



Appeal of Byron C. Beam

<u>Year</u>	<u>Additional Tax</u>	<u>Penalty</u>
1969	\$ 819.53	\$204.88
1970	1,917.16	479.29
1971	1,868.79	467.19
1972	1,110.70	277.67

The issues presented are (1) whether certain advances received by appellant from his employers constituted loans or taxable-income, and (2) whether respondent properly imposed penalties for appellant's failure to file timely returns for the years on appeal.

Since 1930, appellant has engaged in business as an insurance broker, financial agent, and investment counselor. His business activities have included the sale of commercial and industrial properties, consultation with landowners regarding subdivision development and zoning regulations, arranging corporate mergers, and advising corporate clients regarding the sale of securities to the public.

Although quite successful in the business activities outlined above, appellant began experiencing personal financial difficulties in 1960 due to divorce litigation and health problems. As appellant's financial position continued to deteriorate he found it necessary to liquidate most of his assets and to seek financial assistance from friends and relatives.

Early in 1968, appellant was contacted by a former client and principal owner of a 340 acre parcel of unimproved farmland located in Ventura County, California. Appellant was informed that the landowners were prepared to sell the parcel for approximately \$25,000,000, and that they desired to employ appellant as their exclusive sales representative. Appellant advised the client that although he was interested in the employment it would be difficult for him to independently finance a successful sales effort. Ultimately, on April 14, 1968, appellant entered into an oral brokerage agreement pursuant to which he was granted the exclusive right to sell, at a commission of 5 percent, the Ventura property. Apparently, one or more of the landowners also agreed to provide appellant with funds for his personal use.

Appeal of Ryron C. Beam

On April 26, 1973, appellant and two of the landowners reduced the oral agreement to writing. <sup>1/</sup> Among the provisions of the written agreement are the following:

7. Owners agree to provide, from time to time, sums of money to Broker as non-interest bearing personal loans required by Broker; the total amount thereof shall be deducted from such commissions as may thereafter become due Broker from Owners ....

8. Broker acknowledges receipt of periodic personal loans from Owners commencing April 15, 1.968 ....

10. Broker agrees ... that all commissions that may become due Rroker from Owners in accordance with the terms of this Agreement shall. be assigned to Owners to apply against any loan balance due until such time all loans have been fully satisfied ....

During the years 1969 through 1973, appellant and the landowners were frustrated in their attempts to have the Ventura property annexed to the City of Ventura and zoned for industrial, commercial, or residential use. Consequently, al though appellant produced several potential buyers during that period, he was unable to negotiate a final sale of the property. Finally, in 1974, the landowners commenced negotiations with an established land developer for a joint-venture subdivision and residential development of the property. Appellant has indicated that he expects to receive his commission in increments as the property is improved and sold.

During the years on appeal, appellant received "personal loans;" from the landowners in the total amount of over \$90,000. As of December 31, 1972, appellant had not repaid any portion of the purported loans. Apparently, appellant had no other source of financial support

---

1/ Apparently, appellant drafted the written agreement from handwritten notes which he had prepared at the time of the oral agreement. Those notes are not a part of the record on appeal.

Appeal of Byron C. Beam

during this period. The record on appeal indicates that appellant utilized the funds received from the landowners for both personal and business expenses. 2/

In February 1973, after discovering that appellant had not filed California personal income tax returns for the years 1969 through 1972, respondent commenced an investigation of appellant's business activities during those years. As a result of its investigation, respondent determined that the funds received by appellant from the Ventura landowners constituted unreported taxable income. Accordingly, respondent issued the proposed assessments and penalties for failure to file timely returns which gave rise to this appeal. The penalties were imposed pursuant to section 18681 of the Revenue and Taxation Code.

It is respondent's position that the funds in question represent advance payments of the commission which appellant expected to receive, and which the landowners expected to pay, pursuant to the brokerage agreement. Appellant, on the other hand, contends that the advances represent nothing more than "personal loans", as provided in the written brokerage agreement.

If the funds in question represent loans, as appellant contends, they do not constitute taxable income. However, if the funds represent compensation for services, even though the services were to be performed or completed in the future, they constituted taxable income in the year received. (See Anson Beaver, 55 T.C. 85, 91 (1970); Irving D. Fisher, 54 T.C. 905 (1970) .)

The primary consideration with respect to proper characterization of advances received in connection with an employer-employee relationship is whether the parties genuinely intended to create and maintain a debtor-creditor relationship. (Irving D. Fisher, supra, 54 T.C. at 909-910.) The determinative intent, however, is necessarily the objective intent as disclosed by all relevant facts and circumstances surrounding the transaction. (Robert W. Adams, 58 T.C. 41, 58-60 (1972); Sidney W. Fairchild, ¶70,329 P-H Memo. T.C. (1970).)

