OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18032515
M. HOURIANI AND N. HOURIANI	)
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	)
	)
	)

OPINION

Representing the Parties:

For Appellants:	John D. Faucher, Attorney
For Respondent:	Bradley W. Kragel, Tax Counsel III Matthew Miller, Tax Counsel IV
Office of Tax Appeals:	William J. Stafford, Tax Counsel III

R. TAY, Administrative Law Judge: This appeal is made pursuant to section 19045 of the Revenue and Taxation Code (R&TC) from the actions of the Franchise Tax Board (respondent) on appellants' protest of a proposed assessment of $172,346 in additional tax, plus applicable interest, for the 2010 tax year.

Office of Tax Appeals Administrative Law Judges Richard Tay, Josh Lambert and Keith T. Long held an electronic oral hearing for this matter on May 18, 2021. At the conclusion of the hearing, we left the record open to allow for additional briefing. At the conclusion of the additional briefing period, this matter was submitted for an opinion on October 12, 2021.

ISSUE

Whether appellants have demonstrated error in respondent's proposed assessment for the 2010 tax year.

FACTUAL FINDINGS

Acquisition of Property

1. Aramro Corp, a Delaware corporation (Aramro), was incorporated in the State of Delaware on January 29, 2004.
2. Shortly thereafter, Aramro borrowed funds to purchase real property on Queensborough Lane in Los Angeles (the Queensborough property). Based on the Settlement Statement dated March 2, 2004, the sale price of the Queensborough property was $1.18 million, the "principal amount" of the loan was $780,000, and the "earnest money" deposit was $426,500.
3. Appellant-husband paid the earnest money deposit of $426,500. The Settlement Statement on the loan used to acquire the Queensborough property lists the "Name of Borrower" as "Aramro Corporation" and the "Name of Seller" as an independent third-party.
4. As part of the loan process, Aramro and the bank also entered into a Hazardous Substances Certificate and Indemnity Agreement, which appellant-husband signed on behalf of Aramro as its president. In addition, appellant-husband separately signed the Hazardous Substances Certificate and Indemnity Agreement as a "guarantor" in his individual capacity.
5. Aramro received the Queensborough property by a Grant Deed, which was recorded in the Los Angeles County Recorder's Office on March 2, 2004, along with the Hazardous Substance Agreement, which was recorded on the same date.
6. For tax years 2004 and 2005, the bank issued Forms 1098 Mortgage Interest Statements to Aramro reporting mortgage interest payments totaling $37,212.21 and $15,616.12, respectively. From tax years 2004 to 2009, the Los Angeles County Tax Collector sent property tax statements to Aramro. The property taxes were paid by United Management Company, of which appellant-husband is a co-owner.
7. On March 17, 2005, the bank sent a letter to Aramro enclosing documents to extend the loan and requesting a payment of $7,116.70 towards loan fees and interest. In response, United Management Company issued a check to the bank on behalf of Aramro for payment of the loan fees and interest.

8. United Management Company paid other expenses related to the Queensborough property on behalf of Aramro, including property tax, HOA fees, mortgage payments, and other maintenance fees.

Sale of Property

9. Aramro's corporate status was suspended by the State of Delaware on March 1, 2008.
10. Approximately two years later, appellant-husband, as president of Aramro, signed a Quitclaim Deed dated February 24, 2010, by which Aramro executed a transfer of the Queensborough property to appellant-husband as an individual. The Quitclaim Deed was notarized on the same date. On or about the same date, appellant-husband entered into an agreement to sell the Queensborough property to an unrelated third-party for $2.5 million.
11. Appellants filed a timely joint 2010 California Resident Income Tax Return. On a federal Schedule D, appellants reported a sale of the Queensborough property for $2.5 million, a basis in the property of $2,053,072, and a capital gain from the sale of $446,928. In addition, they reported the acquisition date of the property as March 2, 2004, and the sales date as March 10, 2010.

Respondent's Examination

12. Respondent audited appellants' 2010 income tax return. During audit, respondent determined that appellant-husband received a corporate distribution of $2.5 million from an entity named "Aramro Corporation." Respondent issued a Notice of Proposed Assessment (NPA) to appellants that listed an additional tax of $217,341, plus applicable interest. Respondent also issued an NPA to Aramro Corp., a *California* corporation.[1] Appellants filed a timely protest.
13. After considering appellants' protest, respondent withdrew the NPA issued to Aramro Corp., the California corporation. Respondent determined, however, that appellant-husband received property worth $2.5 million from the Delaware company in 2010. Further, respondent determined that appellant-husband's basis in Aramro's stock was $426,500, which respondent calculated based on the earnest money deposit of $426,500 that appellant-husband paid towards purchase of the property. Based on the foregoing, respondent

[1] Copies of the NPAs are not provided in the appeal record.

determined that appellant-husband received a taxable distribution of $2,073,500 in 2010 from Aramro.

