

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
LYNN P. AND SANDRA K. JENSEN) No. 84A-717-PD

Appearances:

For Appellants: Gary M. Cooper
Attorney at Law

For Respondent: B. S. (Bill) Heir
Counsel

O P I N I O N

This' appeal is made pursuant to section 18593^{1/} of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Lynn P. and Sandra K. Jensen against proposed assessments of additional personal income tax in the amounts of \$2,251.53, \$5,044.04, and \$10,780.00 for the years 1978, 1979, and 1980, respectively.

1/ Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the years in issue.

Appeal of Lynn P. and Sandra K. Jensen

The sole issue for determination is whether withdrawals by appellants from their closely held corporation were **loans** or constructive dividends for the appeal years.

Appellants own 90 percent of the stock of **Color West, Inc.**, a California corporation., The mother of one of the **appellants owns** the remaining 10 percent. Appellants were employed by the corporation. During the **years at issue**, appellants' average annual joint salary was **\$148,400**. The corporation also maintained open accounts for appellants which were designated loan accounts on the corporation's books of original entry and financial statements. Appellants made frequent **cash** withdrawals from, and partial repayments to, the corporation which were recorded in the open accounts. The **summary** of **that** activity during each **of** the years at issue is as follows:

	<u>Withdrawals</u>	<u>Repayments</u>	<u>Net</u>
1978	\$ 73,928	\$ 53,462	\$ 20,466
1979	118,684	72,829	45,855
1980	<u>146,344</u>	<u>48,347</u>	<u>97,997</u>
	\$338,956	\$174,638	\$164,318

No notes or other formal indications of indebtedness were executed at the time of the withdrawals. No interest was charged, no collateral was given, no ceiling was placed on the amounts which could be withdrawn, and no repayment schedule existed. The outstanding amounts owed by appellants were shown as assets on the corporation's balance sheets. The corporation declared no dividends during the years at issue although it had substantial accumulated earnings and profits. At the end of **1980**, the corporation had **\$908,421** in unappropriated retained earnings.

Apparently, appellants used the money withdrawn to buy real estate for personal investments and used net rental income and receipts from the sale of those investments to **make** the repayments. Appellants did not report their withdrawals as income on their income tax returns.

After examining appellants' joint personal income tax returns as well as the corporation's returns for the years at issue, respondent determined that appellants' net withdrawals charged to the loan account were

Appeal of Lynn And Sandra K. Jensen

not bona fide loans but were distributions of corporate earnings which were taxable to appellants as dividends. That determination increased appellants' income for those years. Accordingly, respondent issued notices of additional tax proposed to be assessed in the amounts of **\$2,251.53** for 1978, **\$5,044.04** for 1979, and **\$10,780.00** for 1980. Appellants protested. After re-examining appellants' returns as well as the corporation's returns and records for the years at issue, respondent affirmed its assessments. This appeal followed.

The question of whether appellants* withdrawals are to be characterized as dividends or loans depends on all the facts and circumstances surrounding the transactions between them and the corporation. (Wiese v. Commissioner, 35 B.T.A. 701 (1937), affd., 93 F.2d 921 (8th Cir.), cert. den., 304 U.S. 562 [82 L.Ed. 1529] (1938); Roschuni v. Commissioner, 29 T.C. 1193 (1958), affd., 271 F.2d 267 (5th Cir. 1959), cert. den., 362 U.S. 988 [4 L.Ed.2d 1021] (1960); Williams v. Commissioner, ¶ 78,306 T.C.M. (P-H) (1978); Appeal of Albert R. and Belle Bercovich, Cal. St. Bd. of Equal., Mar. 25, 1968.) Specifically, the question is whether at the time of each withdrawal there existed an intent by the shareholder to repay the loan and by the corporation to enforce the obligation. (Commissioner v. Makransky, 321 F.2d 598 (3d Cir. 1963); Clark v. Commissioner, 266 F.2d 698 (9th Cir. 1959); Haber v. Commissioner, 52 T.C. 255 (1969), affd., 422 F.2d 198 (5th Cir. 1970); Turner v. Commissioner, ¶ 85,159 T.C.M. (P-H) (1985).) Furthermore, special scrutiny of the situation is invited where the withdrawers are in substantial control of the corporation. (Haber v. Commissioner, supra; Baird v. Commissioner, 25 T.C. 387 (1955); Wilson v. Commissioner, 10 T.C. 251 (1948), affd., Wilson Bros. & Co. v. Commissioner, 170 F.2d 423 (9th Cir. 1948); Meyer v. Commissioner, 45 B.T.A. 228 (1941).) Withdrawals under such **circumstances are** deemed to be dividend distributions unless the controlling stockholders can affirmatively establish their character as loans. (Wilson v. Commissioner, supra.)

