

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA'

In the Matter of the Appeal of )  
GEORGE AND HELEN S. MEKJIAN ) No. 84R-486-GO

For Appellants: M. B. Shah  
Certified Public Accountant

For Respondent: David Lew  
Counsel

O P I N I O N

This appeal is made pursuant to section 19057, subdivision (a), <sup>17</sup> of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of George and Helen S. Mekjian for refund of personal income tax in the amount of \$9,287 for the year 1979.

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 is whether respondent properly disallowed appellants' deduction of \$150,726 in 1979 denoted as a guaranteed payment to appellants' partner and, instead, amortized such payment pursuant to the provisions of section 17237 thereby-permitting appellants to deduct only 20 percent of that payment, or \$30,141, in 1979.

Pursuant to a **written** partnership agreement executed on February 12, 1979, appellants and Realty and Mortgage Investors of the Pacific, a California business trust (hereinafter "**RAMPAC**"), formed a partnership-for the purpose of purchasing and developing **certain** real estate into a **mobile** home park. The partnership agreement provided that the real property was to be purchased for a total price of **\$2,700,000** with the seller accepting a promissory note and deed of trust for **\$1,100,000** of the purchase price. The remaining **\$1,600,000** of the purchase price was to be contributed by RAMPAC, and RAMPAC was thereby "entitled to a guaranteed return on its capital contributed . . . [i.e. **\$1,600,000**] at the rate of 11% per annum from the date [of] each contribution' . . . ." (Resp. Br., Ex. A-4.) Moreover, such payments were to be made to **RAMPAC** on-an annual or more frequent basis and charged directly to appellants' drawing account. The agreement also provided that concurrent with the purchase of the land, appellants were to secure a construction loan in order to finance such permanent improvements which would convert the land to a functional mobile home park. The record indicates that beginning in June of 1979 and continuing through September 1980, improvements (**e.g.**, underground utilities, sewer lines, water and electric lines, street paving and **offsite** improvements) were constructed on the subject real property.

Sometime in 1979, the partnership made a guaranteed payment of \$150,726 to RAMPAC based upon the **\$1,600,000** which it had contributed to the venture. Initially, appellants did not report the guaranteed payment to RAMPAC as a deductible partnership expense on their 1979 personal income tax return. However, in 1980, appellants filed an **amended** return for 1979 in which they claimed the \$150,726 plus an additional \$970 of unrelated partnership loss as a deduction. (Resp. Br., Ex. **C.**) Since this claimed loss resulted in a revised tax liability of zero, appellants claimed a refund of the full amount of tax which they initially paid of \$12,710 plus a \$54 underpayment penalty paid at the time of filing **for** a total of \$12,764.

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Upon review, respondent concluded that "the guaranteed payment actually constituted an interest payment for the use of RAMPAC's capital which was used to develop and construct the mobile home park." (Resp. Br. at 3.) As such, respondent determined that the payment constituted "construction period interest" within the meaning of section 17237,<sup>2/</sup> and, accordingly denied the deduction of that amount claimed. Instead, pursuant to that statute, respondent allowed as a deduction for 1979 an amortizable share of that payment (i.e. 20 percent or \$30,145) plus the additional claimed partnership loss of \$970, but denied the excess of such claim. (Rev. and Tax. Code § 17237, subd (b).) This recomputation resulted in a determination that appellants' claim for refund should be granted only up to the amount of \$3,423. Thereupon, appellants filed this appeal.

On appeal, appellants appear to concede that the subject payment was indeed an interest expense, but first argue that the payment was made **prior** to the commencement of the construction period so that it would not be "construction period interest"; (Appeal Ltr.) Thereafter, appellants also argue that none of the **\$1,600,000** contributed by RAMPAC was used to finance improvements and that, accordingly, interest paid thereon could not be classified as "construction period interest". In either case, appellants argue section 17237 limits should not apply to the subject payment.

Neither of appellants' arguments has any merit. Appellants' first argument is entirely factual. Appellants, admitting that construction began in June of 1979, allege that the subject payment was made prior to that date. **However, no** documentation or other evidence of the date of payment has been presented by appellants which would substantiate their allegation and we must conclude that appellants have not met their burden of proof. (Appeal of John A. and Julie M. Richardson, Cal. St. Bd. of Equal., Oct. 28, 1980.) Moreover, since the

**2/ Section 17237** provides, in relevant part, that "no deduction shall be allowed for real property construction period interest" for payments which otherwise would be deductible interest, but instead such payment must be amortized in accordance with a statutory table which, based upon the subject facts, is 20 percent of such payment for each amortization year.

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partnership agreement does not provide for a prepayment of such payment but, instead provides that such **liability** must first accrue, it is likely that such a substantial payment as \$150,726 was made late in 1979, well: after the construction period began. Appellants' second argument is also misplaced. Pursuant to the clear reading of section 17237, whether the **\$1,600,000** contributed by RAMPAC was used to finance improvements is irrelevant. Section 17237, subdivision (e)(1) (A) provides that 'construction period interest' includes interest incurred to "acquire, construct, or carry real property) . . ."

Accordingly, based upon the record presented, we conclude that **respondent's** action must be sustained.

