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8 **BOARD OF EQUALIZATION**
9 **STATE OF CALIFORNIA**

10
11 In the Matter of the Appeal of:) **HEARING SUMMARY**
12) **PERSONAL INCOME TAX APPEAL**
13 **ESTATE OF EVA M. LINDSKOG (DEC'D)**) Case No. 466455
14)

15 Proposed
16 Assessment

17	<u>Year</u>	<u>Tax</u>	<u>Penalty</u>
	2002	\$175,063.00	\$7,869.44

18 Representing the Parties:

19
20 For Appellant: William Shine, Executor
21 For Franchise Tax Board: Daniel V. Biedler, Tax Counsel III
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23 QUESTION: Whether appellant has shown that respondent erred by treating transfers from appellant's
24 wholly-owned corporation as taxable distributions in respect of stock rather than as
25 loans.

26 HEARING SUMMARY

27 Background

28 Prior to and including the tax year in issue, Eva M. Lindskog (Eva) and her husband,

1 Robert Lindskog (Robert) (collectively, “the Lindskogs”), were the owners of Central Valley Homes,
2 Inc. (CVH), a California subchapter S corporation that began business in 1984.¹ Eva was also vice-
3 president of CVH. CVH’s assets were twenty-four single-family homes located in Marin County,
4 California. Eva and Robert filed a joint 2002 income tax return and reported on the Schedule L, loans to
5 shareholders in the amount of \$2,529,404, which included a loan of \$605,516 (Loan 1) and a loan of
6 \$2,314,920 (Loan 2) less the amount of \$391,032 loaned in prior years. Eva died in January 2004 and
7 Robert died in August 2009. Respondent commenced an audit of CVH and concluded that the
8 \$2,314,920 disbursed to the Lindskogs was a distribution on the stock of CVH, and not a loan. (Resp
9 Opening Br., pp. 2-3.)

10 Respondent issued a Notice of Proposed Assessment (NPA) dated December 26, 2006,
11 which explains that respondent’s examination at the corporate level determined the Lindskogs received a
12 \$2,314,920 distribution during tax year 2002 and had an adjusted stock basis of \$328,948. For that
13 reason, the NPA states that the Lindskogs should have reported a \$1,985,972 capital gain rather than the
14 \$21,704 capital loss that was reported. Appellant protested the NPA which respondent affirmed in a
15 Notice of Action (NOA). Appellant filed this timely appeal of the NOA. (Appeal Letter, attachments 1
16 and 2.)

17 **QUESTION:** Whether appellant has shown that respondent erred by treating transfers from appellant’s
18 wholly-owned corporation as taxable distributions in respect of stock rather than loans.

19 Contentions

20 Appellant’s Contentions

21 The appeal letter is a brief statement of disagreement with respondent’s proposed
22 assessment and also states that appellant’s prepayment was intended to avoid further accrual of interest
23 and penalties. Attached to the appeal letter is a copy of the Last Will and Testament of Eva. (Appeal
24 Letter, pp. 1-2, attachment 5.)

25 In a reply brief, appellant states that Robert died in 2009 after suffering from Alzheimer’s
26 disease. Prior to his death, appellant states that Robert received comprehensive health care services
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¹ Robert was the 100 percent owner of CVH stock in which Eva held a community property interest.

1 financed with \$1 million borrowed from CVH. Appellant further states that respondent granted Robert's
2 petition for innocent spouse relief for the 2002 tax year which involved the proposed assessment at issue
3 in this appeal.² Appellant also states that the Linskog's son, Tony Linskog, suffers from severe
4 emotional problems and receives comprehensive health care services funded by \$1 million borrowed
5 from CVH. Appellant states that the \$1 million was contributed to the Tony Linskog Revocable Care
6 Trust. Appellant states that the remaining \$314,920 of the amount borrowed from CVH was required
7 for rental property improvements to the corporate assets of CVH. Appellant states that Eva held a
8 Power of Attorney over all corporate affairs during the period of Robert's care for Alzheimer's disease.
9 Appellant states that it acted "responsibly and passionately in arranging refinancing of [CVH's] rental
10 property for generating the cash needed" for the expenses described above. (App. Reply Br., p.2 and
11 p.4.)

