Transferee's liability where insolvency o

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
)
A. BRIGHAM AND ZELLETTA M. ROSE, AND)
LORE, LTD., INCORPORATED, A. BRIGHAM)
AND ZELLETTA M. ROSE, TRANSFEREES)

Appearances:

For Appellants: A. Brigham Rose, in pro. per.

For Respondent: Peter S. Pierson
Associate Tax Counsel

O P I N I O N

The appeal of A. Brigham and Zelletta M. Rose is made pursuant to section 19059 of the Revenue and Taxation Code from the action of the Franchise Tax Board denying their claim for refund of personal income tax, penalty and interest in the amount of $4,855.89 for the year 1955.

The appeal of Lori, Ltd., Incorporated, A. Brigham and Zelletta M. Rose, Transferees, is made pursuant to section 26077 of the Revenue and Taxation Code from the action of the Franchise Tax Board denying their claims for refund of franchise tax in the amounts of $1.50, $6.80, $5.30, $3.80, $2.30, $0.80 and $3,440.07 for the income years 1949 through 1955, respectively.

Appellant. A. Brigham Rose is an attorney, For many years he controlled the operation of a hotel in California consisting of 78 rooms, called the Brevoort Hotel, and a group of bungalows at the rear of the hotel, called Villa Courts. Until 1944, the hotel was held in the name of an attorney associated with Mr. Rose, Thereafter, it was

held in the name of Mrs. Rose. The courts were held in the name of Lori, Ltd., Incorporated, a corporation formed by Mr. Rose. The courts were the only asset of the corporation:. One third'of the corporation's stock was in the name of Mr. Rose, one third in the name of an attorney associated with him, and one third in the name of a relative of a client of Mr. Rose.

During part of 1955 he hotel and courts were leased and operated by M. C. Sommers Co. Of the $1,000 monthly rental, $650 was attributed to the hotel and $350 to the courts. During the period from January 1, 1955, to September-30, 1955, the rental payments for the hotel totaled $5,850 and those for the courts totaled $3,150.

On September 30, 1955, the hotel and the courts were sold to the lessee for $175,000. The down payment, was $15,000 and the balance was payable in monthly installments of $2,000 for 24 months and $1,000 a month thereafter, with 5 percent annual interest. Part of the price, $19,907, consisted of the buyer 's assumption of an obligation to pay delinquent property taxes and federal income taxes of Lori, Ltd. Those taxes had become liens against the property. Appellants allocated $109,000 of the sales price to the hotel and $66,000 to the courts,

Following the sale, a trust was established to hold the assets of Lori, Ltd., with Mr. Rose as trustee. Part of the sale proceeds were used to satisfy (1) a judgment against the Roses and Lori, Ltd., for breach of an agreement by Mr. Rose to pay a client for the use of funds invested in the hotel and courts, (2)a related judgment against the Roses alone and (3) a tax assessment issued against the Roses by respondent. The record does not show how the rest of the proceeds were used.

Lori, Ltd., filed no returns with respondent for the income years 1949 through 1955. Upon demand of respondent, Mr, Rose paid the mini-mum California franchise tax on behalf of the corporation for those years, explaining that during that period Lori, Ltd., had no assets. The corporate powers of Lori, Ltd. ., were suspended on July 2, 1956, for failure to pay interest on the delinquent taxes.

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Mr. and Mrs. Rose filed no timely personal income tax return for 1955. In 1958, upon discovering the sale of the hotel and courts, respondent issued a jeopardy assessment of personal income tax against the Roses for 1955 based on estimated income equal to the entire sales price of the hotel and courts plus $20,000. Between September 24, 1958, and June 29, 1960, respondent collected $10,836.82, primarily by attaching payments due on the sales contract, leaving an uncollected balance of $2,907.90 on the assessment. Meanwhile, in November 1953, the Roses filed a delinquent joint personal income tax return for 1955, reporting a net loss of $1,004.68.

On July 28, 1960, after further investigation, respondent issued a jeopardy assessment of corporation franchise tax against Mr. Rose as transferee of the assets of Lori, Ltd. This assessment, totaling $3,460.57, was based primarily upon the corporation's share of the rental income for the year and the gain on the sale of the courts.

