



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
JOSEPH J. HEALY) No. **82A-1766-PD**

Appearances:

For Appellant: Richard Balleau
Certified Public Accountant

For Respondent: Kendall E. Kinyon
Assistant Chief Counsel

OPINION

This appeal is made pursuant to section **18593^{1/}** of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Joseph J. Healy against proposed assessments of additional personal income tax in the amounts of \$884.89 and **\$2,754.61** for the years 1978 and '1979, respectively.

1/ Unless otherwise specified, all section references **are** to sections of the Revenue and Taxation Code as in effect for the years in **issue**.

206
37

Appeal of Joseph J. Healy

The issues to be determined are (1) whether appellant realized income at the time of his receipt of stock, and, if he did, (2) whether respondent properly determined the fair market value of that stock.

During 1978, appellant's employer gave him a bonus of 930 shares of Tiger International, Inc., stock, which then sold on the open market for \$16.25 a share. During 1979, his employer gave him a bonus of 1,945 shares of Tiger International, Inc., stock, which then sold on the open market for \$25.75 a share. Appellant paid nothing for his shares. Appellant's employer imposed a restriction on the stock preventing it from being sold for five years. The employer also reported only 75 percent of the market price of the bonus stock on appellant's W-2 forms. Believing his employer had over-valued his shares for reporting purposes, appellant reported 50 percent of the market price as income on his income tax returns for 1978 and 1979. Appellant resigned from that employment in 1980. The restrictions on the sale of the bonus stock were released in 1982, and appellant sold the stock.

Respondent increased appellant's income for 1978 and 1979 to include the full market-prices of the shares he had received during those years. Appellant protested, and this appeal followed in due course.

Appellant first contends that the bonus shares were not distributed as part of his compensation for services as an employee and, so, should not be considered income. He argues that the shares were simply given to officers and managers of the company to provide them with an ownership interest which would motivate them to perform well for their employer in the future.

Appellant also contends that respondent over-valued his shares by attributing to them the current **market price for similar shares while he was prohibited from selling his shares for five years. Appellant maintains that airline deregulation was then imminent and would cause his stock to decline in value during the period he was disabled from selling the shares.** Accordingly, appellant concludes, the reasonable value of his shares when he received them were in the amounts he reported on his returns.

The first two contentions of appellant involve the application and interpretation of section 17122.7, which provides, in part:

Appeal of Joseph J. Healy

If, in connection with the performance of services, property is transferred to any person other than the person for whom such services are performed, the excess of--

(1) The fair market value of such property (determined without regard to any restriction other than a restriction which by its terms will never lapse) at the first time the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, over

(2) The amount (if any) paid for such property, shall be included in the gross income of the person who performed such services in the first taxable year in which the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever is applicable. . . .

This section is substantially similar to section 83 of the Internal Revenue Code. Both these sections were enacted with the intent of eliminating the unfair tax advantages resulting from the treatment of stock acquired under nonstatutory stock option plans. (Appeal of David and Judith G. Kleitman, Cal. St. Rd. of Equal., Nov. 14, 1979.) **Interpretations** of section 83 of the Internal Revenue Code are persuasive of the proper interpretation of section 17122.7. (Meanley v. McColgan, 49 **Cal.App.2d** 203 [**121 P.2d 45**] (1942).) Although appellant's shares were acquired as part of a stock bonus plan rather than a stock option plan, section 17122.7, by its terms, applies to the shares transferred to appellant.

Whether the stock was given to appellant in connection with the performance of services, within the meaning of the statute, or whether it was provided as a gift is a question of fact. The "**intent**" of the parties is determined from an examination of the facts of each case. (Wilkie v. Commissioner, 127 **F.2d** 953 (6th Cir. 1942).) **All the** circumstances in this case point to the conclusion that the bonus stock was paid as compensation for appellant's services and must be included in his gross income. Appellant received the stock from his employer. The employer reported the transfer of the stock as income to the employee. Appellant stated that the shares were distributed to him as an annual bonus for

Appeal of Joseph J. Healy

achieving pre-set objectives for the years 1977 and 1978. The fact that the distribution may have had an additional purpose of vesting the appellant with a proprietary interest in the employer or its parent corporation to provide an incentive to make the employer more profitable in future years does not indicate an intent to make a gift. Rather, such a purpose is indicative of a stock transfer in connection with the performance of past **or** future services. (Commissioner v. Lobue, 351 U.S. 243 [100 L.Ed. 11421 (1956).])

With regard to the valuation of appellant's shares, the statute requires that the fair market value for reporting purposes be determined without regard to any restrictions except for nonlapsing restrictions. Appellant argues that his employer's restrictions on his sale of his bonus stock effectively lowered the value of the bonus stock he received. But the sale restriction would lapse in five years. So the statute requires that the fair market value of his bonus shares be included in his gross income. The open market prices were the amounts which respondent considered **to be** the fair market values of appellant's shares for the purpose of its assessments. Appellant simply reported his bonus shares at lower values, which the applicable statute does not permit.

Finally, appellant points to one **of** respondent's letter rulings, which concluded that another person who received Tiger International bonus stock should be considered to have received the income from the stock at the time the restriction on their transfer lapsed and in the amount of the value of the shares at the time of that lapse. Appellant contends that he should be accorded the same treatment.

The 1983 letter was concerned with whether another executive, who received Tiger International bonus stock, had validly made the election, offered by subsection 17122,7(b)(1), to report that stock as income in the year of receipt rather than in the year he was first permitted to transfer his bonus shares. That letter concluded that the executive had not validly made the election, and, therefore, those shares must be included in the later year in which the shares first became transferable. The letter did not repeat the facts upon which it was based and did not address the question of whether those shares were **or** were not subject to any substantial risk of forfeiture before they became transferable.

Appeal of Joseph J. Healy

In this case, there is no reason to conclude that appellant's shares were subject to any risk of forfeiture after he received them. Accordingly, under subsection 17122.7(a), it would appear that appellant's shares were necessarily reportable in the year he received them and that no election existed under subsection 17122.7(b)(1) to report the value of the shares in gross income in the year they were transferable and at their value at that time.

Respondent, citing Sakol v. Commissioner, 67 T.C. 986 (1977), affd. 574 F.2d 694 (2d Cir.) cert. den. 439 U.S. 859 [58 L.Ed.2d 168] (1978), argues that the letter opinion was based on an erroneous conclusion that an employer's restriction of the sale of the employee's stock constituted a substantial risk of forfeiture. But if respondent erred in **that** opinion, should appellant also benefit from that error? We think not. To hold otherwise would require that we apply the doctrine of estoppel. However, under the facts on this case, appellant cannot establish that he detrimentally relied on respondent's 1983 letter for actions he took prior **to that time**. In the absence of detrimental reliance, the principles of estoppel simply do not apply to this appeal. (Cf. Appeal of Harry H. and Alice P. Freer, Cal. St. Bd. of Equal., Sept. 12, 1984.)

For the reason stated above, we must sustain respondent's action.

Appeal of Joseph J. Healy

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 Joseph J. Healy against proposed assessments of additional personal income tax in the amounts of \$884.89 and **\$2,754.61** for the years 1978 and 1979, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 9th day Of April , 1986, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Collis, Mr. Bennett and Mr.. Harvey present.

Richard Nevins _____, Chairman
Conway H. Collis _____, Member
William M. Bennett _____, Member
Walter Harvey* _____, Member
_____, Member

*For Kenneth Cory, per Government Code section 7.9