72-SBE-040

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
VINEMORE COMPANY, Successor)
in Interest to the E. E.
Hassen Foundation

Appearances:

For Appellant: Stephan Z. Katzan
Attorney at Law

For Respondent: Benjamin F. Miller
Counsel

O P I N I O N

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Vinemore Company, successor in interest to the E. E. Hassen Foundation, against proposed assessments of additional franchise tax and delinquent filing penalties in the total amounts of $6,442.12 and $5,240.36 for the income years ended February 28, 1954, and February 28,1955, respectively.

The issues presented are: (1) whether appellant was taxable on adjustments which were based upon a final agreed federal determination; (2) whether the proposed assessments were barred by the statute of limitations; and (3) whether a 10 percent penalty for delinquent filing of 'returns was properly-imposed.

Appeal of Vinemore Company, Successor in Interest to the E. E. Hassen Foundation

Appellant Vinemore Company is successor in interest to the E. E. Hassen Foundation (hereafter sometimes referred to as "Foundation",) The Foundation was incorporated, in California on February 17, 1953. Its stated purposes were to establish, maintain, and operate hospitals and the like for the care and treatment of the sick, afflicted, and aged, and to furnish and supply care, treatment, hospitalization and other services. Incorporators and original members of its Board of Trustees were Dr. E. E. Hassen, and his relatives, Nathan and William S. Hassen. On February 13, 1953, the Foundation obtained a ruling from respondent designating it as a charitable organization exempt from franchise tax pursuant to section 23701d of the Revenue and Taxation Code. The ruling was based upon the incorporators' representations with respect to the prospective operations of the corporation. It was explained that if the character, purpose, or method of operation changed, such changes should be immediately reported to determine their effect upon the corporation's exempt status. On February 27, 1953, the Foundation purchased all the stock of Hassen Hospital Inc., Dr. Hassen's wholly owned taxable corporation. The latter corporation was dissolved and its assets and liabilities were acquired by the Foundation. On April 11, 1955, the Attorney General of California filed a complaint in the Los Angeles Superior Court alleging in essence that the trustees of the Foundation, particularly Dr. Hassen, had violated the charitable trust impressed upon the Foundation's assets. The suit was dismissed in 1957 pursuant to an agreement dated August 22, 1957. The parties to the agreement included the Foundation, the State of California, appellant and Dr. Hassen. This agreement provided that appellant would assume all indebtedness of every nature owed by the Foundation, whether disputed or undisputed, contingent or -otherwise, including the claim of the United States for certain successor and contingent tax liabilities. It further provided that appellant undertook to clear up any and all tax claims of the United States and the State against the Foundation.

On July 5, 1957, the Foundation's initial request for federal income tax exemption under the similar federal provision in section 501(c)(3) of the Internal Revenue Code of 1954 was denied. This action was based upon findings that during the period from its incorporation in February 1953 to December 31, 1955, the Foundation was engaged in a

number of activities unrelated to the purposes for which it was organized and that the income derived from operating a hospital was used in furthering such outside activities. The Internal Revenue Service expressly stated that during this period the Foundation was operated in part "for the financial benefit of Doctor Hassen in connection with his various business interests".

In 1959, the Internal Revenue Service's ruling of non-exemption became known to the respondent which then revoked the exemption retroactively by letter dated April 20, 1959. On April 23, 1959, respondent requested that tax returns be filed for all years,beginning with the calendar year ended December 31, 1954. On August 31, 1959, returns for the years in question were filed.

On April 18, 1958, the Internal Revenue Service issued Revenue Agent's Report concerning the Foundation's income for the fiscal year ended February 28, 1954, through February 28, 1957. The federal adjustments to specific items resulted in assessments of additional federal income taxes in the amounts of $95,323.44 and $58,425.86 for the fiscal years ended February 28, 1954, and February 28, 1955, respectively. Due to appellant's express assumption of the Foundation's liabilities, the proposed federal taxes were assessed against appellant as transferee of the Foundation's assets. Appellant petitioned the United States Tax Court and, on May 6, 1964, a decision was entered pursuant to a stipulated agreement between the Internal Revenue Service and appe 11 ant. Under this agreement, the.deficiency for the first fiscal year was sustained in full but the def iciency assessment for the second year was reduced from $58,425.86 to $54,676.56.

On November 9, 1964, appellant furnished the Tax Court decision and the details of the stipulated agreement to respondent. On March 22, 1965, respondent issued notices of proposed assessment of additional franchise tax for the income years ended February 28, 1954, and February 28,1955, against appellant as successor in interest to the Foundation. These proposed assessments reflected the same federal adjustments which were contained in the stipulated agreement for those years incorporated in the Tax Court decision. All of the federal adjustments were based upon statutes with virtually identical counterparts in the California law.

