

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
ALBERT R. AND BELLE BERCOVICH)

Appearances:

For Appellants: Frank F. Weinberg
Certified Public Accountant

For Respondent: A. Ben Jacobson
Tax Counsel

O P I N I O N .

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Albert R. and Belle Bercovich against proposed assessments of additional personal income tax in the amounts of **\$373.54**, **\$926.09**, **\$310.54**, **\$996.02**, and **\$121.91** for the years 1960, 1961, 1962, 1963, and 1964, respectively.

The question for decision is whether amounts withdrawn by Albert R. Bercovich (hereafter "appellant") from a family-owned corporation constituted loans to him by the corporation, or whether they were taxable to appellant as dividends.

Appellant is president and majority stockholder of E. Bercovich & Son (hereafter "the corporation"), a company engaged in the retail furniture business in Oakland, California. Prior to 1955 appellant owned 47.96 percent of the corporation's stock; in that year he acquired a controlling interest of 56.5 percent. The remaining stock in the corporation is owned by appellant's two brothers, Harry and Sam Bercovich. During the years in question appellant's primary source of income was his salary as president of the corporation which approximated \$12,000 per year.

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From time to time since 1942 appellant has withdrawn money from the corporation for his personal use, or has had the corporation pay his personal obligations. Those amounts were recorded on the corporation's books as advances to appellant. Partial repayments were made to the corporation by appellant on an irregular basis, but the balance in appellant's account has not been fully paid off since 1954. Appellant's two brothers also received advances from the corporation but in much smaller amounts than those to appellant. During the years in question appellant's total withdrawals, repayments, and the net balance in his advance account at the end of each year were:

<u>Year</u>	<u>Withdrawals</u>	<u>Repayments</u>	<u>Balance</u>
1959			\$17,020.42
1960	\$45,264.40	\$35,700.00*	26,584.82
1961	30,225.12	9,000.00	47,809.94
1962	17,957.19	8,500.00	57,267.13
1963	35,752.93	14,117.90	78,902.16
1964	5,448.80	1,600.00	82,750.96

* Proceeds from sale of house

None of appellant's withdrawals were evidenced by notes, nor was any security given. No due dates for repayment were specified and no interest was paid by appellant or accrued on the corporate books. The corporation had not formally declared a dividend since 1953 or earlier. The accumulated balance in its earned surplus account at the end of each taxable year in question was:

1960	\$86,292.71
1961	89,476.49
1962	93,531.41
1963	91,405.71
1964	91,518.95

Respondent determined that the net amounts withdrawn by appellant from the corporation in each year, i.e., the total withdrawals less the amounts repaid, were not bona fide loans but were distributions of corporate earnings which were taxable to appellant as dividends. That characterization of the withdrawals gave rise to this appeal.

Whether withdrawals from a corporation by a stockholder represent loans or taxable distributions depends on all the facts and circumstances surrounding the transactions between

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the shareholder and the corporation. (Harry F. Wiese, 35 B.T.A. 701, aff'd, 93 F.2d 921, cert. denied, 304 U.S. 562 [82 L. Ed. 1529], reh. denied, 304 U.S. 589 [82 L. Ed. 1549]; Elliott J. Roschuni, 29 T.C. 1193, aff'd, 271 F.2d 267, cert. denied, 362 U.S. 988 [4 L. Ed. 2d 1021].) A determination that the withdrawal constitutes a loan depends upon the existence of an intent at the time the withdrawal was made that it should be paid back, (Atlanta Biltmore Hotel Corp., T.C. Memo., Sept. 19, 1963, aff'd, 349 F.2d 677; Clark v. Commissioner, 266 F.2d 698.)

Special scrutiny is given where the withdrawer is in substantial control of the corporation (Elliott J. Roschuni, supra; W. T. Wilson, 10 T.C. 251; Ben R. Meyer, 45 B.T.A. 228), and withdrawals under such circumstances are deemed to be dividend distributions unless the controlling stockholder can affirmatively establish their character as loans,, (W. T. Wilson, supra.) Furthermore, family control of a corporation invites careful examination of transactions between shareholders and the corporation. (William C. Baird, 25 T.C. 387; Ben R. Meyer, supra,)

The record in the instant case reveals a steady pattern of withdrawals by appellant from the corporation which he and his family owned. Appellant's withdrawals were entirely for his personal use and there was no apparent ceiling on the amount which he could withdraw for such personal purposes. No indicia of debt were ever executed by appellant and there was no definite time specified for his repayment of the withdrawals. In no instance did appellant pay any interest for his use of the corporation's money. In addition the corporation had not paid a formal dividend for a number of years, notwithstanding the fact that in each of the years in question its earned surplus exceeded \$86,000.

