



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of))
)
ANGELUS BUILDING CO. NO. 202948 AND)
GEORGE D. RIDDLE AND DAVID SALOT,)
 TRANSFEREES)

Appearances:

For Appellant: Harry W. Pattin, Certified Public
 Accountant

For Respondent: John S. Warren, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Angelus Building Co. No. 202948, and George D, Riddle and David Salot, Transferees, to proposed assessments of additional franchise tax in the amounts of \$1,913.98, \$1,913.98 and \$1,860.02 for the taxable years ended January 31, 1948, 1949 and 1950, respectively. On recognizing an error in its computations, the Franchise Tax Board now has conceded that its proposed assessment for the taxable year ended January 31, 1950, should have been \$1,460.20.

Appellant was incorporated in California on February 26, 1946, with \$3,000 capital paid in by George D. Riddle and David Salot and two others who shortly thereafter sold their interests to Riddle and Salot. In September, 1948, S. M. Taper acquired a one-third interest in the corporation.

During the years in question Appellant developed three residential housing tracts, Nos. 12263, 12152 and 14691. The first two were developed under a contract requiring Appellant to buy land, obtain construction loans, construct houses and sell the developed properties to Riddle and Salot for a price equal to all costs, except income taxes, plus 5 percent of such costs. Riddle and Salot performed for Appellant without compensation substantially all of the services essential to developing the tracts, advanced all necessary funds and executed completion bonds as guarantors. The houses constructed were ultimately sold to individual purchasers for an aggregate amount of approximately \$1,315,050, or about \$207,607 above Appellant's costs.

The third tract, No. 14691, was deeded by Appellant to a partnership consisting of Riddle and Salot. The tract then was similarly developed under a contract requiring Appellant to build

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residences on this property for a fee of \$200 per building. The partnership provided all funds needed for construction except Appellant's overhead expenses and taxes. Costs of developing this tract, including overhead expenses and the cost of the land, were \$1,303,292.48. The Appellant's building fees amounted to \$18,200.

During the year ended January 31, 1948, Appellant's net profits from the foregoing operations were \$55,359.31. This sum was about 8.7 times its capital and surplus. Except for minor items, this amount constituted its reported net income for that year. Appellant's reported net income for the next year was \$12,211.43, or a sum approximately equal to 33% of its capital and surplus. This sum included, in addition to net profits from the foregoing operations, rental income from an office building and profits from sale of other land.

Sales to the public of individual homes in Tracts 12263 and 12152 were promoted and negotiated by Riddle and Salot, either directly or through brokers. Each sale, whether for cash or on contract, was between Riddle or Salot and the buyer. Except for the fact that Appellant's name appeared on correspondence with the mortgagee which handled construction loans and, later, on substitution-of-liability agreements related to individual sales, Appellant had nothing to do with negotiations of these sales. Although many individual sales had reached various stages of finality before the houses and lots were transferred by Appellant to Riddle and Salot, no transfers were made by Appellant directly to individual purchasers.

The Franchise Tax Board determined that the sales of houses in Tracts 12263 and 12152 were attributable to Appellant rather than to Riddle and Salot, citing the case of Samuel Donner, T. C. Memo., Dkt. Nos. 36844-36847, 36857, entered November 27, 1953, aff'd 227 Fed. 2d 381, and it redetermined Appellant's net income under authority of Section 14, second paragraph, of the Bank and Corporation Franchise Tax Act (now Section 25103 of the Revenue and Taxation Code). The resultant deficiency assessments were based upon computations of net income which were more than twice (1948) or four times (1949) the amounts reported by Appellant.

In the case of Samuel Donner, supra, the corporation had entered into a contract with a sales agent who was to sell houses on behalf of the corporation for a specified amount and was to transfer to the corporation a definite sum for each house. The agent sold some of the houses before and some after the corporation transferred and conveyed all of its property, including the houses, to its stockholders in complete liquidation. The stockholders were "mere conduits" through which title to the houses

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passed to the ultimate purchasers upon terms previously agreed upon by the corporation. Here the Appellant's stockholders, Riddle and Salot, in their dealings with ultimate purchasers were not governed by any terms previously negotiated or agreed upon by Appellant. They were free to deal with ultimate purchasers on their own terms and on their own account rather than on behalf of Appellant. They were free to agree upon sales in advance of their acquiring the properties from Appellant. (See 50 Cal. Jur. 2d, Vendor and Purchaser, 52.)

We conclude that the houses on Tracts 12263 and 12152 were sold to the public by Riddle and Salot on their own accounts and not on behalf of Appellant.

Section 14, second paragraph, of the Bank and Corporation Franchise Tax Act, provides:

"In the case of a corporation doing business within the meaning of this act, whether under agreement or otherwise, in such a manner as either directly or **indirectly to benefit** the members or **stockholders** of the corporation, or any of them, or any person or persons, directly or indirectly interested in such business, by rendering services of any nature whatsoever, or acquiring or disposing of its product or the goods or commodities in which it deals, at less than a fair price therefor, the commissioner [Franchise Tax Board], in order to prevent evasion of taxes or clearly to reflect the income of such corporation, may require a report of such facts as he deems necessary and may **determine the amount which shall be deemed to be the entire net income allocable to this State** of the business of such 'corporation for the calendar or fiscal year, and compute the tax upon such net income. In determining the entire net income the *commissioner* [Franchise Tax Board] shall have regard to the fair profits which, but for any agreement, arrangement, or understanding, **might be or could** have been obtained **from** dealing in such products, goods or **commodities.**"

Whether the Franchise Tax Board was authorized under this section to redetermine Appellant's net income depends upon whether Appellant sold property or rendered services to its stockholders, Riddle and Salot "at less than a fair price therefor."

In view of the valuable services and financial backing given by these stockholders, which was part of the consideration in their **contracts** with Appellant, we **cannot** say that Appellant failed to receive its money's worth for its property and services, (Compare Seminole Flavor Co., 4 T. C. 1215, 1233.) The contracts

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viewed at the time they were executed, virtually guaranteed Appellant's profits upon every house that it constructed. Compared to its paid in capital and earned surplus during the years on appeal, its profits were extraordinarily high. We are of the opinion that the uncontroverted facts are sufficient to rebut any presumption that Appellant received less than a fair price for its property and services.

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 protests of Angeius Building Co. No. 202948, and George D. Riddle and David Salot, Transferees, to proposed assesaments of additional franchise tax in the amounts of \$1,913.98, \$1,913.98 and \$1,860.02 for the taxable years ended January 31, 1948, 1949 and 1950, respectively, be and the same is hereby reversea.

Done at Sacramento, California, this 15th day of November, 1960, by the State Board of Equalization.

John W. Lynch, Chairman

Geo. R. Reilly, Member

Alan Cranston, Member

Paul R. Leake, Member

Richard Nevins, Member

ATTEST: Dixwell L. Pierce, Secretary