In addition, respondent recomputed the personal income tax of the Roses for 1955. Of the items claimed on their return, respondent disallowed various deductions and additions to the bases of the properties sold in 1955. Respondent also added dividend income of $69,150, representing the sales price of the Villa Courts plus the rentals received by Lori, Ltd, The recomputation resulted in tax, penalty and interest totaling $4,855.89, an overassessment of $8,888.83 in the jeopardy assessment of personal income tax, and an overpayment of $5,980.93.

On July 28, 1960, respondent sent the Roses a form titled "Computation of Overassessment," reflecting the personal income tax adjustments, including the amount of the overassessment but not the amount of the overpayment. Accompanying the form was a schedule showing the recomputation of income in detail. The form contained a section titled "Claim for Refund," whichstated that "If you protest the accompanying Notice(s) of Proposed Assessment you are advised to sign this section as a claim for refund to protect your interest in this overpayment, pending settlement of the protest."

On September 23, 1960, the Roses replied to the Computation of Overassessment by signing the Claim for Refund

section and returning the form together with a statement that they protested the adjustments which respondent had made to their 1955 income. On June 16, 1961, they again wrote to respondent asking for a refund of $8,888.83 "which your office has acknowledged was excessive" and stating that "A protest was filed as to certain adjustments msde by you, but such protest, if allowed, would not reduce the $8,888.83 but would increase the amount of refund allowable."

On August 10, 1962, respondent sent the Roses a form titled "Notice of Action on Cancellation, Credit, or Refund." From the amount of the overpayment which respondent had determined, respondent deducted franchise tax liability totaling $3,460.57 for the income years 1949 through 1955, which had been attributed to Mr. Rose as transferee of Lori, Ltd. An amount of $2,768.10, apparently including interest, was refunded to the Roses on August 28, 1962.

The appeal with respect to the personal income tax of the Roses was filed on September 11, 1962, and the appeal with respect to the franchise tax of Lori, Ltd., was filed on November 5, 1962,

The first issue we shall consider concerns the propriety of respondent's assessment of the franchise tax liability of Lori, Ltd., against Mr. Rose as transferee of the assets of Lori, Ltd.

Section 25701a of the Revenue and Taxation Code provides for the assessment of "The liability, at law or in equity, of a transferee of property of a taxpayer, in respect of the tax ... imposed upon the taxpayer.,,." A similar provision has long been a part of the federal law and is now contained in section 6901(a)(1) (A) of the Internal Revenue Code of 1954.

Questions concerning transferee liability have been construed many times by the federal courts. One of the principles established by the federal courts is that the existence and extent of a transferee's liability must be determined under state law. (Commissioner v. Stern, 357 U.S. 39 [2 L. Ed. 2d 1126].) Transferee liability for federal taxes was found to exist under California law in Oscar C. Stahl, T. C. Memo., Dkt. Nos. 74690, 79580-79595, July 29, 1963.

There, a corporation had distributed all of its assets to its stockholders in complete liquidation without paying corporate taxes. The court found that the tax obligation left the corporation insolvent and that the stockholders were liable for the taxes under section 3439.04 of the California Civil Code to the extent of the assets received by them. That section provides that:

> Every conveyance made ... by a person who is or will be thereby rendered insolvent' is fraudulent as to creditors without regard to his actual intent if the conveyance is made ...without a fair consideration.

Accordingly, if the cash and contract rights arising from the-sale of Villa Courts, the only asset of Lori, Ltd., were transferred without adequate consideration, then the corporation became insolvent to the extent of its franchise tax liability and the transferee is liable for the tax.

As a prima facie matter, the record supports respondent's conclusion that the proceeds from the sale of the courts were effectively transferred to Mr. Rose without adequate -consideration. After the sale Mr. Rose became the sole trustee of the proceeds. Although he was in name a trustee, he apparently had the unrestricted use of the proceeds. Except for an initial amount of $19,907 which was used to pay some of the liabilities of Lori, Ltd., Mr. Rose has not specified any corporate purposes to which the proceeds were devoted. There is no indication that any part of the proceeds went to stockholders other than Mr. Rose or that the other stockholders had any real interests. Even if they did receive or were entitled to receive part of the proceeds, Mr. Rose's share exceeded the tax liability asserted against him as transferee,

We conclude that the franchise tax liability of Lori, Ltd., was properly assessed against Mr. Rose as transferee of the assets of Lori, Ltd.