In support of his contention that the advances to him from the corporation constituted loans, appellant stresses that such withdrawals were treated on the corporate books as loans. That fact is not conclusive, however, since it is well settled that book entries may not be used to conceal realities. (William C. Baird, supra; Ben R. Meyer, supra.) The treatment given the transactions on the corporation's books is merely one fact to be considered within the total factual picture. Neither is it decisive of the existence of loans that the withdrawals by appellant and his two brothers from the corporation were not in proportion to their stockholdings, or that the brothers agreed to the larger withdrawals made by appellant. (Lincoln National Bank v. Burnet, 63 F.2d 131; William C. Baird, supra.)

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In our opinion the repayments made by appellant are not persuasive that the advances constituted loans, when the fact of repayment is viewed with all other facts and circumstances. Appellant was under no legal obligation to repay the amounts which he withdrew from the corporation. In addition, despite the repayments which he did make there was always a substantial increasing balance which remained unrepaid at the close of each taxable year.

Furthermore it appears that appellant's primary source of income during the years in question was his salary as president of the corporation, which was approximately \$12,000 per year. In each of the years 1960, 1961, and 1963 his withdrawals exceeded \$30,000. Under those circumstances it is difficult to believe that at the time the withdrawals were made either appellant or the other stockholders of the corporation entertained any bona fide belief or intent that those amounts would actually be repaid in full to the corporation.

Appellant places considerable reliance on a recent memorandum decision of the United States Tax Court (Theodore O. Wentworth, T.C. Memo., 'July 14, 1966), in which the court determined that net withdrawals of corporate funds by a corporation's president were intended as loans and therefore did not constitute taxable distributions to him. That case is factually distinguishable from the instant case on several grounds. In Wentworth, (1) the taxpayer was not a controlling shareholder; (2) the taxpayer had the apparent ability to repay the advances from other income; and (3) dividends were declared and paid by the corporation during the years in question. In view of these factual distinctions, and the numerous cases in which, on comparable facts, the opposite conclusion has been reached, we do not consider the Wentworth case controlling here.

Upon review of all the facts it is our opinion that appellant's net withdrawals from the corporation in the instant case were in the nature of dividend distributions rather than bona fide loans from the corporation. Respondent's determination on that question must therefore be sustained.

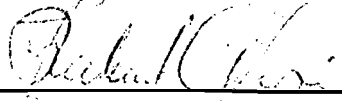
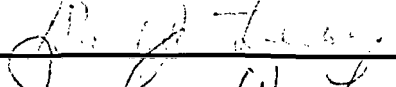
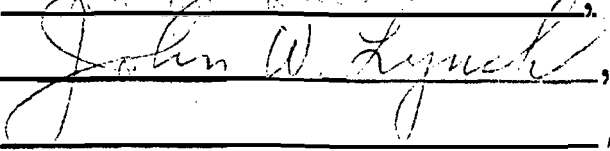

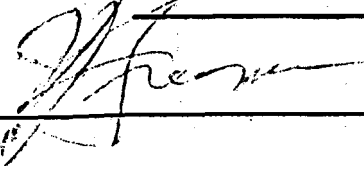
O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

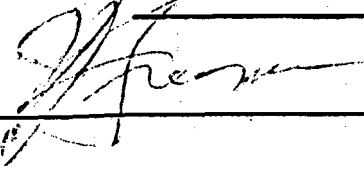
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IT I'S HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on **the protest** of Albert R. and Belle Bercovich against proposed assessments of additional personal income tax in the amounts of \$373.54, \$926.09, \$310.54, \$996.02, and \$121.91 for the years 1960, 1961, 1962, 1963, and 1964, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 25th day of March, 1968, by the State Board of Equalization:

, Chairman
, Member
, Member
, Member
, Member

ATTEST:

, Secretary