12 Appellant contends that the "corporate borrowings from CVH were repaid by a reduction
13 in the division of community property assets following [Eva's] death." In support of that contention,
14 appellant quotes a letter dated December 10, 2007, from Vincent J. DeMartini, whom appellant
15 describes as its real estate attorney, in which Mr. DeMartini states that Eva's "estate bears the entire cost
16 and burden of that \$2,321,982 debt. Because the debt was charged to her allocated share, that is the
17 same as if she had paid it back." Appellant contends this charge against the gross community property
18 assets allocated to appellant "establishes and verifies the existence of a bona fide loan owed by Eva . . .
19 to [CVH]." Appellant also refers to an amended 2002 Form 100X for CVH that explains settlement
20 with appellant. (App. Reply Br., p.5 and attachments 2 and 3.)

21 In reply to respondent's opening brief, appellant states that it disagrees with respondent's
22 erroneous conclusion that appellant received a cash distribution rather than a loan from CVH. Appellant
23 further contends that respondent erroneously concludes that Robert, as the sole shareholder of CVH, was
24 the corporate decision maker and controlled 100 percent of the corporation. Appellant contends that
25 responsibility for the management and operations of CVH had been transferred to appellant by power of
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28 ² Robert's representative and conservator of his estate, Lois Watson, filed a petition for innocent spouse relief dated July 6, 2009, with the Board. By letter dated October 30, 2009, respondent informed the Board that Robert's claim for innocent spouse relief for tax year 2002 had been granted, and the Board dismissed his appeal.

1 attorney. Appellant further states that Eva borrowed the \$2 million to provide health care for Robert and
2 Tony. According to appellant, “it was common knowledge within the immediate family” that the money
3 would be repaid to CVH even though formal note receivables were not executed. Furthermore,
4 appellant contends, Eva was inexperienced in the management of S corporation tax matters and it would
5 be reasonable to assume that she would be unaware that “withdrawing funds in excess of shareholder
6 basis is a taxable event.” Thus, appellant contends that the disbursement of funds should be
7 characterized as a Loan Receivable due from appellant. (App. Reply Br., pp. 7-8.)

8 Appellant addresses the fifteen factors cited by respondent in its opening brief to
9 determine whether a transfer from a corporation to a shareholder is a loan or taxable distribution in
10 excess of basis as follows:

- 11 1. Existence of a Note. Although appellant did not execute a note, the loan was “clearly implied
12 and fully recognized” in the division of the marital estate of Eva and Robert.
- 13 2. Whether Interest is Charged. It can be reasonably assumed that no interest was charged due to
14 appellant’s inexperience in these matters.
- 15 3. Whether the Loan has a Maturity Date. It was common knowledge within the immediate family
16 that appellant would repay the loan when health care for Robert and Tony was no longer
17 necessary.
- 18 4. Whether Security was Given. Eva’s “honest, compassionate, and responsible character” was a
19 solid guarantee of repayment.
- 20 5. Whether the Shareholder is in a position to repay. Based on Eva’s community property interest
21 in the marital estate, “it can reasonably be concluded” that she had the means available to repay
22 the loan.
- 23 6. Whether the Shareholder had an Absolute and Unconditional Duty to Repay. The settlement
24 agreement shows a \$2,321,982 reduction in Eva’s community property assets which indicates
25 she had an absolute and unconditional duty to repay.
- 26 7. Whether there is a Repayment Schedule. The settlement agreement is evidence that the loan has
27 been repaid in full.
- 28 8. Whether the Shareholder made an Attempt to Repay. No attempt to repay was made or was

1 necessary because the loan disbursement was not expected to be repaid until the health care
2 needs of Robert and Tony were met.

3 9. Whether the Corporation Forces Repayment. The settlement agreement is evidence that the
4 successors to CVH were directly involved in forcing repayment.

5 10. The Extent to which the Shareholder Controls the Corporation. Appellant agrees with
6 respondent that Eva had a community property interest in Robert's interest as sole shareholder of
7 CVH.

8 11. Whether the Advances are Proportionate to the Shareholder's Ownership. Appellant states that
9 the loan disbursement was in direct proportion to ownership because Eva had a community
10 property interest in Robert's sole ownership of CVH and had management control of CVH under
11 a power of attorney.