14. Respondent issued a Notice of Action (NOA) to appellants that listed a taxable distribution of $2,073,500, a subtraction of $446,928 for the capital gain that appellants previously reported on their 2010 return, and an itemized deduction phaseout of $74,605. The NOA set forth an additional tax of $172,346, plus applicable interest. Appellants filed this timely appeal.

DISCUSSION

Burden of Proof

The FTB's determination is presumed correct and a taxpayer has the burden of proving the determination to be wrong. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509.) Unsupported assertions cannot satisfy a taxpayer's burden of proof. (*Appeal of Bracamonte*, 2021-OTA-156P.)

On appeal, appellants make three arguments that we will address here.[2] First, appellants argue that Aramro was a sham corporation that should be disregarded for tax purposes, and consequently, that appellant-husband did not receive a taxable distribution in 2010. Second, appellants argue that even if Aramro were a recognized entity for tax purposes, that it could not have executed a distribution of the Queensborough property as a suspended corporation. Finally, appellants argue that respondent understated appellant-husband's basis in Aramro, and consequently, inflated the amount of the taxable distribution.

Disregarded Entity For Tax Purposes

First, we are not persuaded that Aramro should be disregarded as a corporate entity for tax purposes. Generally, a corporation is a taxpayer separate and distinct from its stockholders. (*New Colonial Ice Co. v. Helvering*, (1934) 292 U.S. 435, 442.) Courts have disregarded a corporate entity in limited circumstances – when, based on the facts, a corporation is found not to be a "viable business entity." (*Shaw Construction Co. v. Commissioner* (9th Cir. 1963) 323 F.2d 316, 320.) "Only in situations where a corporation performs no function but the holding of

[2] Appellants make a number of arguments in their briefs. During the oral hearing, appellants conceded their arguments that respondent lacked jurisdiction and that OTA lacked jurisdiction over this appeal. To the extent appellants' remaining arguments are not discussed in this opinion, we summarily dismiss those arguments as meritless.

title to real estate, have courts ignored the corporate entity." (*Taylor v. Commissioner* (1st Cir. 1971) 445 F.2d 455.) The inquiry is essentially factual. (*Shaw Construction Co. v Commissioner*, *supra*.)

The degree of corporate business purpose or business activity requiring recognition of a corporation's separate existence is minimal. (*Lukins v. Commissioner*, T.C. Memo. 1992-569 (*Lukins*).) Indeed, "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 of Internal Revenue* (1943) 319 U.S. 436.) If a corporation has a purpose that is the equivalent of a business activity *or* engages in business activity, its separate tax existence is established. (*Ibid*; see also *Dooley v. Commissioner*, T.C. Memo. 1984-548.)

The parties have provided scant argument and evidence regarding the purpose of Aramro; thus, we focus on the second prong. Appellants argue that Aramro was a "sham corporation" that never engaged in business activity and should be disregarded for tax purposes. Aramro purportedly never had any shareholders, it never issued any stock, and it never transacted any business. Based on the record before us, we acknowledge that Aramro had little activity other than to hold title to the Queensborough property. The documentary evidence appellants provided after the hearing shows that appellants and United Management Company paid most of the bills associated with the management, maintenance and development of the Queensborough property on Aramro's behalf. In 2009, Appellants personally sought a construction loan secured by the Queensborough property, and paid the fees associated with that loan.

However, we also find it significant that Aramro secured the initial mortgage to obtain the Queensborough property. Aramro was the sole borrower listed on the original loan from Pacific Western Bank, and the subsequent refinance in 2005. This activity alone is sufficient to treat Aramro as a separate entity for tax purposes. Obtaining a loan from a third-party may constitute business activity requiring recognition of a corporation's separate existence, even in the absence of other business activity. (*Paymer v. Commissioner* (2d Cir. 1945) 150 F.2d 334, 336-337 (*Paymer*).)

