad debt losses are fully deductible in the year sustained whereas nonbusiness bad debt losses are regarded as short-term capital losses which are allowed only to the extent of capital gains, plus taxable income or one thousand dollars ($1,000), whichever is less, (Rev. & Tax. Code, §§ 17207 and 18152.)

Section 17207, subdivision (d)(2) defines a nonbusiness debt as a debt other than:

> (A) A debt created or acquired . . . in connection with a trade or business of the taxpayer; or
>
> (B) A debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business.

Devoting one's time and energies to the affairs of one, or several, corporationsis not of itself, a trade or business where the motivation is that of an investor and gain is sought in the form of enhancement in the value of the investment or in dividends. Even if the taxpayer establishes an independent trade or business of his own it is necessary to distingui-sh bad debt losses arising from his own business and those actually arising: from activities peculiar to an investor concerned with and participating in the conduct of a corporate business or businesses. Absent substantial evidence, furnishing. management and other services to corporations for a reward no different than that flowing to an investor is not a trade orbusiness. (Whipple v Commissioner, 373 U.S. 193 [10 L. Ed. 2d 288], and United States v. Byck, 325 F.2d 551.) It was established at the hearing that neither management fees nor salaries were anticipated by appellants in connection with this particular project, nor was it anticipated that the Fort Hood joint venture would purchase any materials or supplies from appellants. Accordingly, with respect to this specific project, appellants* bad debt losses appear to have been more proximately related to the business of their corporations rather than to their own construction business. Nor was there any other business activity of appellants to which the bad debt loss was proximately related. (Whipple v. Commissioner, supra, and United States v. Byck, supra.)

Appellants nevertheless contend that because they are in the building construction business the various corporations utilized throughout the year were used in conducting that business, and that the intent with respect to the Fort Hood project and elsewhere was to receive a return other than the normal return flowing to an investor. However, revenue derived by appellants from their corporations, partnerships, and joint venture8 as a result of management fees and salaries was relatively small,

In support of their contention that a business bad debt loss was incurred, appellants cite Louis Lesser, 42 T.C. 688, aff'd on other grounds, 352 F.2d 789, cert. denied, 384 U.S. 927 [16 L. Ed. 2d 530); Lundgren v. Commissioner, 376 F.2d 623; Isidor Jaffe, T.C. Memo,, Oct. 30, 1967; Gandy v. Squire, 52 Am. Fed. Tax R. 1404, 57-l U.S. Tax Cas. 56,721; and Calhoun v. United States, 2 Am. Fed. Tax R.2d 6053, 58-2 U.S. Tax Cas. 69,643. Upon review, we do not believe that these cases warrant a determination in favor of the appellants. In Louis Lesser, supra, the partnership in which the taxpayer was a member directly and specifically participated with the debtor corporation in the building project giving rise to the losses. Pursuant to the agreement the taxpayer was to receive a definite percentage of the corporation's netreturn from the sale of the houses built by taxpayer 's partnership for the corporation. The taxpayer's indirect interest in the project as a stockholder of the debtor corporation was clearly a more remote interest than his direct business interest in the project. In Lundgren v. Commissioner, supra, the taxpayer-lender anticipated direct benefits to his trade or business of selling timber and of rendering services for a salary as an officer and employee to his various enterprises rather than merely receiving the benefits flowing to an investor. In Isidor Jaffe supra, the court determined that the taxpayers made loans and guarantees to their wholly-owned corporation primarily to preserve their salaried positions, and the court also concluded that the taxpayers were in the trade or business of being salaried employees. The decisions in Candy v. Squire, supra, and Calhoun v. United States, supra, have been qualified by the subsequent decision in the Whipple case,

Appellants further assert that the losses are business bad debt losses because their professional reputations would be seriously impaired and their licenses placed in jeopardy if any corporation under their control should fail to meet its financial obligations.,

It is undoubtedly true that appellants' reputations would be injured and their individual contractors licenses possibly jeopardized if these particular corporate debts were not paid. Nevertheless, the personal guarantees were signed to obtain bonds for the corporations so that the joint venture could contract for the project and provide ultimate returns to appellants as investors. The subsequent debts, accordingly, principally arose from the activities of taxpayer-investors seeking to enhance their investment by participating in the corporate businesses. (Whipple v. Commissioner, supra, 373 U.S. 193 [10 L.Ed. 2d 288].)

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 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Walter E. and Pearl Robertson and on the protest of Max and Sadye Maltzman against proposed assessments of additional personal income taxes in the amounts of $2,502.47 and $1,263.15 (including penalty), respectively, for the year 1961, be and the same is hereby sustained.

Done at Sacramento, California, this 2nd day of June, 1969, by the State Board of Equalization.

John W. Lynch, Chairman

Paul R. Leake, Member

Richard Nevins, Member

_____, Member

_____, Member

ATTEST: _____, Secretary