Respondent asserts that no notes were executed, no interest was charged, no collateral was given, and no ceiling was placed on the amounts appellants could withdraw. Respondent also maintains that the amounts were used for real estate investments of appellants, and that the repayments were less than the withdrawals during the years at issue and apparently dependent on the success of appellants' investments. Finally, respondent asserts

Appeal of Lynn P. and Sandra K. Jensen

that the corporation owned and controlled by appellants had a large amount of unappropriated retained earnings but declared no dividends during the years at issue.

Appellants point to the facts that the withdrawals were at all times denominated and accounted for as loans which were regarded as assets on the corporation's balance sheets; that appellants made repayments during each of the years at issue; and that eventually, after respondent's audit had commenced, appellants completely repaid the outstanding amounts. Appellant, Lynn P. Jensen, specifically stated that he intended to repay the withdrawals and that at all times he had the financial ability to repay the loans in full.

Appellants argue that this appeal presents "the classic 'running account'--where withdrawals and repayments are made, from time to time, subject to the circumstances of the moment." (Apps. Br. at 4.) In support of this position, appellants cite a myriad of cases in an attempt to demonstrate that certain factors relied on by respondent in this appeal do not require a conclusion that the withdrawals were dividends; for example, that the withdrawals were by controlling shareholders, that no interest was paid on the outstanding balances, that the withdrawals, were not evidenced by notes, that the withdrawals were used by them for their personal purposes, and that the withdrawals had no fixed repayment date. (See, e.g., Al Goodman, Inc. v. Commissioner, 23 T.C. 288 (1954); Shaken v. Commissioner, 21 T.C. 785 (1954); White v. Commissioner, 17 T.C. 1562 (1952); Faitoute v. Commissioner, 38 B.T.A. 32 (1938); Wiese v. Commissioner, supra; Boshwit Brothers, Inc., et al. v. Commissioner, ¶ 82,156 T.C.M. (P-H) (1982); Baird v. Commissioner, ¶ 82,220 T.C.M. (P-H) (1982); Pearl v. Commissioner, ¶ 77,262 T.C.M. (T-H) (1977); Thorman v. Commissioner, ¶ 53,287 T.C.M. (P-H) (1953); Courtemanche v. Commissioner, 53-1 U.S.T.C. ¶ 9303 (CCH) (1953).) In each of these cases, one or more of the above facts was usually present, yet the court held in each case that the withdrawals were loans and not dividends.. We agree, of course, that no one factor is controlling and that all of the facts must be examined. (See Pierce-v. Commissioner, 61 T.C. 424 (1974).)

In the cases cited by appellants, the courts' determinations were based on the totality of the evidence presented, not on a single factor. Similarly, when all of the facts are considered in the present appeal, we

Appeal of Lynn P. and Sandra K. Jensen

cannot conclude that the facts **demonstrate** appellants' intent to **repay** the advances at the time they were made, or the corporation's intent to enforce the obligations. **On** the contrary, we are convinced that appellants had no definite intention of making final payment prior to the time respondent commenced its audit. Rather, we **believe** that amounts were repaid from time to time simply because they were in excess of appellants' personal investment needs. Therefore, since appellants have not satisfied their burden of establishing the withdrawals as loans, we must sustain respondent's action.

Appeal of Lynn P. and Sandra K. Jensen

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 protest of Lynn P. and Sandra K. Jensen against proposed assessments of -additional personal income tax in the amounts of **\$2,251.53, \$5,044.04, and \$10,780.00** for the years 1978, 1979, and 1980, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 29th day Of July , **1986**, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Bennett, Mr. **Dronenburg** and Mr. Harvey present.

Richard Nevins....., Chairman
William M. Bennett....., Member
Ernest J. Dronenburg, Jr......, Member
Walter Harvey*....., Member
....., Member

*For Kenneth Cory, per Government Code section 7.9

BEFORE THE STATE **BOARD** OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
LYNN P. AND SANDRA **K.** JENSEN) No. **84A-717-PD**

ORDER DENYING PETITION FOR REHEARING

Upon consideration of the petition filed August 25, 1986, by Lynn P. and Sandra K. Jensen for rehearing of their appeal from the action of the **Franchise** Tax Board, we are of the opinion that none of the grounds set forth in the petition constitute cause for the granting thereof and, accordingly, it is hereby denied and that our order of July 29, 1986, be and the same-is hereby affirmed.

Done at Sacramento, California, this 17th day of November, 1987, by the State Board of Equalization, with Board **Members** Mr. Collis, Mr. Dronenburg, and Ms. Baker present.

Conwav H. Collis	, Chairman
Ernest J. Dronenburg, Jr.	, Member
Anne Baker*	, Member
	, Member
	, Member

*For Gray Davis, per Government Code section 7.9