



BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
 )  
BEVERLY DESIGN CENTER CORPORATION, )  
TAXPAYER, EUGENE L. HUDSON AND )  
ROBERT B. HUDSON, ASSUMERS )  
AND/OR TRANSFEREES )

For Appellant: James J. Brown  
Attorney at Law

For Respondent: Carl G. Knopke  
Counsel

O P I N I O N

This appeal is made pursuant to section 25666 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Beverly Design Center Corporation, Taxpayer, and Eugene L. Hudson and Robert B. Hudson, Assumers and/or Transferees, against a proposed assessment of additional franchise tax and penalty in the total amount of **\$5,275.73** for the income year ended May 31, 1977.

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The issue presented by this appeal is whether the appellant-corporation is taxable on a portion of the distribution it made to its shareholder-creditors.

Beverly Design Center Corporation (the "corporation") was owned by five family members. **Appellants** Eugene and Robert Hudson each owned one-third of **the** outstanding stock, and **three other** family members each owned one-ninth. In addition, the corporation was indebted to each of the shareholders in proportion to his or her stock ownership. On May 2, **1977** the corporation was liquidated in accordance with the requirements of Revenue and Taxation Code sections **17402** and **24503** and their federal counterpart, Internal Revenue Code section **333**. At the time of liquidation, the corporation had only one asset, a parcel of appreciated real property, which was distributed to the shareholder-creditors. Immediately after the distribution, the property was sold. On its franchise tax return for the taxable year ended **May 31, 1977**, which was not timely filed, appellant-corporation reported no gain from the property's distribution. Appellants contend that the distribution was a **liquidation** distribution to shareholders and thus, pursuant to Revenue and Taxation Code section **24511**, **the** corporation **recognized** no gain.

Upon audit, respondent determined that the corporation had distributed a portion of the property in payment of its indebtedness, and thus had disposed of that portion of the property in a **taxable** transaction. Respondent issued a proposed assessment reflecting this determination and imposing a 25 percent penalty for failure to file a timely return. Appellants protested the proposed assessment of **additional** tax, but apparently did not dispute the imposition of the penalty. After considering appellants' protest, respondent reaffirmed the proposed assessment, and this timely **appeal** followed.

Revenue and Taxation Code section **24511** and the substantially identical federal statute, Internal Revenue Code section **336**, provide that, with the exception of a disposition of installment obligations,, a corporation recognizes no gain or loss on the distribution of property in partial or complete liquidation. These sections do not apply when a corporation distributes property to a creditor in satisfaction of indebtedness; **such a transfer** is treated as a sale or exchange with gain or loss being recognized by the corporation. (Rev. Rul. 76-175, 1976-1 Cum. Bull. 93.) Upon the liquidation of a corporation, any amount received by a shareholder who is also a

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creditor is first applied to satisfy the indebtedness, and only the remaining amount constitutes a distribution in liquidation in exchange for stock. (Houston Natural Gas Corporation, 9 T.C. 570 (1947); Rev. Rul. 76-175, supra; see also, O.D. Bratton, 31 T.C. 891 (1959), affd., 283 F.2d 257 (6th Cir. 1960), cert. den., 366 U.S. 911 [6 L.Ed.2d 235] (1961).)

Appellant-corporation distributed appreciated property to its shareholders while they were also creditors. Therefore, this property first applies to satisfy the debts and to that extent, the transfer is treated as a sale or exchange of the property, causing the appellant-corporation to be taxable upon the gain realized.

Appellants contend that the property was distributed to the shareholders subject to the indebtedness with the implicit understanding that the shareholders would immediately sell the property and satisfy the indebtedness out of the sale proceeds. Appellants cannot prevail with this argument since they have produced no evidence to prove that this was the form of the transaction. Even if they had shown this to be the form, it is unlikely that such an arrangement would be found to have economic significance; thus, the form would not determine the tax consequences of the transaction. (Braddock Land Company, Inc., 75 T.C. 324 (1980).) Appellants also argue that several methods exist by which they could have effected their desired result while avoiding the imposition of tax at the corporate level. While this may be true, the tax consequences are determined by what action was taken, not by what might have been. (\*peal of Bonzer, Inc., Cal. St. Bd. of Equal., Feb. 5, 1968.) The actions taken by appellant-corporation and its shareholder-creditors result in that corporation having to recognize gain on the portion of the property used to satisfy the shareholders' indebtedness.

For the foregoing reasons, the action of respondent must be sustained.

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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 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Beverly Design Center Corporation, **Taxpayer**, Eugene L. Hudson and Robert B. Hudson, Assumers and/or Transferees, against a proposed assessment of additional franchise tax and **penalty** in the total amount of **\$5,275.73** for the income year ended May 31, 1977, be and the same is hereby sustained.

Done at **Sacramento**, California, this **17th** day of November, **1982**, by the State Board of **Equalization**, with Board **Members** Mr. Bennett, Mr. Collis, Mr. Dronenburg and Mr. Nevins present.

William M. Bennett , Chairman  
Conway-H. Collis , Member  
Ernest J. Dronenburg, Jr , Member  
-Richard Nevins , Member  
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