



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
THOMAS V. MULLAN) No. 83A-237-VN
)

For Appellant: Charles T. Lombardi
Certified Public Accountant

For Respondent: Alison M. Clark
Counsel

O P I N I O N

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 Thomas V. Mullan against a proposed assessment of additional personal income tax in the amount of \$5,434.24 for the year 1978.

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

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The issue presented for our decision is whether respondent properly determined that appellant received a taxable distribution from his professional corporation in 1978.

Appellant is a dentist specializing in periodontics. He currently resides in San Francisco. Prior to moving to the Bay Area, appellant practiced in Chico for several years. In August 1974, he entered into a lease for office space in Chico and then obtained financing for his dental office by securing a \$46,500 loan from the Small Business Administration. Repayments on the SBA loan were to begin on July 25, 1975. On February 13, 1976, appellant formed a professional corporation and incorporated as "Thomas V. **Mullan, D.D.S., Inc.**" (Corporation) under the laws of California. Appellant was president and sole shareholder of the corporation. The corporation began doing business on April 1, 1976.

Two years later, in April 1978, appellant entered into an agreement on behalf of the corporation to sell the dental practice. The agreement of sale provided that the corporation would sell the dental supplies and **equipment**, lease and leasehold improvements, patient charts and records, and the business goodwill of the **practice** for a price of \$35,000. The corporation **retained** the accounts **receivable** to the extent of billings generated prior to consummation of the sale. In addition, appellant signed a covenant not to compete in which he agreed not to practice dentistry within 75 miles of Chico for three years. On June 15, 1978, the corporation sold the dental practice and related assets and the buyer assumed liability for the lease of the dental office. Four days later, on June 19, 1978, the sales proceeds were used to pay the remaining **\$30,522.46** balance of the SBA loan plus accrued interest. With the remainder, the corporation reimbursed the buyer **\$2,237.50** for patient collections and paid \$150 in attorney's fees, leaving a balance of \$614.67 from the sale of the dental practice.

For the taxable years 1978 and 1979, appellant filed timely California personal income tax returns. Upon audit, the Franchise Tax Board determined that appellant received a **\$27,497.53** distribution from his corporation **which** was not reported on his 1978 return. Respondent determined the amount of the distribution from an unaudited financial statement of the corporation prepared in September **1978** by an accountancy corporation,

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Subsequently, in January 1982, appellant filed an amended 1979 return in which he reported receipt of a \$27,277 distribution from his professional corporation upon its liquidation in 1979. On a schedule attached to the amended return, appellant explained that this shareholder distribution consisted of a \$22,132 dividend from retained earnings, \$1,000 in return of capital, and \$4,145 in gain from the aforementioned sale of the dental practice and corporate assets in April 1978. Concurrently, appellant filed an untimely corporation franchise tax return for the corporation for its income year ended January 31, 1979. On the corporate return, appellant indicated that this was the final return of the corporation since it was dissolved and ceased doing business three years before on January 31, 1979.

After considering the additional information from these returns, respondent nevertheless determined on the basis of its audit that appellant should have reported a **\$27,497.33** corporate distribution in 1978. In addition, respondent determined that appellant had not reported \$15,911 in **capital gains from the** sale of his personal residence and disallowed a \$6,000 deduction claimed by appellant on his "Schedule C--Profit or Loss from Business or Profession" due to his failure to substantiate the deduction. Respondent thereupon issued a proposed deficiency assessment which reflected the inclusion of these additional items in appellant's 1978 taxable income.

During the subsequent protest proceedings before the Franchise Tax Board, appellant agreed to the inclusion of the capital gains income in his 1978 taxable income and to the disallowance of the Schedule C deduction. However, appellant did not withdraw his protest with regard to respondent's determination that he received a corporate distribution in 1978. He continued to assert that the distribution constituted proceeds from the dissolution of his professional **corporation, in** 1979 and was, therefore, income to him in **that year.**^{2/} Respondent did not agree and affirmed its assessment without modification. Appellant then filed a timely appeal with this board.

2/ Since appellant had a substantial net operating loss **in 1979**, inclusion of the distribution in his 1979 taxable income would not result in a tax deficiency for that year.

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Under the California Personal Income Tax Law, cross **income** means ail income frdm whatever source derived, including dividends. (Rev. & Tax. Code, § 17071, subd. (a)(7).) A distribution of property, including money, by a corporation to a shareholder with respect to its stock shall be included in gross income to the extent the amount distributed is considered a dividend. (Rev. & Tax. Code, §§ 17321, 17323, subd. (a), 17383; Appeal of Joel Bellman, Cal. St. Bd. of Equal., Feb. 2, 1976.) A **dividend** is defined as any distribution of property, including the cancellation of indebtedness of a shareholder, made by the corporation to its shareholders out of earnings and profits. (Rev. & Tax. Code, § 17381; Treas. Reg. § 1.301-1(m).) All distributions are presumed to be made out of earnings and profits and from the most recently accumulated earnings and profits. (Miller v. Commissioner, 26 T.C. 115 (1956).) A distribution shall be included in a **distributee's** gross income when the cash or other property is unqualifiedly **made subject** to his demands. (Treas. Reg. § 1.301-1(b).)

