BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
PENN CO., LTD.)

Appearances:

For Appellant: Phillip Singer
Attorney at Law

For Respondent: Richard A. Watson
Counsel

O P I N I O N

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Penn Co., Ltd., against a proposed assessment of additional franchise tax in the amount of $2,194.04 for the income year 1964.

Appellant, a California corporation, was formed on January 5, 1931. The three incorporators were employed by Leonard J. Meyberg, a Los Angeles attorney. Appellant's articles of incorporation indicate that it was created for broad general purposes concerning the ownership, management and disposition of real and personal property. The corporate purposes include the operation of a mortgage and loan business

as well as dealing in both real and personal property. The articles also provide that the corporation may engage in almost any other conceivable business activity and do not restrict appellant's right to act in its own behalf in any way. However, appellant maintains that the only purpose for its creation was to hold property as a nominee or a straw corporation for Mr. Meyberg and others in order to avoid any reference to their names as record owners of property,

The articles authorized the issuance of 250 shares of $100 par value stock. The corporation was to obtain a permit to issue stock from the Commissioner of Corporations in exchange for certain real property which was transferred to it. However, no permit was obtained and no stock was ever issued.

From time to time during its existence, appellant has held title to various parcels of real property. Included in these holdings was a parcel known as the Wilshire Property. Using that property as security, appellant obtained loans in its own behalf of $15,000 in 1954 and $25,000 in 1932 from the Bank of America.

In 1935 appellant acquired the fee title to a parcel of real estate known as the Highland Property for a recited consideration of $10. Affixed to the deed was a **50-cent** revenue stamp indicating **that the** net value of, or the net consideration paid for, the realty conveyed was $500. Appellant maintains, however, that the purchase price was paid by Mr. Meyberg and not by appellant. Apparently, **Mr.** Meyberg continued to pay the property taxes on the property,. year after year, with his own funds.

In 1964 appellant, by corporation grant deed, conveyed the fee title in the Highland Property to Swift-Chaplin, Inc., for a consideration of $42,500. The grant deed was signed by **appellant's vice** president and secretary. These officers also negotiated and signed the escrow instructions for the sale of the+ property. In executing these instructions, appellant's officers did warrant and represent that the execution was on behalf of the corporation. The execution of **both the** escrow instructions and the corporation grant

deed was authorized by a formal resolution of appellant's board of directors at a meeting held for that purpose. The resolution also stated that the actual owners of the Highland Property were Leonard J. and Lorraine K. Meyberg, and authorized appellant to transfer all funds received from the sale to them. The resolution was signed by appellant's vice president and secretary, as well as by L. J. Meyberg, and bore the corporate seal.

Appellant did not report the sale in its franchise tax return for the calendar year 1964. Appellant's return for 1964, like its returns for at least the preceding 20 years, showed no income and no expense. The return merely stated that the corporation conducted no business for its own account or from which it derived any income for the year 1964. Appellant did, however, pay the minimum tax of $100. Gain from the sale of the Highland Property was reported on the installment basis by Leonard J. and Lorraine K. Meyberg on their 1964 joint personal income tax return. There was no indication in the Meybergs' return that title to the Highland Property had been conveyed by appellant. This fact was discovered by respondent during a routine audit of the Meybergs' 1964 and 1965 personal income tax returns.

Respondent attributed the gain from the sale to appellant rather than to the Meybergs on the basis that it was a viable corporation created for a business purpose and engaged in business activity. However, appellant contends that its corporate status should be disregarded and the gain from the sale attributed to the Meybergs. Appellant's basis for this contention is that the corporation was not engaged in business, its only purpose being to hold real property in the corporate name as nominee.

The primary issue for determination is whether appellant's corporate form should be disregarded or whether appellant should be treated as a taxable corporate entity. If it is determined that appellant is a taxable corporate entity a second question arises, whether the gain from the sale was properly computed.

While the question of whether a corporation is to be treated as a viable separate entity or ignored

for tax purposes is a vexing one, particularly in this factual setting, it is not a new one. (See, e.g., Moline Properties, Inc. v. Commissioner, 319 U.S. 436 [87 L. Ed. 1499]; National Carbide Corp. v. Commissioner, 336 U.S. 422 [93 L. Ed. 779]; Harrison Property Management Co., Inc. v. United States, 475 F.2d 623; Love v. United States, 96 F. Supp. 919; David F. Bolger, 59 T.C. 760.) The general rule is that the corporate entity will be ignored only in exceptional situations where it would otherwise present an obstacle to the protection or enforcement of public or private rights. (New Colonial Ice Cream Co. v. Helvering, 292 U.S. 435 [78 L. Ed. 1348].)