12 12. Whether the Corporation had Adequate Earnings and Profits (E&P). Eva was not interested in
13 receiving dividend distributions and instead it is evident that "the cash disbursements were
14 clearly intended as loans to [Eva] to finance the health care services of [Robert] and [Tony]."
15 For that reason, appellant contends that whether CVH had adequate earnings and profits is not
16 relevant.

17 13. Dividend History of the Corporation. Appellant states that "[w]ith depreciable real estate
18 property as its principal business activity, it's reasonable to assume [CVH] had paid minimal (if
19 any) dividends . . . Accordingly, [Robert] had not been accustomed to receiving regular corporate
20 dividend distributions."

21 14. Magnitude of the Advance. Although the amount is substantial in relation to the value of the
22 total assets of CVH, "the disbursement is indicative of a major refinancing of corporate assets
23 based on current fair market values" to fund the loan to Eva for personal family needs.

24 15. Whether a Ceiling or Other Limits Exist on the Withdrawals. The evidence shows that Eva did
25 not seek to borrow additional amounts from CVH.

26 (App. Reply Br., pp. 7-11.)

27 Respondent's Contentions

28 In its opening brief, as part of its factual background, respondent states that on March 13,

1 2009, it was first contacted by an authorized representative for Ms. Lois Watson, the court-appointed
2 conservator for Robert, and that representative stated that Ms. Watson first received notice of this matter
3 by receipt of courtesy copies of two letters sent by the Board to respondent. Respondent also states that
4 appellant's representative, Mr. William Shine, "referenced" both Eva and Robert as recently as two
5 months prior to filing the appeal and Mr. Shine provided a power of attorney notarized in 1998 in which
6 Eva, or if Eva was unable to act, then Mr. Shine held a power of attorney over Robert's affairs.
7 Respondent further states that Mr. Shine provided a copy of a check dated December 18, 2002, for \$1
8 million written to Morgan Stanley, Dean Witter and authorization for the firm to accept the check.
9 Mr. Shine also provided a letter dated October 24, 2007, from Vincent J. DeMartini in which
10 Mr. DeMartini states that in 2002 CVH loaned Eva \$2 million which had not been repaid at the time of
11 her death in 2004. Mr. Shine also provided a spreadsheet of the potential litigation settlement between
12 the Linskogs' children and Mr. Shine, Mr. DeMartini and another associate of Mr. Shine. According to
13 appellant, Loan 2 was included in the settlement and was repaid to CVH in August or September 2007
14 as a debit against appellant's share of the division of litigation settlement assets. (Resp. Opening Br.,
15 pp. 3-5.)

16 Respondent asserts that the characterization of the transfer from CVH depends on all of
17 the facts and circumstances surrounding the transaction. Specifically, respondent states, the question is
18 whether the shareholder intended to repay the amount transferred and whether the corporation intended
19 to enforce the obligation. When the recipient of an alleged loan has substantial control of the
20 corporation, respondent argues that "special scrutiny of the situation is invited" and a transfer is deemed
21 to be a distribution unless the controlling shareholder can affirmatively establish its character as a loan.
22 In addition, respondent argues that the shareholder has the burden of proving intent to repay and the
23 shareholder's testimony is only one factor in meeting that burden. Furthermore, respondent states that
24 the courts generally consider various factors to determine a valid loan and no single factor is conclusive.
25 Respondent contends that the critical element is the extent to which the shareholder is able to control the
26 affairs of the corporation, irrespective of whether that control derives from stock ownership, family
27 relationship, or some other source. (Resp. Opening Br., p.6.)

28 Respondent argues that the courts have generally held that a taxpayer must accept the tax

1 consequences of the taxpayer's chosen form of a transaction and may not benefit by arguing that an
2 alternative form could have been chosen. Respondent cites *Commissioner v. Nat'l Alfalfa Dehydrating*
3 *& Milling* (1974) 417 U.S. 134, 149, in which the U.S. Supreme Court held that allowing taxability of a
4 transaction to depend on "whether there existed an alternative form which the statute did not tax would
5 create burden and uncertainty." (Resp. Opening Br., p. 7.)