In Appeal of Milton K. and Irene T. Harwood, decided on June 30, 1980, **this** board had occasion to discuss the law with respect to dividends arising from the cancellation of indebtedness:

In determining whether a corporate distribution **constitutes a constructive dividend, the crucial** question is whether the corporation conferred an economic benefit on the shareholder without expectation of repayment. (See, e.g., United States v. Smith, 418 F.2d 589, 593 (5th Cir. 1969).) It is well settled that corporate payments in discharge of a **shareholder's** personal debts and liabilities are in the nature **of** a constructive dividend. (See United States v. Smith, supra; Sam E. Wilson, Jr., 27 T.C. 976 (1975).)

In that appeal, we found that the taxpayer received constructive dividends taxable as ordinary income when the accounts receivable due from him were removed from the assets of his wholly owned corporation.

In the present matter, the Franchise Tax Board determined that appellant received a dividend from his

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professional corporation in the 1378 taxable year after the corporation sold the dental practice. Appellant does not contest that he received a taxable distribution from his corporation but claims that the distribution occurred in 1979. We find that the record in this appeal supports respondent's determination. First, the **financial** statement of the corporation for 1978 shows that the amount of appellant's stockholder equity in the corporation was **\$27,497.53**. Whereas appellant does not deny that the corporation made a distribution to him, it was reasonable for respondent to have assumed that this equity was distributed in 1978 after the corporation sold the dental practice and related assets and appellant was precluded from practicing dentistry in the Chico area. Moreover, there is no evidence in the record to suggest that after the sale of the practice, the corporation **continued** to do business or **that appellant** continued to practice dentistry as an employee of his professional corporation in another locale.

Second, there is probative evidence suggesting that appellant received the distribution in the form of constructive dividends in 1978 in excess of the amount determined by respondent. Since the SBA loan was incurred prior to the incorporation of appellant's professional dental corporation, it appears that this loan was obtained by appellant in his personal capacity and not by the corporation. When the corporation under appellant's control used the proceeds of the sale of the dental practice to pay the **\$30,522.46** balance of the SBA loan plus accrued interest, it **conferred** a direct economic benefit on appellant by discharging his personal obligation. This payment in our view constituted a constructive dividend includible in appellant's 1978 taxable income. Moreover, the corporation's financial statement reveals that appellant withdrew \$8,500 from the corporation between February 1978 and September 1978. Even though the corporation treated these withdrawals as loans, the surrounding **circumstances**, including the concurrent sale of the dental practice and the absence of any evidence of repayment, indicate that these advances were in fact dividends. (See, e.g., Appeal of Ben B. Eisenberg, Cal. St. Bd. of Equal., Mar. 2, 1977; Appeal of Richard M. and Beverly Bertolucci, Cal. St. Bd. of Equal., May 4, 1976.) These two forms of dividends are **more** than sufficient to cover the deficiency assessment in this appeal.

In any event, it is well settled that respondent's determinations as to issues of **fact** are only

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presumptively correct, and appellant can rebut these determinations by showing error in respondent's actions. (See, e.g., Todd v. McColgan, 89 Cal.App.2d 509 [201 P.2d 414] (1949); Appeal of George H. and Sky G. Williams, et al., Cal. St. Bd. of Equal., Jan. 5, 1982.) Unsupported **assertions** are inadequate to sustain appellant's burden. (Appeal of James and Eileen R. McDonald, Cal. St. Bd. of Equal., Sept. 30, 1980.) Hence, appellant has not offered any credible evidence to prove that the distribution took place in 1979 as a result of the liquidation of the corporation. For example, he has not submitted any corporate resolutions or documents which demonstrate that the corporation elected to dissolve and adopted a plan of liquidation providing for the payment of liabilities and distribution of assets. (See Corp. Code, § 1900 et seq.) **Nor** has appellant shown that a **certificate of winding up and dissolution** was filed with the **Secretary of State** in accordance with section 23331. The only evidence that purportedly supports appellant's position that the corporation was dissolved in 1979 are the amended 1979 return and the untimely corporate franchise tax return that he filed after the commencement of the Franchise Tax Board audit. In fact, **respondent has** informed us that it has since discovered that appellant's professional corporation was not dissolved but was actually suspended on May 1, 1980, pursuant to the provisions of section 23302. We therefore find untenable appellant's claim that the corporation was dissolved and its assets distributed to him in 1979.

Based on the foregoing, we find that appellant has not shown error in respondent's determination that he received a taxable distribution from his corporation in 1978. Accordingly, respondent's action in this matter will be sustained.

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O R D-E-E

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 Thomas V. **Mullan** against a proposed assessment of additional personal income tax in the amount of **\$5,434.24** for the year 1978, be and the same is hereby sustained.

Done at Sacramento, California, **this 29th** day of July , 1986, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Bennett, Mr. Dronenburg and Mr. Harvey present.

_____Richard Nevins....., Chairman
.....William M. Bennett....., Member
.....Ernest J. Dronenburg, Jr......, Member
.....Walter Harvey*....., Member
....., Member

*For Kenneth Cory, per Government Code section 7.9