BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
)
ENCINO PARK, INC., et al.)

Appearances:

For Appellants: Chris G. Deme triou and Ronald J. Del Guercio, Attorneys at Law

For Respondent: Crawford H. Thomas, Associate Tax Counsel

OPINION

The appeals of Encfno Park, Inc,, and Ben Weingart, Louis H. Boyar and Spfros G. Ponty, Transferees; and Encino Park 2 and Spfros 6, Ponty, Trustee for Stockholders, are made pursuant to sections 26077 and 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the claim of Encino Park, Inc., for refund of franchise tax in the amount of $11,011.76 for the taxable year ended November 30, 1950; on the protests of Encino Park, Inc., and its transferees against proposed assessments of additional franchise tax in the amounts of $34,410.62 for each of the taxable years ended November 30, 1949, and November 30, 1950; and on the protest of Encino Park 2 and the trustee for its stockholders against a proposed assessment of additional franchise tax in the amount of $34,087.27 for the taxable year ended December 31, 1950.

The four questions involved are: (1) whether income from certain sales was reported in the proper year, (2) whether the transfer of certain property from Encino Park, Inc., to Encino Park 2 constituted a reorganization within the meaning of section 23251, subdivision (a), of the. Revenue and Taxation Code, (3) whether the income from certain sales consummated by the trustee for the stockholders of Encino Park, Inc., is properly attributable to that corporation, and (4) whether the deduction of certain expenses incurred by Encino Park, Inc., in the income year ended November 30, 1949, was properly disallowed.

YEAR OF SALES

Encfno Park, Inc., (hereafter "Encino") was incorporated in California on November 13, 1948. Its officers and directors, Ben Weingart, Louis H. Boyar and Spiros G. Ponty, owned about 85 percent of the outstanding shares of stock, although there were some 70 shareholders in all. Encino was formed for the purpose of constructing and selling inexpensive homes to veterans, To this end, Encino acquired 487.8 acres of land in the San Fernando Valley, consisting of two parcels, 348.07 *acres* located *immediately* north of Ventura Boulevard (hereafter "Parcel 1"), and 139.73 acres immediately south of Ventura Boulevard (hereafter "Parcel 2").

Parcel 1 was divided into 1,741 lots, Plans, *maps,* and specifications were submitted to the Veterans" Administration and Federal Housing Administration for appraisal. and issuance of certificates of reasonable value so that the homes to be constructed could be sold to eligible veterans under government guaranteed or insured loans on a no down payment basis,

For its taxable year *ended* November 30, 1949, Encino reported income from the sale of 420 homes and, based upon that income, paid franchise taxes for that year and also for the following taxable year, as required of commencing corporations by *section* 13, subdivision (c) of the Bank and Corporation Franchise Tax Act (now section 23222 of the Revenue and *Taxation* Code), Encino was dissolved on December 21, 1949, and reported the sale of 810 additional homes during the period December 1 to December 20, 1949. The remaining 511 houses were distributed to Encino's stockholders and eventually sold through Ben Weingart, acting as trustee,

'The Franchise Tax Board determined that the income from the sale of 609 *of* the 810 homes reported sold during the period December 1 to December 20, 1949, should be allocated to the prior period. This action was based on respondent's conclusion that on November 30, 1949, no substantial contingencies remained to be fulfilled in the case of the disputed sales and that they were, therefore, closed transactions on that date for purposes of taxation,

In the usual sequence of events involved in the sale *of a* home, *the* purchasing veteran first signed an agreement to purchase,' Although few deposits, if any, were ever made, the agreement provided, in part, that if the purchaser cancelled the transaction for any reason other *than the* seller's failure to approve the sale "or failure to obtain approval of 'GI' or

'FHA 'loan," all sums paid by the purchaser could be retained 'as liquidated damages by the seller, The purchaser then applied for a loan, for a Veterans' Administration's home loan guarantee or insurance, for a certificate of eligibility from the Veterans0 Administration, and made out a credit report.

