BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
JACK A. AND NORMA E. DOLE)

Appearances:

For Appellants: Leonard T. Cain
Attorney at Law

For Respondent: John D. Schell
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 protests of Jack A. and Norma E. Dole against proposed assessments of additional personal income tax in the amounts of $581.97, $1,261.78, $30.00, and $24.00 for the years 1962, 1963, 1964, and 1965, respectively.

This is a companion appeal to the Appeal of Oilwell Materials & Hardware Co., Inc., decided today. In that decision we sustained respondent's determination that certain business expense deductions claimed by Oilwell should'be disallowed because those "business expenses" were really expenditures for the personal benefit of Oilwell's officer-shareholders, appellants Jack A. and Norma E. Dole. We are now presented with the question of whether respondent was correct in treating the amount of these expenditures in each year as part of the Doles' personal income. Prior decisions of this board leave no doubt that on this issue respondent must be sustained. (Appeal of Howard N. and Thelma Gilmore, Cal. St. Bd. of Equal., Nov. 7, 1961; Appeal of Andrew K. and Mary A. Thanos, Cal. St. Bd. of Equal., Nov. 13, 1962; Appeal of Jack W. and Ruth Simpson, Cal. St. Bd. of Equal., Feb, 3, 1965; Appeal of Charles and Helga Schonfeld, Cal. St. Bd. of Equal., May 10, 1967.)

The issue remaining for decision on this appeal relates to certain cash withdrawals from Oilwell by the Doles. Respondent contends that these withdrawals should be treated as constructive dividends, while appellants argue that the withdrawals were bona fide loans.

Prior to 1961 appellant Jack 'Dole and Mr. Asta were equal partners in two firms, (1) Oilwell Materials and Hardware Co., and (2) Asta-Dole Building, owner of the building in which the Oilwell partnership and several other businesses were located. Because of serious differences between the two partners over the conduct of Oilwell's business, the Oilwell partnership was dissolved on December 31, 1960, by appellant's acquisition of Asta's interest. Shortly thereafter, appellant and Asta entered into a lease agreement whereby appellant leased Asta's one-half interest in the property owned by Asta-Bole Building. As part of this agreement appellant obtained an option to purchase Asta's interest in Asta-Dole Building.

For some time after the dissolution of the Oilwell partnership, appellant operated the business as a sole proprietorship. On August 7, 1962, he formed a corporation, named Oilwell Materials & Hardware Co., Inc., to which he transferred the assets of the sole proprietorship in exchange for the full issue of the corporation's stock having a stated value of $90,000.00.

During the months remaining in 1962, appellant withdrew funds totaling $7,713.88 from the corporation. These funds were in addition to appellant's salary of $5,000.00 for the same period, and the corporation's books reflected these withdrawals by an entry denominated as "advances to stockholders." Of the total amount withdrawn, $5,000.00 was used to make a quarterly payment of appellants' estimated federal income tax, and approximately $1,000.00 was used to pay certain withholding taxes.

In 1963 appellant made further withdrawals from Oilwell amounting to $20,230.00. These funds, together with a personal bank loan of $60,000, were used to exercise the option to purchase Asta's interest in Asta-Dole Building. Like the previous ones, these withdrawals were entered on the corporate books as "advances to stockholders." Title to the building was later transferred to Dole Building Corporation, which appellant formed on January 21, 1964, in exchange for all of that corporation's capital stock.

Appellant did not execute any notes evidencing indebtedness to Oilwell, nor did he give Oilwell any security for repayment. There were no fixed maturity dates for the alleged loans, and no part of the withdrawals has yet been repaid. No specific interest charge was agreed upon, and no interest has been paid by appellant or accrued on Oilwell's books. Oilwell had a substantial earned surplus in each relevant year, but as of December 31, 1967, it had never declared a dividend.

Whether a stockholder's withdrawals from a corporation are loans rather than taxable distrubutions of earnings is a question of fact to be determined from all the circumstances present in a particular case, and the controlling factor is whether at the time of each withdrawal the parties intended that it should be repaid. (Harry E. Wiese, 35 B.T.A. 701, aff'd, 93 F.2d 921, cert. denied, 304 U.S. 562 [82 L. Ed. 1529]; Clark v. Commissioner, 266 F.2d 698; Chism's Estate v. Commissioner, 322 F.2d 956; Berthold v. Commissioner, 404 F.2d 119.) Withdrawals are deemed to be dividend distributions, as determined by respondent, unless the taxpayer can affirmatively establish their character as loans, and when the corporation is wholly owned by the withdrawer, his control invites a special scrutiny. (Ben R. Meyer, 45 B.T.A. 228; W. T. Wilson, 10 T.C. 251, aff'd, 170 F.2d 423; Appeal of Goodwin D. and Bessie M. Key, Cal. St. Bd. of Equal., Dec. 15, 1966.)

