



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
)
GEORGE H. AND SKY G. WILLIAMS AND)
ROBERT L. AND RITA WILLIAMS)

Appearances:

For Appellants: Jack B. Campbell
Certified Public Accountant

For Respondent: Carl G. Knopke
Counsel

O P I N I O N

These appeals are made pursuant to section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of George H. and Sky G. Williams and Robert L. and Rita Williams against proposed assessments of additional personal income tax in the respective amounts of \$4,399.66 and \$4,399.47 for the year 1975.

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sky G. and Rita Williams are parties to this appeal solely because they filed joint income tax returns with George and Robert Williams, their husbands, for the year in issue. Accordingly, only George H. and Robert L. Williams will hereinafter collectively be referred to as "appellants."

In 1957, appellants formed Classic Sales, a California corporation', for the purpose of wholesaling used automobiles. From 1959 through 1968, Classic Sales elected to be treated as a subchapter "S" corporation for federal income tax purposes. Prior to 1967, the corporation's profits were distributed to its shareholders, who reported the distributions on their individual federal income tax returns, but not on their state returns.

On its California franchise tax returns, Classic Sales' distributions to shareholders were shown as loans: its return for 1974 showed that such loans had increased to \$112,701. The corporation's franchise tax return for 1975 indicated that its shareholders had repaid \$32,728 of the loans and that the balance of \$79,973 had been cancelled. Upon receipt of this information, respondent commenced an audit of Classic Sales' franchise tax returns and appellants' personal income tax returns in order to determine if the cancellation of the indebtedness shown on Classic Sales' 1975 return had resulted in income to appellants during that year.

During the course of the audit, respondent discovered that Classic Sales' corporate minutes were virtually nonexistent, that its books were in poor condition, that all pages for 1974 and 1975 were missing -from its general ledger, and that what remained of the ledger did not reconcile with the corporation's franchise tax returns. Additionally, respondent discovered that the corporate books did not correspond to the information found on Classic Sales' federal income tax returns. Classic Sales' bookkeeper was unable to provide any information concerning the missing journal pages or the loans made to appellants.

As part of the audit, respondent interviewed appellants' former tax representative, who had prepared the corporate returns prior to 1976. He stated that while appellants had received and reported corporate earnings on their federal income tax returns prior to 1967, they had never reported such distributions for California personal income tax purposes. Rather, he

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claimed, the amounts distributed to appellants were shown on the corporation's balance sheet as increases in loans to shareholders. Further, he stated that there existed no book entries or notes evidencing these loans and no interest had been paid on the indebtedness. Respondent also spoke to appellants' current tax representative during the course of the audit. He informed respondent that corporate income distributed to appellants was not reported by them on their state personal income tax returns from 1964 through 1966. While he acknowledged that this income should have been reported in the years received, he asserted that the statute of limitations now blocked collection of the tax.

On the basis of the information acquired during the course of the audit, respondent determined that: (i) appellants were the equal and sole owners of Classic Sales from its inception through 1975; (ii) distributions to appellants by Classic Sales were shown as loans to shareholders on both the corporation's franchise tax returns and on their California personal income tax returns; (iii) such loans had increased to \$112,701 in 1974; and (iv) in 1975, \$32,728 of the indebtedness was repaid by appellants and the remaining indebtedness of \$79,973 was cancelled by Classic Sales, thereby resulting in income of \$39,987 (one-half of \$79,973) to each appellant.

The issues presented for our determination are: (i) whether respondent properly determined that appellants owed Classic Sales \$79,973 in 1975; and (ii) if they did, whether the cancellation of this indebtedness by the corporation resulted in additional income of \$39,987 to each appellant in 1975.