6 Respondent then analyzes fifteen factors to determine whether a transfer from
7 corporation to a shareholder is a valid loan as follows:

- 8 1. Whether the purported loan was evidenced by a note. Appellant has not provided evidence of a
9 note.
- 10 2. Whether interest was charged. No interest has been charged or paid and the purported repayment
11 occurred in August or September of 2007, after the audit commenced, and was done as part of an
12 accounting in the settlement of litigation over appellant's estate and other matters.
- 13 3. Whether there was a maturity date. There was no written note, hence, no maturity date.
- 14 4. Whether security was given. Appellant has not provided any evidence that security was given
15 for the purported loan.
- 16 5. Whether the shareholder was in a position to repay. Eva was earning about \$70,000 a year at the
17 time the purported loan was made and was using that money to pay family medical expenses.
- 18 6. Whether the shareholder had an absolute and unconditional duty to repay. An obligation to
19 repay did not exist in 2002 and the repayment obligation agreed to as part of the settlement was
20 not derived from the disbursement in 2002. Furthermore, the Board has held that an obligation to
21 repay at a mutually agreed upon time does not constitute an absolute obligation.
- 22 7. Whether there is a repayment schedule. Appellant has not provided evidence of a repayment
23 schedule.
- 24 8. An attempt to repay. There was no attempt to repay until 2007 when, appellant contends,
25 payment was made in settlement of litigation. However, appellant has provided only a copy of a
26 "journal entry" on a "settlement statement" rather than actual evidence of repayment.
- 27 9. Whether the corporation forces repayment. Appellant has not presented any evidence that CVH
28 forced repayment and considering that appellant had complete control of the corporation it was

1 very unlikely that CVH would force repayment.

2 10. The extent to which the shareholder controls the corporation. Appellant held complete control
3 through a power of attorney and community property law.

4 11. Whether the advances are proportionate to the shareholder's ownership. Appellant owned 100
5 percent of CVH so this factor does not apply.

6 12. Whether corporation had adequate E&P. CVH did not have adequate E&P for a dividend
7 distribution. CVH's net income for taxable year 2002 was \$88,035 and had retained earnings of
8 a negative \$492,323. Thus, the transfer from CVH was a distribution unless determined to be a
9 bona fide loan.

10 13. Dividend distribution history of the corporation. Respondent is unaware that CVH has a history
11 of dividends.

12 14. Magnitude of the advance. CVH had total assets of \$3,789,777 in taxable year 2002 so the
13 transfer of \$2,314,920 is significant in comparison and CVH's outstanding liabilities were
14 greater than its assets.

15 15. Whether a ceiling or other limit exists on the amount of withdrawal. There is no evidence in the
16 record of a limit on the amount appellant could withdraw.

17 Based on an application of the foregoing factors, respondent contends that appellant has not met its
18 burden of proving the intent to repay and thereby show the 2002 distribution was a valid loan. (Resp.
19 Opening Br., pp. 7-10.)

20 Respondent explains that a distribution from a corporation with respect to stock is taxable
21 to extent that it exceeds the shareholder's adjusted basis in the stock. Respondent further describes the
22 types of adjustments that increase and decrease a shareholder's stock basis and explains that the timing
23 and ordering of these adjustments can affect the extent to which a distribution is treated as a return of
24 capital. In the determination of appellant's basis in the CVH stock, respondent states that appellant
25 provided very little information or documentation but suggested a basis in excess of \$10 million
26 "calculated speculatively". Respondent states that appellant proposed that appellant's basis should be
27 based on the average price per square foot of the rental properties owned by CVH which have a value of
28 \$10,778,809. If appellant had a basis in excess of \$10 million, respondent notes that a distribution

1 would not have been taxable pursuant to Internal Revenue Code (IRC) section 1368 so that a loan would
2 have been a more expensive way obtain the use of funds due to the payment of interest on the loan.
3 (Resp. Opening Br., p. 11.)

