



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal)
of)
ASSOCIATED DEVELOPMENT CORPORATION)

Appearance for Appellant: Phillip Reiner, Accountant

Appearance for Respondent: Burl D. Lack, Chief Counsel;
Crawford H. Thomas, Associate
Tax Counsel

OPINION

This appeal is made pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (now Section 25667 of the Revenue and Taxation Code) from the action of the Franchise Tax Board on the protest of Associated Development Corporation to a proposed assessment of additional franchise tax in the amount of \$2,866.80 for the income year ended June 30, 1946.

The Appellant is a California corporation organized in 1939. On February 28, 1946, Mrs. Anita Weatherholt was the owner of 2,498 shares of Appellant's 2,500 authorized and issued shares of no-par capital stock. On that date Mrs. Weatherholt made a written tender of all of her shares of stock to Appellant in consideration of the transfer to her of certain interests in real property owned by Appellant and carried on the books at a value of \$38,899.00, plus the cancellation of indebtedness in the amount of \$40,946.06 which she owed to the corporation. The reason for this offer was stated to be, "In order that I may be relieved of any further active participation in the affairs of your Corporation ...". Following acceptance of this offer by Appellant's Board of Directors the stock was transferred to the corporation, the corporate assets mentioned were conveyed to Mrs. Weatherholt and her indebtedness was cancelled. The shares thus acquired by Appellant were not retired but have since been held by the corporation as treasury stock. The corporation continued to do business in the years following this transaction,

The 2,498 shares of stock held by Mrs. Weatherholt had a book value of \$164,206.46. For the taxable year in question Respondent has increased the net income of Appellant by the sum of \$84,361.40 which represents the difference between the book value of the stock and the book value of assets transferred and the indebtedness cancelled.

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Section 19 of the Bank and Corporation Franchise Tax Act (now Section 24901 of the Revenue and Taxation Code) **provided:**

"(a) The gain from the **sale** or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis . . .

"(b) The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received,"

The Respondent has taken the position that the Appellant realized gain on the sale of assets. The indebtedness owing from Mrs. Weatherholt has been established from the corporate books, but no evidence has been presented with respect to the adjusted basis of the other assets transferred, or of the fair market value of the corporate stock, which was the "amount realized." Nevertheless, where there is no evidence that the figures are unreliable book value is sufficient to establish fair market value. Commissioner of Internal Revenue v. Erier Hill Collieries, 50 Fed. 2d 777; Edwards v. Commissioner of Internal Revenue, 39 B.T.A. 735. In determining taxable gain to a corporate stockholder from surrender of stock in exchange for corporate assets the book value of the assets will support a finding as to their fair market value. Wessel v. United States, 49 Fed. 2d 137. So also, book value of the stock of a close corporation was held to be its fair market value in Estate of James Hogan, T.C. Memo., Docket No. 366, entered April 6, 1944.

During the period in question Regulations 111 of the United States Treasury Department, Section 29.22(a)-15 provided:

"Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

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"But if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of the Internal Revenue Code."

In this case we are concerned with so much of the regulation as relates to gain on the acquisition by a corporation of its own stock; and not with the issues which arise on the disposition of its stock by a corporation. As so limited the applicable portion of the regulation merely enunciated the rules previously established by Commissioner of Internal Revenue v. S. A. Woods Machine Company, 57 Fed. 2d 635, cert. den. 287 U.S. 613 (upholding the income tax on a corporation's receipt of its own shares in satisfaction of a decree in a patent infringement suit), Commissioner of Internal Revenue v. Boca Ceiga Development Company, 60 Fed. 2d 1004 (sale of land by corporation in receipt of its own stock), and Houghton and Dutton Company, 26 B.T.A. 52 (receipt of corporation's own stock as settlement of account receivable). These cases have been followed by the later Circuit Court decisions (Dorsey Co. v. Commissioner of Internal Revenue, 76 Fed. 2d 339, cert. den., 296 U.S. 589; Hammond Iron Co. v. Commissioner of Internal Revenue, 122 Fed. 2d 4; and Trinity Corporation v. Commissioner of Internal Revenue, 127 Fed. 2d 604, cert. den., 317 U.S. 651) and by the Tax Court (C. G. Meaker Co., 16 T.C. 1.348 and Country Club Estates, Inc., 22 T. C. 1283).