Previously, appellant had informed respondent on July 12, 1961, of the Revenue Agent's Reports but at that time the adjustments were still in dispute.

Appellant filed a protest against these proposed assessments which included delinquent filing penalties. Respondent reaffirmed its assessments and appellant filed this appeal.

The first question for decision is whether appellant was taxable based upon a federal Tax Court decision entered pursuant to a stipulated agreement. With respect to this question, appellant contends that there cannot be retroactive revocation of tax exempt status, that lack of federal exemption has no bearing, that appellant was not a transferee, and that, in any event, it believes, no specific adjustments were agreed to with the federal government but merely a "money amount" for purposes of settlement.

Respondent's determination based upon a final federal determination is presumed correct and appellant bears the burden of proving the adjustments erroneous. (Todd v. McColgan, 89 Cal. App. 2d 509 [201 P.2d 414]; Appeal of Nicholas H. Obritsch, Cal. St. Bd. of Equal., Feb. 17, 1959.) Appellant has failed to carry this burden of proof.

In regard to the retroactive revocation, it is well settled that exempt status can be retroactively revoked where the taxing authority is not fully informed of the material facts or where there have been material. changes. subsequent to the time the exemption was given. (Stevens Bros. Foundation, Inc., 39 T.C. 93, aff'd on this point, 324 F.2d 633, cert. denied, 376.1J.S. 969 [12 L. Ed. 2d 84]; Birmingham Business College,-Inc. v. Commissioner, 276 F.2d 476.) Unlike the time when the state rendered its exempt ruling, the federal government was aware of the method of operation when it denied the exemption. Furthermore, appellant is liable at law as a transferee since it agreed to pay the transferor's obligations. (Helvering v. Wheeling Mold and Foundry Co., 71 F.2d 749, cert. denied, 293 U.S. 603 [79 L. Ed. 695]; Georgia, Florida and Alabama Railroad Co., 31 B.T.A. 1; Bos Lines, Inc. v. Commissioner, 354 F.2d 830; American Equitable Assurance Co. of New York, 27 B.T.A. 247, aff'd, 68 F.2d 46; United States Trucking Corn., 29 B.T.A. 940.) Clearly, we are not concerned here

with merely an arbitrary monetary settlement because the federal settlement was based upon Revenue Agent's Reports involving specific items such as interest expense, depreciation and bad debt deductions whose counterparts are found in the California code provisions.

With respect to the statute of limitations, the determination of a federal change became final on about August 6, 1964, which was 90 days after the stipulated decision of May 6, 1964. (Int. Rev. Code of 1954, §§ 7481, 7483.) Therefore, no final determination of a federal change was reported within 90 days as required by section 25432 of the Revenue and Taxation Code when notice was given appellant on November 9, 1964. Section 25673 provides for such a four year time limit where there is failure to comply with section 25432. Accordingly, respondent had until four years after such final change, or approximately until August 6, 1968, to issue timely notices of proposed assessment. Respondent issued the notices of proposed assessment on March 22, 1965. Even if notice had been given within 90 days, respondent would still have issued timely notices of proposed assessment since it received notice November 9, 1964, and issued its notices on March 22, 1965, well within the six month limitation then prescribed in section 25674. Appellant places reliance upon the notice it gave to respondent on July 12, 1961, but at that time the proposed federal changes were in dispute and, therefore, this did not constitute notice of any final determination.

With respect to the 10 percent delinquent filing penalty, section 25931 of the Revenue and Taxation Code provides that reasonable cause and the absence of willful neglect must be shown to avoid imposition of the penalty. The latter computes at the rate of 5 percent of the tax for each 30 days or fraction thereof elapsing between the due date of the return and the actual filing date, but the penalty cannot exceed 25 percent. While the appellant's exempt status remained unrevoked there was reasonable cause for failure to file. (Stevens Bros. Foundation, Inc., supra.) On April 20, 1959, Foundation's exemption was revoked, and on April 23, 1959, respondent requested returns for the years in question. The returns were not mailed to respondent until August 31, 1959. The statutory period for filing returns is two and one-half

months after the close of the income year. In the Stevens Bros. case for purposes of measuring when a return is due where an exemption is revoked, the court equated the revocation and notice to taxpayer that returns were due with the end of a taxable time period. Thus, two and one-half months after April 23,1959, the returns of Foundation were due. The returns were filed later by a period in excess of one, but less than two months, and therefore the penalty was properly imposed and measured by ten percent of the tax.

Based upon the record before us, we must sustain the action of respondent.

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 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest- of Vinemore Company, successor in interest to the E. E. Hassen Foundation, against proposed assessments of additional franchise tax and penalties in the total amounts of $6,442.12 and $5,240.36 for the income years ended February 28, 1954, and February 28, 1955, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 12th day of December, 1972, by the State Board of Equalization.

John W. Lynch, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: _____, Secretary/