4 Respondent further contends that appellant's methodology is "unreliably speculative and
5 unsupported by fact". Specifically, respondent states that the fixed depreciable assets on CVH's balance
6 sheet totaled \$2,490,544, which provides an approximation of the cost of the assets. In addition,
7 respondent notes that CVH reported on its 1999 income tax return the ending balance of its retained
8 earnings account as a negative \$821,655 and reported net operating loss (NOL) carryovers from taxable
9 years 1995, 1996, and 1997, which would have reduced appellant's stock basis. Thus, respondent
10 contends, in view of the lack of an evidentiary basis for appellant's position, appellant's adjusted basis
11 in the CVH stock as of December 31, 1999, is zero. (Resp. Opening Br., pp. 11-12.)

12 Respondent states that for taxable year 2000 appellant reported flow-through income
13 from CVH of \$135,983. For taxable year 2001, appellant reported flow-through income of \$104,437
14 and flow-through portfolio income of \$492. For taxable year 2002, appellant reported flow-through
15 income of \$87,707 and portfolio income of \$329. By totaling those amounts, respondent determined
16 appellant's adjusted stock basis (before considering distributions) as \$328,948 as of December 31, 2002,
17 and determined that appellant received \$1,985,972 in excess of basis. After deducting the capital loss of
18 \$21,704 reported by appellant for taxable year 2002, respondent asserts that appellant had taxable capital
19 gain of \$1,964,268. (Resp. Opening Br., p.12.)

20 Respondent distinguishes the facts presented here from the facts of an unpublished
21 summary decision cited by appellant at protest to support appellant's position that appellant should have
22 an increase in basis from a personal guarantee for the debt. First, respondent asserts, appellant has not
23 provided any evidence of a guarantee of debt of CVH or any other type of evidence sufficient to permit
24 an increase in appellant's basis in CVH. In addition, respondent states, the Board rejected the taxpayers'
25 argument for an increase in stock basis because they failed to prove they were the primary obligors on a
26 loan or that they made a loan payment or other economic outlays. (Resp. Opening Br., p.13.)

27 Respondent contends that appellant tries to ignore the complete lack of indicia of intent to
28 repay and does not establish evidence of a loan by customary loan documentation contemporaneous with

1 the withdrawal of funds from CVH. Respondent further contends that appellant should not be allowed
2 to engage in such “post transaction planning” because it would encourage other similarly situated S
3 corporations to re-characterize prior year distributions in an attempt to obtain more favorable tax
4 treatment. (Resp. Opening Br., p.14.)

5 In its reply brief, respondent repeats its contentions that appellant failed to provide
6 supporting documentary evidence and instead relies on unsubstantiated assertions. In reply to
7 appellant’s reply brief, respondent states the following:

- 8 1. Appellant has not provided evidence showing the disposition of the funds from CVH and, even if
9 appellant’s representation is true, such use of the funds does not support a determination that the
10 transfer was a loan.
- 11 2. Appellant’s assertion that it was “common knowledge within the immediate family” that the
12 fund would eventually be repaid lacks merit considering the litigation surrounding appellant’s
13 financial affairs.
- 14 3. Respondent contends that it properly characterized the distribution of funds from CVH to
15 appellant based on all available evidence.
- 16 4. The assertions made in the December 10, 2007 letter from Vincent J. DeMartini are not
17 supported by any documentation and, therefore, is not reliable evidence. In addition, the
18 amended returns attached to appellant’s May 13, 2010 brief have no supporting documentation
19 and are unsigned and thus not subject to penalty of perjury, which is an indicator of reliability.

20 With respect to appellant’s application of the factors, respondent states the following:

- 21 1. Mere assertions of accounting for the distributions as loans in the settlement of litigation do not
22 constitute evidence of a loan. Moreover, appellant is liable for all taxes from the affairs of CVH,
23 which liability could well be the actual accounting for the income tax consequences for the
24 distributions contemplated by the settlement litigation.
- 25 2. Appellant’s request that the Board assumes interest was charged is without merit or support.
- 26 3. Respondent questions appellant’s assertion that the amount would be repaid when the health care
27 needs of Robert and Tony were satisfied because of the possibility that those needs would (and
28 did) outlive Eva and, if used in that manner, the funds would have been depleted.

