

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
BEN B. EISENBERG )

Appearances:

For Appellant: Albert E. Fink  
Attorney at Law

'For Respondent: James C. Stewart  
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 Ben B. Eisenberg against proposed assessments of additional personal income tax in the amounts of **\$3,371.53**, \$822.60, **\$1,875.50**, and **\$2,417.70** for the years 1967, 1968, 1969, and 1970, respectively.

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Appellant **Ben B. Eisenberg** is the sole stockholder of the Kes Corporation, a California **corporation**. He is **also employed** by the corporation and draws an annual salary of \$7,800.

Kes Corporation owns and operates a two-story medical building in Beverly Hills, California. Until 1974 appellant personally owned the lots immediately north and south of this building, but in that year he transferred the northern lot to Kes Corporation. According to appellant, the building site is underdeveloped and more suitable improvements have been planned for several years. Such improvements would allegedly require common ownership of the present building and both the adjacent lots. Various circumstances have delayed adoption of a final plan for the improvements, however, and as of the date of this appeal, no decision had as yet been made **as to** whether the property should be **owned** entirely by appellant or entirely by the corporation;

Kes Corporation did not declare any formal dividends during the years at issue, despite ample earnings, allegedly because it might need the cash when a final decision is made on the improvement plan. Each year the corporation did distribute most of its earnings to appellant, however. The distributions were carried **as** loans on the corporate books, with interest charged **at** the rate of four percent per **year**, and were allegedly intended as investments which would not tie up the **corporation's** cash reserve. The record does not reveal the use to which appellant put the money distributed to **him**.

Appellant purported to repay each of the distributions within one year of the date he received the **funds**. The distributions and repayments were typically carried out in the following manner. Early in August, the first month of the corporation's fiscal year, **appellant** would **withdraw** a sum of money from the **corporation**. He would repay this amount plus interest on **December 31**. Appellant would then make additional withdrawals during the first few days of the next calendar year and repay the additional withdrawals plus

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interest late in July. <sup>1/</sup> Usually each repayment was followed within a few days by a withdrawal equal to or greater than the repayment, so that the outstanding "loan balance" steadily increased from year to year. The increases are as follows:

<u>Year</u>	<u>Highest Balance During Year</u>	<u>Increase From Prior Year's Highest Balance</u>
1966	\$68,000	---
1967	97,000	\$29,000
1968	100,000	3,000
1969	<b>115,000</b>	15,000
1970	<b>122,500</b> <sup>2/</sup>	7,500

Respondent audited appellant early in 1971. At the first three conferences with appellant's accountants, the accountants told respondent's auditor that there were no promissory notes to evidence the **purported** loans. **Subsequently, however,** appellant's attorney submitted copies of demand notes dated contemporaneously with each withdrawal. He also submitted an affidavit from the Kes Corporation's secretary stating that appellant had executed promissory notes at the time the withdrawals were **made**.

As a result of its audit, respondent determined that the purported loans were actually disguised dividends. It therefore added to appellant's income each year's increase in the "loan balance," and also disallowed claimed deductions for the alleged interest he had paid on the purported loans. After the filing of this appeal, however, respondent agreed with appellant to treat as dividend income only the amount by which the increase in each year's "loan balance" exceeded the purported

1. Sometimes substantially smaller withdrawals and repayments were made at other times of the year.

2. Respondent originally determined that **the 1970** balance was \$135,000. Subsequent investigation disclosed that this figure erroneously included some withdrawals which appellant made early in 1971. Respondent has agreed to revise its proposed assessment for 1970 accordingly.

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interest paid in that year. The sole question remaining for our decision is whether the withdrawals were in fact loans or dividends.

Whether a withdrawal of corporate funds by a shareholder **represents** a taxable dividend or a nontaxable loan is a question of fact on which the taxpayer bears the burden of proof. (Appeal of Gordon A. and Zelda Rogers, Cal. St. Bd. of Equal., May 7, 1968.) The **ultimate** determination is **whether**, at the time the **withdrawal was** made, the **parties** to the transaction intended that the funds would be repaid. (Appeal of Richard M. and Beverly Bertolucci, Cal. St. Bd. of Equal., May 4, 1976.) The question of intent must be resolved by **examining** all the surrounding circumstances, and no one **factor or** group of factors is conclusive. Where a **taxpayer** withdraws funds from his wholly-owned corporation, **the** surrounding facts should be viewed with special scrutiny, since his control of the corporation gives **him** the ability to manipulate its affairs to obtain **permanent** use of the withdrawn funds under the guise of a loan. (Appeal of Richard M. and Beverly Bertolucci, supra.)

Appellant contends primarily that the formal indicia of loans, such as notes, interest charges and **repayment**, are present in this case and evidence his **intent** to **repay** the withdrawals. This evidence is **weakened by several circumstances, however.** For instance, **in** light of the statements which appellant's accountants made to respondent's auditor, it is questionable whether **the** notes presented to this board were actually executed contemporaneously with the withdrawals. Even if they **were**, the notes were demand notes and did not provide for a definite repayment date. The amounts of the **withdrawals** greatly exceeded appellant's minimal salary **from** the corporation, but no collateral secured the **alleged** loans. Although interest was charged, the rate **was quite** low. Moreover, despite ample earnings, the **corporation** declared no formal dividends during this **period.** In our opinion the vague allegations that the **corporation** might need a large cash reserve at some future date do not adequately explain this failure.

More importantly, however, the alleged **repayments** lacked any economic reality. Whenever appellant **paid** off the outstanding "loan balance," he would **ordinarily** withdraw an equal or greater amount within a few days. In substance, therefore, there really was no

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repayment at all, and appellant obtained permanent use of the greater part of the corporation's earnings. No explanation has been offered for appellant's elaborate and apparently meaningless repayment procedure. Absent such an explanation, the so-called repayments appear to be no more than shams to disguise the distribution of corporate profit.. (See Atlanta Biltmore Hotel Corp. v. Commissioner, 349, F.2d 677, 680 (5th Cir. 1965); Parker A. Eckles, T.C. Memo, Dec. 28, 1962.) Harry Hoffman, **decided by** a memorandum opinion of the Tax Court on August 2,- 1967, is not to-the contrary, since repayments made by the taxpayer in that case were found to be both real and substantial.

In conclusion, the fact that appellant followed the formalities of borrowing when he made the withdrawals is not controlling. (Estate of Taschler, 440 F.2d 72 (3d Cir. 1971).) The lack of any real or substantial repayment indicates that appellant had no intent to **repay** (see Kathrine R. Lane, T.C. Memo, Aug. 28, 1969) and, under the circumstances of this case, the alleged demand notes and interest charges do not persuade us to the contrary. We conclude that appellant has failed to meet his burden of proof, and therefore sustain respondent's action as modified by the agreements which it made with appellant.

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,

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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 Ben B. Eisenberg against proposed assessments of additional personal income tax in the amounts of \$3,371.53, \$822.60, \$1,875.50, and \$2,417.70 for the years 1967, 1968, 1969, and 1970, respectively, be and the same is hereby modified in accordance with the adjustments indicated in this opinion. In all other respects the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 2nd day of March, 1977, by the State Board of Equalization.

J. William LeBene Chairman  
George P. [unclear] Member  
[unclear] Member  
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\_\_\_\_\_, Member

ATTEST: W. W. [unclear], Executive Secretary