Under the California Personal Income Tax Law, gross income means all income from whatever source derived, including income from the discharge of indebtedness. (Rev. & Tax. Code, § 17071, subd. (a)(12); Cal. Admin. Code, tit 18, reg. 17071(k), subd. (1).) The courts have consistently held that, in the case of a loan from a corporation to a shareholder, a subsequent cancellation or charge-off of the loan by the corporation against surplus constitutes a dividend to the shareholder in the taxable year during which the loan was so cancelled or charged-off. (See, e.g., Cohen v. Commissioner, 77 F.2d 184 (6th Cir. 1935); Kate Hudson, 34 B.T.A. 155 (1936), affd., 99 F.2d 630 (6th Cir. 1938), cert. den., 306 U.S. 644 [83 L.Ed. 10443 (1939)].) Consequently, if respondent properly determined that

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appellants were indebted to Classic Sales in the amount of \$79,973 in 1975 and that the corporation cancelled that indebtedness in the same year', we must sustain the proposed assessments.

Appellants contend that the \$79,973 in issue was distributed to them from 1959 through 1969. Accordingly, they maintain, they were not indebted to Classic Sales in 1975 and did not realize any income from the alleged cancellation of the \$79,973 indebtedness. To support their contentions, appellants have presented this board with documents especially prepared for purposes of this appeal. This documentation purports to show that from 1959 through 1968 Classic Sales' net income was credited to a shareholder's loan account and distributed yearly to the shareholders, thereby constituting constructive dividends in the years of receipt. It also indicates that there was no debt due to the corporation in 1975 and that, in fact, Classic Sales was indebted to appellants in the amount of \$11,741.52 as of the end of that year. Finally, appellants claim that they were not the equal and sole owners of Classic Sales prior to 1967.

It is well established that a presumption of correctness attends respondent's determinations as to issues of fact and that the appellant has the burden of proving such determinations erroneous. (See, e.g., Todd v. McColgan, 89 Cal.App.2d 509 [201 P.2d 414] (1949); Appeal of Oscar D. and Agatha E. Seltzer, Cal. St. Bd. of Equal., Nov. 18, 1980; Appeal of Robert L. Webber, Cal. St. Bd. of Equal., Oct. 6, 1976) This presumption is a rebuttable one and will support a finding only in the absence of sufficient evidence to the contrary. (Wiget v. Becker, 84 F.2d 706 (8th Cir. 1936); Appeal of Janice Rule, Cal. St. Bd. of Equal., Oct. 6, 1976.) Respondent's determinations cannot, however, be successfully rebutted when the taxpayer fails to present credible, competent, and relevant evidence as to the issues in dispute. (Cf. Banks v. Commissioner, 322 F.2d 530 (8th Cir. 1963): Estate of Albert Rand, 28 T.C. 1002 (1957).)

In the instant appeal, appellant's have failed to offer the credible and competent evidence necessary to rebut the presumption of correctness attending respondent's determinations. Rather than offering any objective or tangible evidence as to the principal factual issues in dispute, appellants have limited themselves to assertions as to the ultimate facts in

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issue, namely, that they were not indebted to Classic Sales in 1975 and; therefore, could not have realized any income from the cancellation of such indebtedness. **Appellants'** assertions are unsupported by any documentation except for that especially prepared for this appeal, which, it should be noted, is largely based on records which were not made available either to respondent or to this board and which cannot be reconciled with Classic Sales' franchise tax returns, statements made by their former tax representative, and information previously obtained from their current tax representative with regard to this appeal. As noted above, assertions of this nature are not sufficient to overcome the presumption of correctness arising from respondent's determinations.

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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 protests of George H. and Sky G. Williams and Robert L. and Rita Williams against proposed assessments of additional personal income tax in the respective amounts of \$4,399.66 and \$4,399.47 for the year 1975, be and the same is hereby sustained.

Done at Sacramento, California, this 5th day of January , 1982, by the State Board of Equalization, with Board Members Mr. Reilly, Mr. Dronenburg, and Mr. Nevins present.

_____	, Chairman
George R. Reilly	Member
Ernest J. Dronenburg, Jr.	Member
Richard Nevins	Member
_____	Member