The institution which was to make the home loan would process the above information and upon being satisfied as to the prospective purchaser's financial responsibility,. would forward the material to the Veterans* Administration for its "prior approval commitment," The prior approval was a commitment to guarantee or insure the loan in question, provided that the home was constructed in accordance with the plans and specifications under which the original certificate of reasonable value had been issued,

After completion of a home, a representative of the Veterans' Administration would make a final compliance inspection to determine whether or not the home had been constructed according to specifications, The prospective purchaser would execute a promissory note and deed of trust which were sent through'escrow to the lender, The lender would record the grant deed and deed of trust, secure the required title insurance, *and* send the Veterans' Administration all necessary documents, including the prior approval commitment and report of final compliance inspection, for guarantee of the loan. The Veterans* Administration would then send to the lender evidence of its guarantee of the loan. The lender would deposit the funds: due Encino in separate escrow and escrow would close,

Frequently a prospective purchaser who had been accepted by the lender and had received a prior approval commitment from the Veterans* Administration was permitted to occupy the home before the Veterans' Administration issued its evidence of guarantee, However, it appears that all sales were contingent upon the veteran's securing a "GI" or "FHA" loan and it was understood that the occupying veteran would vacate if for any reason he failed to secure such a loan,

By November 30, 1949, the purchasers of the *609 homes* which the Franchise Tax Board contends were sold on or before that date had been accepted by the lender as credit risks, had received the Veterans' Administration's prior approval commitment and were. in possession of the homes, Upon the close of each escrow, interest was prorated between the seller and the buyer according to the date that possession was taken.

The sale of realty is complete and the gain is includible in income *when* the buyer has assumed *the* burdens

and benefits of ownership and no substantial contingencies remain to be satisfied, (Commissioner v. Union Pacific R. R., 86 F.2d 637; Harris Trust & Savings Bank, 24 B.T.A. 498; Standard Lumber Co., 28 B.T.A. 352; Ted F. Merrill, 40 T.C. 66, appealed to 9 Cir., Oct. 21, 1963; Abe Pickus, T.C. Memo., Dkt. No, 90659, Dec. 30, 1963.)

Appellant asserts that with respect to each of the 609 homes in question, there were three substantial contingencies remaining on November 30, 1949: (1) the issuance of a title insurance policy, (2) the final compliance inspection, and (3) the actual issuance of the guarantee or insurance by the government,

We cannot agree that the issuance of title insurance was a substantial contingency. As we stated in Appeal of Chapman Manor, Inc., Cal, St, Bd. of Equal., April 20, 1960, involving almost identical facts:

> Appellants were tract owners' well aware of the status of their title, There is no evidence of *any* doubt as to their ability to insure it, Under these circumstances, acquisition of title insurance was not a substantial contingency that would prevent the accrual of income,

Similar reasoning applies to the final compliance inspection, Each of the homes in question had been completed before the critical date, at least to the point of allowing a purchaser to occupy it, Appellant was in a position to know whether the house had been built according to specifications. Minor variations, moreover, would merely require slight delays for correction, There is nothing to indicate that any of the 1,741 homes constructed failed to pass the final compliance inspection or that any sale fell through because of lack of compliance,

Nor do we consider the actual issuance of the government guarantee or insurance a substantial condition precedent, Before that occurred, the government had committed itself to guarantee or insure the loan provided only that the house be built according to specifications, Once this was accomplished the evidence of the guarantee was issued as a matter of course.

The insignificance of the conditions relied upon by appellant is suggested by the fact that all of those conditions were satisfied with respect to 810 homes within the period from

December 1 to December 20, 1949. In our opinion, the Franchise Tax Board properly determined that the gain on the sales of 609 of those homes was attributable to the year ended November 30, 1949, by which date all major conditions had been fulfilled and the purchasers were in possession of completed homes.

REORGANIZATION

As earlier noted, the land Encino acquired was divided by Ventura Boulevard. Parcel 1 was ideal for mass construction of inexpensive homes because it was flat and required little or no leveling. Due to its hilly terrain, Parcel 2 was not suited for such development. Encino purchased it only because the larger Parcel 1 was extremely desirable and the seller insisted on disposing of both plots as a single package. Parcel 2 was acquired with the thought that it would be sold undeveloped. Encino demonstrated this intent by continuously holding Parcel 2 for sale as a single unit throughout its corporate life.

In contemplation of the eventual winding up of Encino's affairs, it was decided to transfer Parcel 2, which amounted to about 5 percent of Encino's total assets, to a second corporation rather than distribute the acreage to the stockholders as tenants in common. Encino Park 2 (hereafter "Encino 2") was formed in August of 1949 and in December it transferred all of its stock to Encino in exchange for Parcel 2. Attempts to sell the land continued. Failing in this, Encino 2 developed a portion of the land in 1950, selling about 400 homes, and disposed of the balance of the acreage at a loss. Encino 2 was dissolved on February 15, 1951.