The Roses assert, nevertheless, that it was erroneous to collect the franchise tax liability by offsetting it against the conceded overpayment which arose from collecting on the jeopardy assessment of personal income tax against them. They contend that this offset was improper because the payments which were attached under the jeopardy assessment of personal income tax were proceeds of the sale of the Brevoort Hotel, which, they allege, was the separate property of Mrs. Rose. They argue that the separate property of Mrs. Rose is not liable for the debts of Mr. Rose.

We are not convinced that the hotel or the proceeds from its sale were the separate property of Mrs. Rose. It appears that Mr. Rose was in control of both the hotel and the courts. Aside from Mr. Rose's own self-serving statements, there is no evidence that Mrs. Rose gave any consideration for the hotel. So far as we can ascertain, none of the proceeds from the sale of the hotel were received by Mrs. Rose as her separate property or were placed in a separate account for her. In our opinion, the proceeds from the sale of the hotel were either the separate property of Mr. Rose or the community property of Mr. and Mrs. Rose. As such the proceeds were subject to Mr. Rose's tax liability.

The Roses also claim that their personal income tax liability for 1955 was $3.08 rather than the total of $4,855.89 in personal income tax, penalty and interest, as determined by respondent.

Most of the items claimed by the Roses in the form of deductions, etc., are unsubstantiated. It clearly appears, however, that respondent erred in treating the entire sales price of the Villa Courts, $66,000, as dividends distributed to the Roses. The record before us indicates that $19,907 of that amount was used to pay property taxes and federal income taxes owed by Lori, Ltd. To the extent of those taxes, there could have been no dividends to the Roses.

Respondent contends, nevertheless, that the Roses did not file a timely claim for refund in excess of the refund which respondent has already allowed, and did not file a timely protest against the jeopardy assessment issued by respondent. The refund claimed by the Roses, according to respondent, was

limited to the overpayment of $5,980.93 which respondent had itself computed, and which it has refunded, partly by offsetting the transferee. liability of Mr. Rose. For the reasons given below, it is our opinionthat the Roses did file a timely claim entitling them to a refund of the additional overpayment which we have found.

Although the Roses ' reply of September 23, 1960, to respondent's Computation of Overassessment was partly in terms of a protest rather than entirely in terms of a refund, the use of that terminology msy be explained by the instructions on respondent's form. Fairly construed in the light of all, the facts, the reply gave ample notice that the Roses sought a return of all of the amounts previously collected and gave ample notice of their grounds. Their intent to claim a refund was verified by their letter of June 18, 1961, which stated that 'the protest, if allowed; would increase the refund. The reply of September 23, 1960, was, in our opinion, an adequate claim for refund (United States v. Kales, 314 U.S. 186 [86 L. Ed, 132];American Radiator & Standard San. Corp. v. United States, 318 F.2d 915; Newton v. United States, 163 F. Supp. 614; Watson v. United states, 246 F. Supp. 755), and the Roses' appeal to us wasproperly taken within 90 days after respondent's notice of action dated August 10, 1962, (Rev. & Tax, Code, § 19057.)

The claim for refund was effective as to all amounts collected within a year preceding September 23, 1960. (Rev. & Tax.' Code, § 19053.) Eased upon figures submitted by' respondent,' those amounts totaled $6,926.25. In addition to the amount of $5,980.93 which has already been refunded, therefore, the Roses are entitled to $945.32, According to' our calculations, that amount does not exceed the tax attributable to the dividend income of $19,307 erroneously assigned to the Roses by respondent,

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,

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IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board denying the claim of A. Brigham and Zelletta M. Rose for refund of personal income tax, penalty and interest in the amount of $4,855.89 for the year 1955 be *modified by* allowing an additional refund of $945.32, In all other *respects* the action of the Franchise Tax Board is sustained,

IT IS FURTHER ORDERED, ADJUDGED AND DECREED, pursuant to section 26077 of the Revenue and Taxation Code, that the action of the Franchise Tax Board denying the claims of Lori, Ltd.,, Incorporated, A, Brigham and Zelletta M. Rose, Transferees, for refund of franchise tax in the amounts of $1.50, $6.80, $5.30, $3.80, $2.30, $0.80 and $3,440.07 for the income years 1949 through 1955, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 1st day of August, 1966, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: _____, Secretary