



Appeal of Harold C. Boyd and the  
Estate of Evelyn A. Boyd, Deceased

The sole issue presented is whether **respondent** properly disallowed a portion of appellant's deduction of a partnership loss.

Appellant herein. shall mean Harold C. Boyd. The Estate of Evelyn A. Boyd, deceased, is a party to this appeal only because Mrs. Boyd filed a joint return with her husband, Harold C. **Boyd**, before she died.

Appellant, as a sole proprietor, was a real estate developer prior to and during 1972. Appellant was also the sole owner of **Builder Boyd, Inc.** ("the corporation"), a California corporation, which had a principal business activity of construction contracting. In 1971, the corporation entered into a contract to construct an apartment complex **in Sunnyvale, California.** During the same time, appellant negotiated with Wells Fargo Bank, N.A., for a line of credit to supply working capital for the construction project. Appellant requested that the loans be made to a partnership which was to be formed by himself and the corporation. The bank refused to accept this arrangement. Therefore, a \$400,000 line of credit was extended to the corporation with appellant as guarantor.

On January 1, 1972, appellant and his corporation formed a partnership to construct the apartment complex. The partnership agreement provided that the **partners** were to share the profits and losses equally. It also provided that the contribution, of capital to the partnership would be composed of appellant's personal guarantee of the working capital for the project and of the corporation's assets including tools, materials, personnel, and the construction contract.

The corporation began to draw on the \$400,000 line of credit by issuing a promissory note endorsed by appellant in his capacity as president of his corporation. The corporation transferred the loan proceeds to the partnership, and the transfers were recorded on the partnership's books as credits to appellant's capital account. By June 1972, the corporation had drawn \$370,000 on the line of credit. At that time, the bank was concerned about the situation and informed appellant that it was looking to him personally to "handle" the corporation's loans. In addition, the bank required appellant to execute deeds of trust, naming the bank as beneficiary, on several parcels of appellant's own real property as further security for his performance as

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guarantor. In September 1972, the corporation was unable to meet the bank's repayment requirements, and the bank requested appellant to assume personal responsibility for the loans to the corporation. Appellant complied with this request, but, as respondent's independent audit revealed, rather than paying the bank directly, appellant transferred money to the corporation and it made the payments on the loans.

In 1972, the partnership sustained a loss of \$624,038 on the project, and appellant deducted one-half of this loss on both his California and federal personal income tax returns. The Internal Revenue Service (IRS) audited appellant's 1972 federal income tax return and determined that appellant's adjusted basis in the partnership was \$33,348. Internal Revenue Code section 704(d) limits a partner's distributive share of the partnership loss to the partner's adjusted basis in the partnership. Accordingly, the IRS limited appellant's partnership loss deduction to \$33,348. However, the IRS allowed the remaining portion of the loss to be carried forward and carried back as net operating losses, resulting in refunds for prior and subsequent years which offset the additional federal tax assessed for 1972.

Since section 17858 of the Revenue and Taxation Code is substantially similar to Internal Revenue Code section 704(d), respondent followed the IRS adjustments limiting appellant's partnership loss deductions for 1972 to \$33,348. This resulted in the subject proposed assessment. Appellant discovered that an offset of the proposed assessment was not available because state law did not provide for the carry back or carry forward of net operating losses. Thereafter, appellant protested the proposed assessment, and, after due consideration, respondent affirmed its determination. This appeal followed.

Revenue and Taxation Code section 17882 prescribes that the basis of an interest in a partnership acquired by a contribution of money shall be the amount of such money. Revenue and Taxation Code section 17915, subdivision (a), provides, "any increase in a partner's individual liabilities by reason of the assumption by such partner of partnership liabilities, shall be considered as a contribution of money by such partner to the partnership."

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Appellant contends that the corporation acted **as** an agent of the partnership when the corporation obtained the loans from the bank and that the obligations to repay the loans were partnership liabilities, **There-**fore, appellant contends that he increased his basfs in the partnership when he assumed these obligations.

It is frequently stated that transactions between members of a family will be carefully scrutinized **because** the existence of the family relationship is a warning that things may not be what they seem.. (Commissioner v. Culbertson, 337 U.S. 733 [93 L.Ed. 1659] (1949); Appeal of Buyer Investment Co., Cal. St. Bd. of Equal., Dec. 29, 1958.) In the immediate case, the entities involved represent the alter egos of **an** individual, and, therefore, the potential for camouflage and illusionis similarly present.

This board is aware that, as a general rule, "[e]very partner is an agent of the partnership for the purpose of its business ...." (Corp. Code, § 15009.) However, there is an exception to this rule, "if [a partner] was acting only in his individual capacity and plaintiff [third party] knew that he was acting solely in that capacity, the partnership [is]' not liable." (Blackmon v. Hale, 1 Cal.3d 548, 558 [83 Cal.Rptr. 194] (1970).)

The terms of the loan agreement with the bank identified the corporation as the borrower and the appellant as the guarantor of the corporation's obligations. The record indicates the bank insisted the loans be made to the corporation rather than to the partnership. In addition, the promissory notes given as evidence of the corporate obligations to the bank were endorsed by appellant in his capacity as president of **the corporation**. When the corporation defaulted on the repayment schedule, the bank looked solely to appellant to discharge the obligations. Furthermore., the file-indicates the bank never considered the partnership liable for the discharge of the obligations. Moreover, there is no evidence that **a** novation of the loan agreement occurred, thereby substituting the partnership for the corporation as the borrower. There is also no evidence that the partnership assumed liability for the loans.

Appellant has asserted that the accounting entries in the books **of** the corporation and the partnership indicate partnership liability for repayment of the

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loans. This assertion is not disputed; however, book entries in the accounts of companies are merely **evidentiary**, and the rights of the parties can neither be established nor impaired by them. (E. L. Kier, 15 B.T.A. 1114 (1929).) While the book **entries are** evidence of partnership liability for the loans, a careful examination of the record supports a finding that the corporation acted in its corporate capacity in obtaining the loans and that the bank knew the corporation was acting solely in that capacity. In other words, the record supports a finding that the corporation was not acting as an agent of the partnership when it borrowed the funds. Therefore, we find that the obligations to repay the loans were not partnership liabilities. (Blackmon v. Hale, supra.) As a consequence, appellant's basis in the **partnership** was not **increased** when he assumed these obligations, and his claimed deduction of the partnership loss was overstated. (Rev. & Tax. Code, § 17858.) Accordingly, respondent's action in this matter must be sustained.