The starting point for our inquiry in this matter is the landmark case of Moline Properties, Inc. v. Commissioner, 319 U.S. 436 [87 L. Ed. 14991, where it was stated:

> The doctrine of corporate entity fills a useful purpose in business life. Whether the purpose be to gain an advantage under the law of the state of incorporation or to avoid or to comply with the demands of creditors or to serve the creator's personal or undisclosed convenience, so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity. (Moline Properties, Inc. v. Commissioner, supra, 319 U.S. at 438-439.)

While the test in Moline is easily stated, its application is often mostdifficult, particularly in situations involving minimal corporate activity such as this one. This difficulty is evidenced by the disarray in which we find the cases in this area, (Compare K-C Land Co., Inc., T.C. Memo., Feb. 29, 1960, with Tomlinson v. Miles, 316 F.2d 710, cert. denied, 375 U.S. 828 [11 L. Ed. 2d 601; compare Alan S. Davis, T.C. Memo., June 23, 1970, and Lloyd F. Noonan, 52 T.C. 907, aff'd per curiam, 451 F.2d 992 with Perry R. Bass, 50 T.C. 595.)

The Moline '"business activity" test has been explained as meaning that in order for a corporation to

be treated as a separate jural person for tax purposes it must engage in some industrial, commercial, or other activity. (National Investors Corp. v. Hoey, 144 F.2d 466 (L. Hand, J.).) Although business activity is required for recognition of the corporation as a separate taxable entity, the activity may be minimal. While many of the cases in this area emphasize the degree of business activity, a determination of whether a corporation is doing business does not necessarily depend upon the quantum of business activity. (Britt v. United States, 431 F.2d 227, 234-237; Herbert v. Riddell, 103 F. Supp. 369; see also Paymer v. Commissioner, 150 F.2d 334.)

The leading case in drawing a fine line separating business from nonbusiness activity is Paymer v. Commissioner, 150 F.2d 334. (See also Commissioner v. State-Adams Corp., 283 F.2d 395, cert. denied, 365 U.S. 844 [5 L. Ed. 2d 809]; Tomlinson v. Miles, 316 F.2d 710, cert. denied, 375 U.S. 828 [11 L. Ed. 2d 60].) In Paymer the taxpayers, who were partners, formed two corporations, Raymep and Westrich. Both corporations were given broad powers to own, manage and dispose of real property. In order to avoid the attachment of partnership property, the partners conveyed a parcel of income producing property to each of the corporations. At the time of the transfer, directors' and shareholders' meetings were held where resolutions were adopted expressly stating that the full beneficial ownership and control of the property remained in the partners and that the corporations were mere title holders. None of the leases were ever assigned to either of the corporations. The partners continued to manage the real estate, collecting the rents, paying the expenses, and depositing the income received in the partnership's accounts. The corporate entities were completely ignored as far as the income producing aspects of the properties were concerned. In fact, Westrich did absolutely nothing with respect to the property held in its name. However, Raymep obtained a loan secured by an assignment of all its rights in two leases of the property to which it held title, covenanting that it was the sole lessor.

The court found that Westrich, the inactive corporation, was a mere passive dummy that could be disregarded for tax purposes. However, the court held that Raymep, the corporation that obtained the loan,

was not a mere dummy and could not be disregarded for tax purposes. The court stated:

> We think that Raymep was active enough to justify holding that it did engage in business in 1938. The absence of books, records and offices and the failure to hold corporate meetings are not decisive on that question. Though Raymep was organized solely to deter creditors of one of the partners, it apparently was impossible or impracticable to use it solely for that purpose when it became necessary or desirable to secure the above mentioned loan in a substantial amount....
>
> Westrich, however, was at all times but a passive dummy which did nothing but take and hold the title to the real estate conveyed to it. It served no purpose in connection with the property and was intended to serve only as a blind to deter the creditors of one of the partners. (Paymer v. Commissioner, supra, 150 F.2d at 336-337.)

