



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
BOLSANA, INC.)

For Appellant: Martin C. Emo
Certified Public Accountant

For Respondent: James C. Stewart
Counsel

O P I N I O N

This appeal is made pursuant to section 26075, subdivision (a), of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of Bolsana, Inc., for refund of franchise tax in the amount of \$14,660.85 for the income year ended October 31, 1969.

Appeal of Bolsana, Inc.

The sole issue for determination, is whether appellant has established that respondent's determination, which was based on corresponding federal action, was erroneous.

Appellant is a closely held California corporation which was incorporated in 1961 with two equal shareholders. Appellant's principal business activity is the investment in and sale of real estate. The Internal Revenue Service audited appellant's federal return for the appeal period and the succeeding year. The audit resulted in an increase in appellant's sales income and certain other adjustments. The net change was a \$116,616 increase to appellant's income for the appeal year. The net increase to appellant's income resulted, primarily, from the Service's determination that a transfer of property from the corporation to one of its shareholders in exchange for the reduction or cancellation of notes payable to the shareholder by the corporation constituted a taxable sale. The audit also disclosed that appellant suffered large operating losses in the fiscal year ended October 31, 1970, and that the carry-back offset the tax deficiency for the appeal year.

Since the federal changes, with the exception of the loss carry-back, were applicable for state purposes, respondent adopted the changes and issued a proposed assessment of \$7,786 for the appeal year. Since appellant's return had been filed three months late, respondent also assessed a 15 percent penalty for late filing. (Rev. & Tax. Code, § 25931.) Ultimately, appellant agreed to the federal determination, paid the state assessment and filed a claim for refund with respondent. The claim was denied and this appeal followed.

Section 25432 of the Revenue and Taxation Code provides that a taxpayer shall either concede the accuracy of a federal determination or state wherein it is erroneous. It is well settled that a determination by the Franchise Tax Board based upon corresponding federal action is presumed to be correct, and the burden is on the taxpayer to overcome that presumption. (Appeal of Jackson-Appliance, Inc., Cal. St. Bd. of Equal., Nov. 6, 1970. When a federal adjustment has not resulted in federal tax liability because of a net operating loss carry-over the presumption of correctness

Appeal of Rolsana, Inc.

still attaches to the determination. (Appeal of Rolsana, Inc., supra.)

The thrust of appellant's argument is that the exchange should not result in any taxable income to the corporation..

Section 24481 of the Revenue and Taxation Code provides that, with exceptions not relevant here, no gain or loss shall be recognized to a corporation on the distribution of property with respect to its stock. Section 24481, is the state counterpart of section 331(a) of the Internal Revenue Code of 1954. Section 24481 is applicable only if the corporation makes a distribution with respect to its stock. The nonrecognition provision does not apply to a transaction between a corporation and a shareholder in his capacity as a creditor where the fact that such creditor is a shareholder is incidental to the transaction. (Treas. Reg. § 1.311-1(e) (1).) In this appeal, the distribution of property to the shareholder was made to the shareholder in the capacity of a creditor not as a shareholder.. Therefore, the nonrecognition provision does not apply. (See Owens Machinery Co., 54 T.C. 877 (1970).)

Appellant has also argued that all of the shareholder's stock was exchanged in part for the properties transferred. However, no evidence of a stock transfer was offered by appellant. In fact, appellant's tax return indicates that no stock was included in the exchange. Accordingly, appellant's argument must be rejected:.

During the course of these proceedings, appellant has made other arguments concerning the amount of the gain on the exchange.. However, appellant has offered no evidence in support of these contentions. Accordingly, we reject them for a failure of proof.

Appellant has offered no argument against the late filing penalty., Therefore, the penalty must be approved:.

Since appellant has failed to establish that respondent's determination which was based on corresponding federal action was erroneous, respondent's action in denying the claim for refund must be sustained.