We find *Paymer* especially helpful. In *Paymer*, two related corporations were formed for the express purpose of holding title to real property. (*Paymer*, *supra*, 150 F.2d at 336.) The court of appeals found that one corporation should be disregarded for tax purposes and the other should be treated as a separate taxable entity. (*Ibid.*) The distinguishing fact between the two corporations was the fact that one corporation had secured a loan, while the other did not. (*Ibid.*) The court held that the loan activity was sufficient business activity for one corporation to be treated as a separate entity for tax purposes. (*Ibid.*) Although it may appear to be a fine distinction, it is consistent with the well-established legal principle that "the degree of business activity required to uphold the corporate form is 'extremely low'." (*Verma v. Commissioner,* T.C. Memo. 2001-132.) Thus, we similarly find Aramro engaged in business activity and should be treated as a separate entity for tax purposes.

At the oral hearing, appellants cited *Lukins v. Commissioner*, *supra*, which we find to be distinguishable. In *Lukins*, the taxpayer formed a corporation, and that corporation took title to property that taxpayer intended to buy personally. (*Lukins, supra,* T.C. Memo. 1992-569.) The corporation engaged in no activity other than those activities that are incidental to ownership of real property. (*Id.* at p. *4.) The court held that the corporation was to be disregarded for tax purposes. (*Id.* at p. *5.) Significantly, when acquiring the property, the taxpayer personally qualified for the loan used to acquire the subject property, and the taxpayer had a valid non-business purpose to use the corporation as the named owner of the property. (*Id.* at p. *4.) Here, there are no such facts. Rather, the facts show that, when it acquired the property, Aramro was the only taxpayer that qualified. Thus, Aramro engaged in business activity and cannot be disregarded for tax purposes. Appellants used Aramro to hold title to the Queensborough property and "cannot escape the tax disadvantages which come from utilizing the advantages of the corporate form. (*Taylor v. Commissioner*, *supra*.)

Suspended Corporation

Aramro was a suspended corporation in 2008, and was consequently void under R&TC section 23302(d). Appellants argue that Aramro, as a suspended corporation, could not have conveyed the Queensborough property to appellants, and thus, no taxable distribution occurred. We disagree.

R&TC section 23302(d) provides that if a corporation is suspended pursuant to provisions of the R&TC, then the corporation shall not be entitled to sell, transfer, or exchange

real property during the period of its suspension. In addition, R&TC section 23304.1 clarifies and provides that any contract made by a corporation suspended under the R&TC is voidable by the other party to the contract. Here, appellant-husband, did not request that the Quitclaim Deed from the Delaware company to appellant-husband, as an individual, be voided. In fact, after appellant-husband received the Quitclaim Deed, he immediately deeded the property to an independent third-party purchaser, as evidenced by the recorded Grant Deed.[3] We find no other basis to invalidate the distribution to appellant-husband on account of Aramro's suspended status. Thus, we find appellants' argument unavailing.

Calculation of Taxable Distribution

Since appellant-husband received appreciated property in 2010, we next turn to respondent's calculation of the taxable distribution. Respondent determined that appellant-husband received property worth $2.5 million from Aramro in 2010. Respondent also determined that appellant-husband's basis in his Aramro stock was $426,500, based on the deposit appellant-husband paid for the purchase of the Queensborough property. Based on the foregoing, respondent determined that appellant-husband received a taxable distribution of $2,073,500 in 2010 from Aramro.

Appellants disputed respondent's basis determination. At the oral hearing, appellants' representative argued that appellant-husband contributed more funds to the company by paying Aramro's expenses. With their post-hearing brief, appellants provided receipts, invoices and canceled checks of various payments made presumably on behalf of Aramro. However, only a portion of those payments was paid by appellants, as evidenced by canceled checks from appellants' personal account. United Management Company paid most of the expenses, and there is no evidence to show appellants reimbursed United Management Company in any way. Thus, we are persuaded that appellants personally paid Aramro's expenses in the amount of $77,070.20,[4] and appellant-husband's basis in his Aramro stock should be increased accordingly.

[3] In California, a deed takes effect when delivered—and whether or not delivery has occurred depends on the intention of the grantor. (Cal. Civ. Code § 1054; *Miller v. Jansen* (1943) 21 Cal.2d 473, 477.) When a deed has been recorded, there is a rebuttable presumption of delivery. (Cal. Evid. Code § 1600.)

[4] Appellants provided canceled checks that show appellants paid Lehigh Construction $50,000, Global Financing $15,000, United Management Company $12,000 and the Department of Building and Safety $70.20.

HOLDING

Appellants have not shown respondent erred in its proposed assessment except in respondent's calculation of appellant-husband's basis in his Aramro stock.

DISPOSITION

Respondent's calculation of appellant-husband's basis in his Aramro stock is modified by $77,070.20. Respondent's action is otherwise sustained.

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Richard Tay
Administrative Law Judge

We concur:

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Josh Lambert
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Keith T. Long
Administrative Law Judge

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