The Appellant contends that a partial liquidation resulted in this case and relies upon Lucius Pitkin, Inc., 13 T.C. 547. In that case the stock was cancelled by the taxpaying corporation and the court held, under Regulations 111, Section 29.22(a)-20 that no loss was realized. The pertinent portion of that regulation read: "No gain or loss is realized by a corporation from the mere distribution of its assets in kind in partial or complete liquidation, however they may have appreciated or depreciated in value since their acquisition." Because of the stock cancellation and all of the many other facts *in* that case which clearly supported the finding of the Commissioner that there was a partial liquidation, the

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decision is not in point here, In the instant case the shares acquired by Appellant were not cancelled by it, but were held as treasury shares. No intention to liquidate in whole or in part was expressed in the resolution of Appellant's board of directors accepting the proposal of Mrs. Weatherholt. No attempt was made to comply with the requirements of Section 347 of the Civil Code (now Sections 1700 to 1703 of the Corporations Code) relating to redemption of corporate shares. No steps were taken for the reduction of stated capital as provided in Sections 348 and 348b of the Civil Code (now Sections 1904 to 1909 of the Corporations Code) or for complete or partial distribution of assets in connection with winding up and dissolution,

Simply because a corporation receives its own stock in payment for corporate property does not change the transaction from a sale to a distribution in liquidation. Country Club Estates, Inc. v. Commissioner of Internal Revenue, supra. Former Section 6(c)(8) of the Bank and Corporation Franchise Tax Act (now, as revised, in part Section 24516 of the Revenue and Taxation Code), provided that "As used in this subsection the term 'amount distributed in partial liquidations means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock." See also Section 115(i) of the Internal Revenue Code of 1939 and Treasury Regulations 111, Section 29.115-5. As stated in C. M. Menzies, Incorporated, 34 B.T.A. 163, 168, "A distribution of corporate assets in liquidation differs widely from a sale of such assets. The liquidation of a corporation is the process of winding up its affairs, realizing its assets, paying its debts, and distributing to its stockholders, as such, the balance remaining ... The transferor receives nothing. It simply conveys, to the stockholder something to which he has a right. A sale, on the other hand, is a transfer of property for a price which is received by the **seller.**"

The written offer of Mrs. Weatherholt to transfer the stock to the Appellant contained the provision, "That in the carrying out of the within proposal the Corporation is to pay all transfer stock, tax charges, as may be required by the Internal Revenue Department . . ." When the regulations with respect to the application of the Federal documentary stamp tax to transfers of stock are considered, this is a further indication that the parties to the transaction did not contemplate the cancellation of the shares of stock following their acquisition by Appellant, Thus, Section 113.33 of Treasury Regulations 71, as it read at the date of the agreement, provided:

Anneal of Associated Development Corporation,

"The following are examples of taxable transactions:

.....

"(h) Transfer to a corporation of its own stock."

Section 113.34 provided:

"... the following are examples of transactions not subject to tax:

.....

"(c) The surrender of stock to the issuing corporation for extinguishment."

It is clear that, if the transfer of the stock to Appellant had been for the purpose of cancellation or extinguishment, the stamp tax would not have been applicable. Transamerica Corporation v. Lewis, 28 Fed. Supp. 765, appeal dismissed, 108 Fed. 2d 1016.

We conclude that the Appellant realized taxable gain on the transaction involved in this appeal.

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 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Associated Development Corporation to a proposed assessment of additional franchise tax in the amount of \$2,866.80 for the income year ended June 30, 1946, be and the same is hereby sustained,

'Done at Los Angeles, California, this 25th day of June, 1957, by the State Board of Equalization.

Robert E. McDavid, Chairman

Paul R. Leake, Member

J. H. Quinn, Member

George R. Reilly, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary