

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }
HOWARD BUILDING CORPORATION }

Appearances:

For Appellant: W. E. Kerwin, Vice President

For Respondent: Crawford H. Thomas, 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 protest of Howard Building Corporation to proposed assessments of additional franchise tax in the amounts of \$2,070.60, \$2,070.60, \$1,150.28 and \$509.76 for the taxable years 1955, 1956, 1957 and 1958, respectively, based upon income for the years 1955, 1956 and 1957.

In filing its tax returns for income years 1955 and 1956, appellant Howard Building Corporation claimed as deductions certain property taxes it had paid. Respondent disallowed those deductions on the ground that title to the property involved had not yet passed to appellant on the date the taxes became a lien thereon. That disallowance presents the only issue in this appeal. Although appellant referred to the income year 1957, taxable year 1958, in its appeal, it has raised no issue with respect to that income or taxable year.

Appellant is a California corporation incorporated on July 15, 1954, by Mr. T. I. Moseley. In early 1955 Moseley negotiated for the purchase of a 70 percent interest in an office building in San Francisco known as the Howard Building (hereafter referred to as "the property"). At that time the property was owned by three individuals: Henry F. Bloomfield, who had a 50 percent interest, and two other persons, each of whom held a 25 percent interest. The 70 percent interest which Moseley wished to acquire was composed of 20 percent of

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Bloomfield's interest and the entire interest of each of the other two owners.

On February 21, 1955, Moseley and Bloomfield (who was acting for himself and the other two owners of the property) executed an agreement of sale with respect to the 70 percent interest. The sale was to be for cash and the purchase price was due within thirty days. Possession was to be given as of the date of recordation of the deed. The agreement specifically provided that "This offer is made and accepted subject to the terms on the reverse hereof."

The terms set out on the reverse side of the agreement provided that the offer was made and accepted subject to the concurrent conveyance, at Moseley's election, of the remaining 30 percent interest in the property and the 70 percent interest which Moseley had contracted to purchase, to "a new corporation" to be formed by Moseley and Bloomfield for the purpose of holding the property. This concurrent conveyance was made an essential condition to the assumption of any obligation by the purchaser. It was further provided that Moseley was to have 70 percent and Bloomfield 30 percent of the stock to be issued by the new corporation. The reverse side concluded with a provision that all prorating was to be made as of February 28 if the transaction was closed by March 5 and if not, then as of the date of closing.

On February 23, 1955, Bloomfield sent to the title company which acted as escrow agent, a copy of the agreement of sale, together with deeds naming Moseley as grantee of interests totaling 70 percent of the property. Subsequently; on March 10, the title company was advised that an application had been made for appellant to issue stock and that the stock would be given to the title company for distribution as soon as the permit was granted. On the following day, March 11, 1955, the title company received a deed transferring Bloomfield's remaining 30 percent interest to Moseley and a deed transferring Moseley's entire interest to appellant,

The title company made payment to the sellers of the 70 percent interest and recorded the various deeds involved on March 14, 1955. It also prorated property taxes between the parties as of that date. On March 23 it distributed additional amounts to Bloomfield, and on March 31, 1955, appellant's stock was issued to Moseley and Bloomfield in accordance with the terms of the agreement of sale,

Appellant originally claimed it was entitled to the following deductions for property taxes which it paid on the property:

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<u>Income Year</u>	<u>Property Tax Fiscal Year</u>	<u>Amount of Tax Claimed as Deduction</u>
1955	X954-1955 (part of 2d installment) 1955-1956 (bat installment)	\$14,255.80 <u>24,808.68</u> \$39,064 ⁴⁸
1956	1955-1956 (2d installment)	24, 808 .68

On appeal, appellant concedes that 70 percent of the property" tax which it paid for the fiscal year 1954-1955 is not deduct-
ible, but it claims that it should be allowed a deduction of
30 percent of the amount which it paid for that fiscal year,
in addition to a full deduction of the property tax Imposed
for the fiscal year 1955-1956.

Section 24345 of the Revenue and Taxation Code
provides that all taxes paid during the income year (with
certain exceptions not relevant here) shall be allowed as a
deduction. Regulation 24121c(1), title 18 of the California
Administrative Code, states that taxes on property may be
deducted only by the one owning the property, or in possession
of the property under a contract to purchase at the time the
taxes become a lien, This regulation is in accord with cases
Interpreting similar federal legislation. (Magruder v. Supplee,
316 U.S. 394 [86 L. Ed, 1555]; Frank W. Babcock, 28 T.C. 781,
aff'd on other grounds, 259 F.2d 689; Pacific Southwest Realty Co.,
45 B.T.A. 426, aff'd on other grounds, 128 F.2d 815.)

The property tax for the fiscal year 1954-1955
became a lien on March 1, 1954. (Rev. & Tax, Code, § 2192.)
Appellant contends that, although-it did not own or possess:
the property on that date, it should be allowed to deduct 30
percent of the tax which it paid for that fiscal year because
one of its stockholders, Bloomfield, owned 50 percent of the
property on the lien date and he still had a 30 percent interest,
in the form of stock in appellant corporation, at the time the
tax was paid,

This contention is totally unsupported by the
authorities, The cases have consistently held that when a
corporation obtains property in exchange for its stock, and
in the course of the transaction the acquiring corporation
pays off accrued property taxes, such payments constitute a
portion of the cost of the property and are not deductible by
the corporation as taxes paid. (Merchants Bank Building Co. v.
Helvering, 84 F.2d 478; The Cable Co., 46 B.T.A. 85; California
Sanitary Co., 32 B.T.A. 122.)

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With respect to the fiscal year 1955-1956, the property tax became a lien on March 7, 1955. (Rev. & Tax. Code, § 2192.) Appellant advances two alternative grounds in support of its deduction of the property tax for that fiscal year. First, it argues that it gained constructive ownership and possession on February 23, 1955, through the deeds delivered to the title company on that date. Although these deeds were for only 70 percent of the property and were in Moseley's name, the argument is made that Moseley was appellant's nominee and that the remaining 30 percent was to be transferred at his election,

Normally, an escrow agreement does not give the vendee control over the property or a claim to it prior to the satisfaction of the terms of the escrow, (Civ. Code, § 1057; Frank W. Babcock, 28 T.C. 781, aff'd on other grounds, 259 F.2d 689.) Under the terms of the agreement here involved, the conveyance of Bloomfield's remaining 30 percent interest to the corporation together with the 70 percent interest which Moseley had contracted to purchase was an essential condition to any obligation by Moseley. This condition was not satisfied until March 11, 1955, after the property tax lien date.

The agreement, moreover, provided that possession was to be given when the deeds were recorded and that taxes were to be prorated as of the date the transaction was closed. The deeds were not recorded until March 14 and, since taxes were prorated as of that date, it is apparent that the transaction was not considered closed until that time,

Thus, even assuming that Moseley was appellant's nominee, the facts demonstrate that there was no transfer of possession or of the burdens and benefits of ownership at the time the deeds to Moseley were placed in escrow.,

Alternatively, appellant relies upon the decision in Miller & Lux, Inc. v. Sparkman, 128 Cal. App. 449[17 P.2d 772]. That case, however, did not involve the deductibility of taxes. It was an action to enforce a contractual arrangement between the buyer and the seller for the payment of property taxes. The two situations are quite different. The United States Supreme Court stated in Magruder v. Supplee, supra, 316 U.S. 394 [86 L. Ed, 1555], that the parties to a contract cannot change the incidence of local taxes by their agreement,

Section 164(d) of the Internal Revenue Code was enacted in 1954. That section provides for a prorated deduction by the buyer and seller of property taxes for the year in which the property is sold. Though similar legislation was proposed in California in 1955, such a section was not adopted in this state until 1961 (Rev. & Tax. Code, § 24346),

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and the principles of the previously cited regulation and federal cases prevailed at all times pertinent in the instant case.

O R D E R

Pursuant to the view 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 Howard Building Corporation to proposed assessments of additional franchise tax in the amounts of \$2,070.60, \$2,070.60, \$1,150.28 and \$509.76 for the taxable years 1955, 1956, 1957 and 1958, respectively, be and the same is hereby sustained,

Done at Sacramento, California, this 23d day of June, 1964, by the State Board of Equalization.

Pang R. Leake, Chairman
Alan Cranston, Member
Robert F. Kennedy, Member
John W. Lynch, Member
Richard C. Boone, Member

Attest: [Signature], Secretary