

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
THOMAS M. AND ELAINE JADOON)

Appearances:

For Appellants: Thomas M. Jadoon, in pro. per.

For Respondent: Richard A. Watson
Counsel

O P I N I O N

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Thomas M. and Elaine Jadoon against a proposed assessment of additional personal income tax in the amount of \$651.58 for the year 1968.

The only issue raised is whether appellants realized income from a sale of corporate stock in 1968.

In 1965 appellant Thomas Jadoon and another man formed Cooper Concrete Pipe Co., Inc., a California corporation. Both men loaned the corporation substantial sums of money for working capital, and each man purchased 100 shares of the corporation's stock for \$10,000. During 1966 and 1967 Mr. Jadoon's loans to the corporation totaled \$41,000. He obtained \$25,000 of this amount by mortgaging his home to a bank. The remaining \$16,000 was the net amount, after deductions for taxes, of Mr. Jadoon's \$18,000 gross annual salary from the corporation.

On April 17, 1968, Mr. Jadoon agreed to sell 99 of his 100 shares in the corporation to Paul A. Galpin for a price of 370,000. For reasons not apparent from

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the record, the documents effecting the stock sale were drawn up by the attorney for the other 50% shareholder, not by the attorneys, if any, representing Mr. Jadoon and Mr. Galpin. The transaction planned by this attorney included an agreement by Mr. Jadoon to contribute to the corporation's capital the net amount of the corporation's indebtedness to him. When the sale was consummated on May 31, 1968, Mr. Jadoon apparently executed a document directing the corporate officers to make the necessary entries in the corporate books to reflect this contribution to capital. Such entries were made, and respondent's audit of the corporate books revealed that the amount so contributed to capital was \$32,716. This figure was computed as follows: \$41,000 in original loans, less repayments by the corporation of \$990, and less \$7,294 which Mr. Jadoon owed the corporation for equipment he had taken out of it and for certain of his personal obligations which the corporation had paid.

Under the terms of the sale agreement, Mr. Galpin paid Mr. Jadoon \$20,000 in cash on the date of the sale (May 31, 1968) and gave him an installment promissory note for the \$50,000 balance of the purchase price. The note was secured by a pledge of the 99 shares of stock. As specified in the note, Mr. Galpin paid the first installment of \$18,000, plus \$388 in interest, 120 days after the date of the sale. Thus, Mr. Jadoon received \$38,000 of the \$70,000 purchase price in the year of the sale.

Appellants did not report the stock sale on their joint California personal income tax return for 1968. They did report it on their 1969 return, however, after being advised to do so by their accountant and after being notified by respondent that it had learned of the unreported sale through a routine audit of the corporation. The 1969 return treated the stock transaction as an installment sale for a gross sales price of \$29,000.

Respondent determined that the sale should have been reported on appellants' 1968 return, that the sales price was \$70,000, that appellants' stock basis was \$42,716 (\$10,000 + \$32,716), that appellants realized a capital gain of \$27,284, and that the sale could not be returned on the installment basis because more than 30% of the sales price had been received in the year of the sale.

Appellants' position appears to be that none of the \$70,000 represented gain. Mr. Jadoon states that the transaction was structured to allow him to get

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back his cash investment in the corporation. He says that he computed the sales price as follows:

\$25,000	loans to the corporation
10,000	original cost of the stock
<u>35,000</u>	representing two years of salary
\$70,000	either loaned back to or not drawn out of the corporation

As he viewed the transaction, -the-\$38,000 cash received in 1968 represented his stock cost plus the loans of \$25,000 and \$3,000 interest on those loans. The part of the purchase price deferred to later years he regarded as salary, At the hearing before this board, appellant indicated that Mr. Galpin defaulted on the note so that he (appellant) never has gotten the salary he earned but left in the corporation,

There can be no question that the sale should have been reported in 1968, when it took place, rather than in 1969, when the appellants did report it. It is equally clear that appellants may not use the installment method of reporting, since the \$38,000 received in the year of sale substantially exceeded 30% of the \$70,000 selling price of the stock. (Rev. & Tax. Code, § 17578, subd. (b)(1)(B),) Therefore, the only remaining question is the amount of gain, if any, realized on the sale.

On the facts presented to us, we think the appellants clearly realized at least as much gain as that determined by respondent.&/ We do not quarrel with the obvious sincerity of appellants' belief that they got no more than was rightfully coming to them, but under no interpretation of the facts could their stock basis be held to be equal to the selling price. Appellants' original basis was certainly increased by the contribution to the corporation's capital, but nothing in the record suggests any way that the adjusted basis could be greater than \$42,716.

That the sales price contained elements of gain is apparent even under the appellants' view of the transaction. As Mr. Jadoon explained it at the hearing, his computation of the price included amounts for interest and one year's salary, none of which was reported on appellants' returns for any year. Clearly, that interest

1/ The proposed assessment appears to contain an inadvertent error in appellants' favor. The original cost for the 99 shares sold by the appellants is given as \$10,000, whereas it should be only \$9,900 since \$10,000 was the cost of 100 shares.

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and salary constitute taxable gain, whether received directly from the corporation or indirectly from a third-party purchaser of appellants' stock. We have no reason to disbelieve Mr. Jadoon when he says that he did not understand the legal ramifications of the documents he signed in making the sale. But we must point out that, under the proposed assessment as it now stands, the transaction successfully converted into capital gain what otherwise would have been ordinary income (the interest and salary) if received directly from the corporation. The result, of course, is a substantial tax benefit for the appellants.

Since it appears that appellants' correct tax liability is at least as great as that determined by respondent, the proposed assessment must be upheld.

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 Thomas M. and Elaine Jadoon against a proposed assessment of additional personal income tax in the amount of \$651.53 for the year 1968, be and the same is hereby sustained.

Done at Sacramento , California, this 31st day
of July , 1972, by the State Board of Equalization.

_____, Chairman

Robert J. ...
_____, Member

...
_____, Member

William G. ...
_____, Member

_____, Member

ATTEST: *W. W. ...*
_____, Secretary