2/ Despite recommendations by both this board and the Franchise Tax Board that appellant submit records to establish the amounts of his business expenses for consideration in connection with this appeal, appellant has continually and adamantly refused to provide such records.

Appeal of Byron C. Beam

Ordinarily, a debt is represented by "an unqualified obligation to pay a sum certain at a reasonably close fixed maturity date along with a fixed percentage of interest payable regardless of the debtor's income or lack thereof." (Gilbert v. Commissioner, 248 F.2d 399, 402 (2d Cir. 1957).) With respect to the instant appeal, we observe at the outset that most, if not all, of these recognized indicia of indebtedness are conspicuously absent. Appellant had virtually unlimited discretion<sup>3/</sup> as to the amounts and frequency of the purported loans. Moreover, the purported loans had no fixed maturity dates, interest was not charged, and no fixed schedules for repayment were established.

Appellant asserts that the written brokerage agreement provides persuasive evidence that the funds in question constituted loans. The written agreement, however, was executed five years after the initial oral agreement and two months after respondent commenced its investigation of appellant's failure to file returns for the years in question. Furthermore, it is the substance of a transaction, not its form, which governs its true nature for tax purposes. (United States v. Henderson, 375 F.2d 36 (5th Cir. 1967).) The record on appeal indicates that during the period over which appellant received the funds his financial position was precarious, he had no substantial assets, and he had no other source of immediate income. Also, appellant did not repay any portion of the purported loans during this period, and the landowners made no demand for repayment. These facts, coupled with the language of the written brokerage agreement providing for reduction of appellant's commission in satisfaction of the outstanding loan balance, suggest that the written agreement, at most, created or affirmed an obligation to repay which was contingent upon appellant's successful negotiation of a final sale of the Ventura property. Under the circumstances, we must conclude that the funds received by appellant during the years on appeal did not constitute true loans. (See United States v. Henderson, supra; Sidney W. Fairchild, supra; Appeal of Armored Transport, Inc., Cal. St. Bd. of Equal., Feb. 2, 1976.) To the contrary, we find ample evidence in the record to support respondent's conclusion that the funds constituted advance payments of appellant's future commission and, therefore, taxable income in the years received. (Anson Beaver, supra.)

---

3/ Appellant does claim that he orally agreed to keep the purported loans within "reasonable limits".

Appeal\_of Byron C. Ream

The remaining issue is whether respondent properly imposed the penalties for appellant's failure to file timely returns. Section 18681 of the Revenue and Taxation Code requires the imposition of such penalties "unless it is shown that the failure is due to reasonable cause and not due to willful neglect." In order to establish reasonable cause for the failure to file timely returns, appellant must demonstrate that his failure to file occurred notwithstanding the exercise of ordinary business care and prudence. (Appeal of Herbert Tuchinsky, Cal. St. Rd. of Equal., July 1, 1970; Appeal of David and Hazel Spatz, Cal. St. Bd. of Equal., May 4, 1970.)

Although the written briefs filed by appellant for purposes of this appeal contain unsupported general assertions concerning his poor health and his reliance on the advice of his accountant, appellant ultimately relies on his belief that he had no substantial taxable income during the years on appeal to explain his failure to file timely returns. However, the mere unsupported belief of a taxpayer that he is not required to file a timely return, no matter how sincere that belief may be, is insufficient to constitute reasonable cause for his failure to so file. (Appeal of J. Morris and Leila G. Forbes, Cal. St. Rd. of Equal., Aug. 7, 1967.) AS we indicated in our discussion of the primary issue presented by this appeal, the record contains very little evidence which would support a reasonable belief that the funds received by appellant from the Ventura landowners constituted something other than taxable income.

Accordingly, on the basis of the record before us, we must conclude that appellant has failed to sustain his burden of proving that the penalties for failure to file timely returns were improperly or erroneously imposed. (Appeal of David and Hazel Spatz, supra.)

Appeal of Byron C. Beam

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 Byron C. Ream against proposed assessments of additional personal income tax and penalties in the amounts and for the years as follows:

<u>Year</u>	<u>Additional Tax</u>	<u>Penalty</u>
1969	\$ 819.53	\$204.88
1970	1,917.16	479.29
1971	1,868.79	467.19
1972	1,110.70	277.67

be and the same is hereby sustained.

Done at Sacramento, California, this 29th day of June, 1978, by the State Board of Equalization.

George L. Kelley, Chairman  
Paul H. Lee, Member  
William B. Bennett, Member  
Lucy Dantley, Member  
\_\_\_\_\_, Member