- 1 4. Appellant requests the Board to assume that Eva’s personal character be considered security for
2 the loan, rather than a written document.
- 3 5. Appellant’s assertion that Eva had a community property interest in the funds transferred from
4 CVH does not lead to the conclusion that she had the ability to repay that amount.
- 5 6. Appellant has not presented documentation to show she had an unconditional and absolute
6 obligation to repay.
- 7 7. Appellant has not presented any evidence of repayment and has not “factually established any
8 true economic accounting for repayment.”
- 9 8. Appellant has not provided any financial records to support its assertion of repayment by an
10 accounting of the settlement litigation.
- 11 9. Even if appellant provided documentation of a true economic accounting for repayment, the
12 litigation settlement does not constitute evidence showing that CVH attempted to enforce
13 repayment.
- 14 10. As appellant concedes, Eva had complete control over the actions of CVH and it would be
15 extraordinary if she were to cause CVH to bring legal action to obtain repayment.
- 16 11. Because appellant owned 100 percent of CVH, the test of whether the advance was proportionate
17 to appellant’s ownership interest is inapplicable.
- 18 12. CVH did not have adequate E&P to issue a dividend distribution and, accordingly, the transfer
19 was a distribution in respect of stock, unless determined to be a loan.
- 20 13. Appellant requests the Board to assume the dividend distribution history of CVH, which facts are
21 not in evidence, even though appellant’s representative presumably has control of and access to
22 such documentation.
- 23 14. Using the cash assets of CVH for personal purposes does not necessarily support appellant’s
24 contention that the transfer was a loan.
- 25 15. Appellant requests the Board to assume without any factual basis that CVH imposed a limit on
26 the amount of shareholder withdrawals. Respondent states that the amount transferred may have
27 been limited by CVH’s lack of additional liquid assets. Furthermore, appellant has not proven
28 with documentary evidence that the estate repaid CVH.

1 (Resp. Reply Br., pp. 6-8.)

2 Applicable Law

3 Presumption of Correctness

4 The FTB's determination with regard to issues of fact is presumptively correct, and the
5 taxpayer must bear the burden of proving error. (*Appeal of Oscar D. and Agatha E. Seltzer*, 80-SBE-
6 154, Nov. 18, 1980.) To overcome this presumption, taxpayers must introduce credible, competent, and
7 relevant evidence to support their assertions. (*Appeal of Oscar D. and Agatha E. Seltzer, supra.*)

8 Treatment of Corporate Distributions

9 California conforms to the federal subchapter S rules of the IRC "relating to the tax
10 treatment of S corporations and their shareholders, except as otherwise provided." (Rev. & Tax. Code,
11 § 23800.) Therefore, if the transfer is treated as a distribution under IRC section 1368(b), as alleged by
12 respondent, then it would be taxable as capital gain to appellant to the extent that it exceeded appellant's
13 adjusted basis.

14 Whether a transfer from a corporation to a shareholder is a bona fide loan is a question of
15 fact, the answer to which must be based upon a consideration and evaluation of all surrounding
16 circumstances. (*Jones v. Comm'r*, T.C. Memo 1997-400.) In *Jones v. Commissioner, supra*, the tax
17 court considered whether disbursements that the taxpayer received from an S corporation constituted
18 loans or taxable distributions. The taxpayer was the sole shareholder of the S corporation. During a
19 three-year period, the S corporation disbursed over \$700,000 to the taxpayer. The disbursements were
20 recorded as loans on the books and records of the corporation and portions of the loans were purportedly
21 repaid through the taxpayer's assumption of the corporation's other debt and the reclassification of some
22 amounts as salary. However, the tax court noted that the taxpayer made numerous withdrawals from the
23 corporation, and there did not appear to be any limit on the amount that the taxpayer could "borrow."
24 Also, the taxpayer did not execute any notes to evidence the debt or provide any security for the debt,
25 and the corporation never set a date for repayment of the debts or demanded repayment of the debt.