We find the instant situation similar to that of Raymep and, therefore, controlled by the decision of the court in Paymer. In both cases the corporations were created for broad general purposes concerning the ownership, management and disposition of real property. In both matters the corporations obtained loans, in their own behalf, secured by the corporate property. We also note that the court in Paymer was not impressed by the fact that Raymep purported to hold only the legal title to the property from its inception. Appellant, in the instant proceeding, stands on even weaker ground since there was no indication that appellant was other than the full beneficial owner of the Highland Property until the time of the sale when a corporate resolution to that effect was passed.

Contrary to appellant's assertion, the court in Paymer did not predicate its decision on the fact that the property produced income.' If that had been the basis of the court's decision, it would have been

compelled to hold that both corporations were taxable entities since the property transferred to each corporation produced income.

Appellant argues most strenuously that, although it held legal title to the Highland Property, beneficial ownership was in the Meybergs. From this appellant concludes that the Meybergs and not the corporation should be taxable on the gain from the sale of the property. Whether the Meybergs or appellant was actually the beneficial owner of the Highland Property, a question which we do not decide in view of the paucity of evidence submitted on the issue, is not controlling. Were we writing on a clean slate, we might be persuaded that the answer to this question is critical to our determination. (See, e.g., United States v. Brager Building and Land Corp., 124 F.2d 349; but see Joseph Rothafel, T.C. Memo., Oct. 19, 1965; cf. Commissioner v. State-Adams Corp., 283 F.2d 395, cert. denied, 365 U.S. 844 [5 L. Ed. 2d 809]; see also, Kurtz and Kopp, Taxability of Straw Corporations in Real Estate Transactions (1969) 22 Tax Lawver 647.) However, in view of the current status of the law we believe that any further argument on this issue is foreclosed. The criterion set out by the Supreme Court in Moline Properties, Inc., supra, for determining when a corporation remains a separate taxable entity does not require that the corporation have beneficial ownership of the property; bare legal title is sufficient. (Tomlinson v. Miles, 316 F.2d 710, cert. denied, 375 U.S. 828 [11 L. Ed. 2d 60]; Paymer v. Commissioner, supra; cf. National Carbide Corp. v. Commissioner, 336 U.S. 422 [93 L. Ed. 7791.)

'Appellant also maintains that Appeal of Fish Machinery Corp., decided by this board on February 20, 1947, is controlling and compels a decision in its favor. We do not agree. In Fish Machinery Corp., we first approved the test in Moline and its application in Paymer. Then we found that, as a matter of fact, the corporation carried on no more business activity than did the corporation held not to be a taxable entity in Paymer. Next, we found that the corporation had been formed for the purpose of protecting its owners by holding bare legal title to property and that it engaged in no other activity. We then held that it was not improper to disregard the corporate entity where the corporation is a dummy not engaged in

any corporate business activity but merely holding bare legal title to property as an instrumentality of the shareholders. However, the holding in Fish Machinery Corp. is not controlling where, as here, we find that the corporation has engaged in business activities and was not merely holding bare legal title to property.

In accordance with the views set out above, we conclude that respondent was correct in determining that appellant was a taxable corporate entity during the year in question.

Since we have concluded that appellant is a taxable corporation, we must now determine whether the gain from the sale was properly computed. The only question is whether respondent used the proper basis in computing the gain. The deed by which appellant acquired title to the property recited a consideration of $10. The revenue stamps attached to the deed indicated that the net value of, or the net consideration paid for, the property did not exceed $500. In view of this, respondent determined that appellant's basis was $500 and computed the gain accordingly.

In establishing the basis of the property in question, we recognize that the weight of evidence adduced by Internal Revenue stamps affixed to a deed is almost inconsequential. However, the burden of producing evidence on the question of basis is upon appellant who is in possession of, or has access to, more persuasive evidence on the question. Since appellant saw fit to submit absolutely no evidence on this issue, we are forced, albeit reluctantly, to accept the only available evidence. Accordingly, respondent's determination on the question of basis must also be upheld.

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,

Appeal of Penn Co., Ltd.

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 Penn Co., Ltd., against a proposed assessment of additional franchise tax in the amount of $2,194.04 for the income year 1964, be and the same is hereby sustained.

Done at Sacramento, California, this 19th day of February, 1974, by the State Board of Equalization.

, Chairman

, Member

, Member

, Member

, Member

ATTEST: , Secretary