After considering all of the facts in this case, we are not persuaded that the withdrawals were intended to be repaid. Except for the fact that the withdrawals were recorded on Oilwell's books as "advances to stockholders," the only evidence favorable to appellants is the testimony of Mr. Dole that he always intended to repay the advances because his attorney had told him, at the time the advances were made, that they would have to be repaid with interest. We think the proper view to be taken of such self-serving testimony is that expressed, under very similar circumstances, by the court in Berthold v. Commissioner, supra, 404 F.2d at p. 122:

> [S]uch testimony (pertaining to transactions between a taxpayer and two of his alter egos) can appropriately be viewed with some diffidence unless supported by other facts which bring the transaction much closer to a normal arms-length loan.. .. The intention of the

> parties relates not so much to what the transaction is called, or even what form it takes, as it does to an actual intent that the money advanced will be repaid.. .. Normal security, interest and repayment arrangements (or efforts. to secure same) are, important proofs of such intent. And here such proofs are notably lacking.

Those same proofs are likewise absent in this case. Consequently, there is insufficient objective evidence to establish affirmatively that the advances were intended to be repaid.

In the briefs of both parties much attention is directed to the uses to which appellant put the funds that he withdrew from Oilwell. Appellant seeks to distinguish this case from several earlier decisions by this board where we mentioned that the money withdrawn was used to pay the taxpayers' personal expenses and obligations. (See Appeal of Goodwin D. and Bessie M. Key, supra; Anneal of Albert R. and Belle Bercovich, Cal. St. Bd. of Equal., March 25, 1968.) However, a finding that the funds were used for personal expenses was not necessary for our holding in either case that the withdrawals were dividends and not loans. Moreover, as a general rule, we cannot see that the use which the taxpayer made of the money is relevant to the issue of whether it was withdrawn as a loan or as a distribution of earnings, since whichever it was, the taxpayer was free to use the money in any way that he pleased. (Regensburg v. Commissioner, 144 F.2d 41.)

When the issue is whether the taxpayer received corporate funds as the corporation's agent for a particular purpose, the taxpayer's use of the money does become relevant. In such a case the taxpayer's use of the money in furtherance of the corporate purpose does not result in any taxable personal benefit to him. This situtation was presented in Joseph McReynolds, 17 B.T.A.331, where the Board of Tax Appeals held:

> [R]espondent erred in treating as dividends that part of the amounts drawn by petitioner which he applied to the purchase of the building site and the construction of the building. The site was acquired and the building constructed in the name of the petitioner, but for the corporation and not

> for himself, as is shown by his subsequent" transfer of the property to the corporation. He received no benefit from the amounts which he drew from the corporation and paid over for property which he was acquiring for the corporation. (17 B.T.A. at p. 334.)

Although appellant claims that he purchased Asta's interest in Asta-Dole Building for the benefit of Oilwell, the fact that he transferred the property not to Oilwell but to a new corporation (which then nearly doubled Oilwell's rent) readily distinguishes this appeal from McReynolds.

Counsel for both parties have also discussed whether appellant had any legal obligation to repay the advances from Oilwell. Although our decisions in Bercovich and Key, supra, stated that the appellants there had no legal obligation to repay their withdrawals, a contrary finding would not have compelled a determination that 'the withdrawals were loans. Where the stockholder who makes the withdrawals is in control of the corporation, the existence of a technical legal obligation to repay means nothing if the stockholder does not intend to have the corporation enforce the obligation. (Cf. Chism's Estate v. Commissioner, supra, 322 F.2d 956, upholding a Tax Court determination that withdrawals were dividends despite the existence of a legal obligation to repay them. The court of appeals said, at p. 960:

> The Nevada probate court adjudication established that the Chisms had a legal obligation to repay the withdrawals that had been made. But it is not the existence of a legal obligation to repay that is controlling. It is the petitioners' intent to honor, and the intent of their collective alter ego, the corporation, to enforce that obligation which determines the nature of the withdrawals.)

Finally, appellant has questioned whether Oilwell had sufficient earnings and profits to support dividends in the amounts determined by respondent for 1962 and 1963. A taxpayer has the burden of proving the insufficiency of earnings and profits to support the dividends claimed by respondent (Max P. Lash, 15 T.C. Memo. 453, rev'd in part on other grounds, 245 F.2d 20) and appellant has not met

that burden. Respondent has shown the existence of sufficient earned surpluses in each relevant year, and appellant has made no effort at all to provide information from which we could make a separate computation of Oilwell's earnings and profits.

For these reasons we must sustain respondent's determination that the withdrawals were dividends rather than loans.

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 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of Jack A. and Norma E. Dole against proposed assessments of additional personal income tax in the amounts of $581.97, $1,261.78, $30.00, and $24.00 for the years 1962, 196.3, 1964, and 1965, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 6th day of November, 1970, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: _____, Secretary