76-SBE-008

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
JOEL HELLMAN)

Appearances:

For Appellant: William N. Roth
Certified Public Accountant

For Respondent: David M. Hinman
Counsel

OPINION

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 Joel Hellman against a proposed assessment of additional personal income tax in the amount of $2,234 for the year 1969.

The sole issue for determination is whether amounts withdrawn from appellant's controlled corporation were simply loans or taxable as constructive dividends.

Appellant is the principal stockholder in J. Hellman Produce, Inc. , a California corporation engaged in the wholesale produce business. The other stockholders are appellant's wife and 'son. During the year in issue appellant made frequent and steady withdrawals from corporate funds, The withdrawals were charged to an account on the corporate books entitled, simply, "Joe Hellman." During 1969 a single repayment was credited to appellant's account. As a result of the various transactions the account reflected withdrawals in excess of $22,000 during 1969. The withdrawals were not made for any corporate purpose; appellant withdrew the funds for personal reasons. He regularly used the account for payment of his own bills. There were no notes or other evidences of indebtedness, and no interest was ever charged or paid. No date for repayment was provided. Appellant's wife and son had made loans to the corporation in the approximate amounts of $35,789 and $38,198, respectively, as of the close of the corporation's fiscal year. While appellant paid no interest to the corporation, the corporation paid eight percent interest on the loans from his wife and son. The record does not indicate that the corporation ever declared any formal dividends.

Appellant's separate return for 1969 did not reflect any income as a result of his withdrawals from the corporation during that year. As the result of an audit respondent proposed to increase appellant's income by the amount of the withdrawals made during the year on the theory that they were constructive dividends. It is from this action that appellant appeals.

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.) The term "dividend" means any distribution of property, including money, made by a corporation to its shareholders out of its earnings and profits of the current year or out of its earnings and profits accumulated after February 28, 1913.9 (See Rev. & Tax. Code, §§ 17381, 17383.) In order to determine

1/ Since appellant has offered no evidence to show that the corporation did not have sufficient earnings and profits, we must conclude that the distribution was made out of earnings and profits.

that a distribution by a corporation to its shareholder is a dividend it is not necessary that the transaction be labeled as the distribution of a dividend. From all the facts it may be concluded that there is a "constructive dividend" which is taxable to the shareholder just as if the parties had labeled it expressly as a dividend. (See generally, 1 Mertens, Law of Federal Income Taxation § 9.07.)

Whether withdrawals from a corporation by a stockholder represent loans or taxable distributions depends on all the facts and circumstances surrounding the transactions. (Harry E. Wiese, 35 B.T.A. 701, aff'd, 93 F. 2d 921, cert. denied, 304 U. S. 562 [82 L. Ed. 1529]; Elliott J. Roschuni, 29 T. C. 1193, 1201, aff'd, 271 F. 2d 267, cert. denied, 362 U. S. 988 [4 L. Ed. 2d 1021].) A determination that withdrawals constitute loans depends upon the existence of an intent at the time the withdrawals were made that they should be paid back. (Clark v. Commissioner, 266 F. 2d 698, 710; Atlanta Biltmore Motel Corp. , T. C. Memo., Sept. 19, 1963, aff'd, 349 F. 2d 677.) Special scrutiny is given where the withdrawer is in substantial control of the corporation. (Elliott J. Roschuni, supra, 29 T. C. at 1202; W. T. Wilson, 10 T. C. 251-256, aff'd 176 F. 2d 423.) Withdrawals under such circumstances are deemed to be'dividend distributions unless the controlling stockholder can affirmatively establish their character as loans. (W. T. Wilson, supra.) Furthermore, family control of a corporation invites careful examination of transactions between shareholders and their corporation. (William C. Baird, 25 T. C. 387.)

In a matter quite similar to the present appeal this board, determined that the withdrawals in question were taxable distributions and not loans. (Appeal of Albert R. and Belle Bercovich, Cal. St. Bd. of Equal. , March 25 1968;see also Lou Levy, 30 T. C. 131.5, 1327.) Like the pr'esent matter, Bercovich revealed a steady pattern of withdrawals by appellant from his family owned corporation. The withdrawals, were entirely for appellant's personal use. No debt instruments were ever executed and no interest was ever paid. Additionally, the corporation had not paid a formal dividend for many years.

The only argument advanced by appellant in support of his position is that the amount of the loans made to the corporation by his wife and son should be offset'against his withdrawals. Appellant

concludes that, in rhe aggregate, the corporation and the family were not indebted to each other; therefore, there were no taxable distributions. Although this argument is certainly novel, we are unaware of any authority to support it and appellant has offered none. Authority does exist, however, for the proposition that there is no rule which forbids treating corporate distributions as dividends merely because the stockholder may also be a creditor of the corporation. (Lou Levy, supra.) It follows that there is no such rule where members of the stockholder's family are creditors of the corporation.

Since appellant has failed to establish that the withdrawals in question were loans, we must sustain respondent's characterization of them as taxable distributions. However, appellant has established that the corporate distributions were community property, taxable one half to him and one half to his wife. Accordingly, since appellant filed a separate return for the year in issue, only one half of the constructive dividends may be attributed to him. (United States v. Malcolm, 282 U. S. 792 [75 L. Ed. 714]; E. H. Stanton, 21 B. T. A. 1380.)

ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

Appeal of Joel Hellman

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 Joel Hellman against a proposed assessment of additional personal income tax in the amount of $2,234 for the year 1969, be and the same is hereby modified in accordance with the opinion of the board.

Done at Sacramento, California, this 2nd day of February, 1976, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: _____, Executive Secretary