The Franchise Tax Board contends that Encino also transferred a portion of its business to Encino 2. Facts developed at the hearing of this appeal, however, completely refute this claim. Although both corporations had the same stockholders, officers and directors, the testimony of Spiros G. Ponts indicates that Encino's building program was conducted primarily by Mr. Boyar and Mr. Weingart, while Encino 2's program was conducted solely by Mr. Ponty. Since further development was not contemplated at the time Encino was dissolved, all of Encino's building equipment, office equipment, tools, trucks, etc., were sold to parties other than Encino 2. Encino 2 did not use the same office personnel, sales organization, escrow company, or the majority of the subcontractors utilized by Encino. We conclude, therefore, that only undeveloped acreage was transferred to Encino 2.

Following its dissolution on December 21, 1949, Encino filed a claim for refund of 11/12 of the tax paid for the taxable year ended November 30, 1950, pursuant to section 23332 of the Revenue and Taxation Code which provides that a

dissolving corporation shall only pay a pro rata portion of the tax for the entire year, based on the number of months of the taxable year which precede the date of dissolution. A refund is prohibited, however, if such dissolution occurs pursuant to a reorganization, as defined in section 23251. The Franchise Tax Board found that the transfer of assets to Encino 2 constituted a reorganization within the purview of section 23251, subdivision (a), and denied the claim for refund. It also included Encino's income for its last taxable year (income which would otherwise escape the measure of tax) in the income of Encino 2, under authority of section 23253. That section provides that where a substantial portion of the business or property is transferred pursuant to a reorganization, the net income, of the transferor from the business or property so transferred shall be included in the measure of the tax of the transferee.

Section 23251, subdivision (a), defines a reorganization as:

> a transfer by a ... corporation of all or a substantial portion of its business or property to another ... corporation if immediately after the transfer the transferor ... [is] in control of the ... corporation to which the assets are transferred.

In view of our finding that no part of Encino's business was transferred to the second corporation, the question of whether a reorganization occurred turns on whether Parcel 2 can be considered a substantial portion of Encino's property. None of the cases to which we have been referred appear to settle the question. We are admonished by San Joaquin Ginning Co. v. McColgan, 20 Cal. 2d 254, 259 [125 P.2d 36] to construe the term "reorganization" liberally. Viewing all of the circumstances of this case, however, we are of the opinion that Parcel 2 could not be considered a substantial portion of Encino's property, within the intent of section 23251.

Our decision is not based solely on the fact that the transferred land amounted to only 5 percent of Encino's total assets. The conditions under which Parcel 2 was acquired, held and disposed of are all important factors. They reflect the incidental nature of this asset in relation to the purpose for which Encino was formed and operated.

TRUSTEE SALES

The Franchise Tax Board determined that the income

from the homes sold by Ben Weingart as trustee for the shareholders should be included in Encino's income for its last taxable year, This action was based on the rule enunciated in Commissioner v. Court Holding Co., 324 U.S. 331 [89 L. Ed. 981]. In that case, a corporation negotiated the sale of its assets and then distributed them to its stockholders who completed the sale. The Court held that the sale had been made by the corporation.

It appears that the appellants' tax liability will remain unchanged regardless of what decision we reach on this issue since our determination of the reorganization question excludes Encino's income for its last taxable year from the measure of tax, We will not, therefore, prolong this opinion in order to decide the question,

EXPENSES,

The Franchise Tax Board disallowed $30,408.29 of the deductions for salaries, office expense, and losses on the sale of land claimed by Encino'for the income year ended November 30, 1949.

Appellants allege generally that the disallowance was improper in that the questioned deductions were for ordinary and necessary expenses of the business. They have not, however, offered any evidence whatever in support of this assertion.

Deductions are a matter of legislative grace and the burden of proof is upon the taxpayer. to show that he is entitled to them. (New Colonial Ice Co. v. Helvering, 292 U.S. 435 [78 L. Ed. 1348].) In the complete absence of any evidence that would support appellants" allegation, we must conclude that the deductions were properly disallowed,

ORDER

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 sections 26077 and 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the claim of Encino Park, Inc., for refund of franchise tax in the amount of $11,011.76 for the taxable year ended November 30, 1950; on the protests of Encino Park, Inc., and its transferees against proposed assessments of additional franchise tax in the amounts of $34,410.62 for each of the taxable years ended November 30, 1949 and November 30, 1950; and on the protest of Encino Park 2 and the trustee for its stockholders against a proposed assessment of additional franchise tax in the amount of $34,087.27 for the taxable year ended December 31, 1950, be modified by giving effect to the determination set forth in the opinion on file that no reorganization occurred. In all other respects the action of the Franchise Tax Board is sustained,

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

Paul R. Leake, Chairman

Alan Grayston, Member

Member

John W. Lynch, Member

Member

Attest: , Secretary