26 In reviewing these facts, the tax court provided the following non-exclusive list of factors
27 to be considered:

28 "(1) The extent to which the shareholder controls the corporation, (2) the earnings and

1 dividend history of the corporation, (3) the magnitude of the withdrawals and whether a
2 ceiling existed to limit the amount the corporation advanced, (4) how the parties recorded
3 the withdrawals on their books and records, (5) whether the parties executed notes, (6)
4 whether interest was paid or accrued, (7) whether security was given for the loan, (8)
5 whether there was a set maturity date, (9) whether the corporation ever undertook to force
6 repayment, (10) whether the shareholder was in a position to repay the withdrawals, and
7 (11) whether there was any indication the shareholder attempted to repay withdrawals.
8 [Citation omitted.]” (*Jones v. Commissioner, supra*),

9 Weighing these factors, the tax court concluded that the disbursements at issue
10 constituted distributions, rather than loans. In reaching its conclusion, the tax court noted that the
11 distributions were recorded as loans on the books of the corporation, but accorded little weight to that
12 fact in light of the lack of other evidence demonstrating the existence of a bona fide debt. (*Id.*)
13 The factors noted by the tax court in *Jones v. Commissioner, supra*, and similar factors have been cited
14 by many courts. (*See Cepeda v. Commissioner* T. C. Memo 1993-477; *Alterman Foods, Inc. v. United*
15 *States* (5th Cir. 1974) 505 F.2d 873.)

16 In *Appeals of Raymond J. and Lillian I. Lull* (87-SBE-045), decided June 17, 1987, the
17 Board considered an appeal in which a corporation disbursed funds to its stockholders over a period of
18 years. On appeal, the taxpayers argued the disbursements were loans. In support of this contention, the
19 taxpayers noted the disbursements were treated as loans on the corporate books and notes were issued to
20 evidence the loans. In considering the taxpayers’ arguments, the Board stated:

21 “[s]pecial scrutiny of the situation is invited where the withdrawer is in substantial
22 control of the corporation [citation omitted] and withdrawals under such circumstances
23 are deemed to be dividend distributions unless the controlling stockholder can
24 affirmatively establish their character as loans. [Citations omitted.]” (*Id.*)

25 The Board noted that the specific question in such cases is “whether at the time of each withdrawal there
26 existed an intent by each shareholder to repay the purported loan and by the corporation to enforce the
27 obligation.” (*Id.*) The Board further explained that it attached little significance to the issuance of notes
28 because the notes lacked a fixed schedule for repayment and it had not been established that the
taxpayers actually paid interest on the notes. (*Id.*) In light of these facts, and the fact that the
corporation had not paid any dividends despite the existence of substantial earnings, the Board
concluded that respondent’s determination that the disbursements were not bona fide loans must be
sustained. (*Id.*)

1 STAFF COMMENTS

2 With respect to supporting written evidence, appellant has provided only the letter from
3 Mr. DeMartini and the spreadsheet of the Linskog settlement agreement as evidence that the transfer
4 was intended as a loan appellant intended to repay, and that appellant had an absolute and unconditional
5 obligation to make repayment. In addition, appellant asks the Board to simply assume the existence of
6 other factors, such as a maturity date, an interest charge and appellant's ability to repay. It appears to
7 the Appeals Division that appellant misapplies other factors such as whether security was given. For
8 example, appellant asserts that Eva's good character was security for the loan but the ordinary meaning
9 of security in this context is property pledged to secure the satisfaction of a debt and subject to forfeiture
10 upon default. (Black's Law Dict., (5th ed. 1979) p.237.)

11 At the hearing, appellant should be prepared to present any other written evidence,
12 preferably created prior to the date of the transfers, that the transfers created a genuine debt that the
13 parties expected to be repaid. (See *Appeals of Raymond J. and Lillian I. Lull, supra.*) For example, it
14 would be helpful if appellant could submit evidence that, prior to the transfers, Eva and CVH's Board of
15 Directors considered when Eva would repay the purported loans and the anticipated source of the funds
16 needed to repay the purported loans. Appellant should also explain the significance of the check dated
17 December 18, 2002, for \$1 million written to Morgan Stanley, Dean Witter, which respondent states was
18 submitted by Mr. Shine as evidence to support appellant's position.

19 The Appeals Division also notes that respondent describes Mr. Shine's roles as
20 representative for appellant and his power of attorney over Robert's affairs in the event that Eva is
21 incapacitated. At the hearing, respondent should be prepared to explain whether Mr. Shine's authority
22 as representative for appellant and Robert is relevant to the Board's decision in the matter.

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26 Linskog_la