BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of BROOKFIELD MANOR, INC., TAXPAYER, AND CHRISTIE F. SMITH, HAVILAND V. SMITH, FRANCES F. SMITH, DONNA S. POMEROY, ASSUMERS AND/OR TRANSFEREES AND HAVILAND V. AND FRANCES F. SMITH, CHRISTIE F. SMITH AND DONNA S. POMEROY	)	Nos. 83A-18-KP 82A-2090

. Appearances:

For Appellants: Thomas H. McPeters
Attorney at Law

For Respondent: Terry L. Collins
Counsel

O P I N IO N

This appeal is made pursuant to section 25666 1/ of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Brookfield Manor, Inc., Taxpayer, and Christie F. Smith, Haviland V. Smith, Frances F. Smith, Donna S. Pomeroy,. Assumers and/or Transferees., and pursuant to section 18593 from the action of the Franchise Tax Board on the protests of Haviland V. and Frances F. Smith, Christie F. Smith, and Donna S. Pomeroy against proposed assessments of franchise tax and additional personal income tax in the amounts and for the income year ended or taxable years as follows:

1/ Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the income year ended or taxable year in issue,

Appeals of Brookfield Manor, Inc., Taxpayer, and Christie P. Smith, Haviland V. Smith, Frances P. Smith, Donna S. Pomeroy, Assumers and/or Transferees and Haviland V. and Frances F. Smith, et .

Appellants	Income Year Ended or Taxable Year	Proposed Assessments
Brookfield Manor, Inc., Taxpayer, and Christie F. Smith, Haviland V. Smith, Frances P. Smith, Donna S. Pomeroy, Assumers and/or Transferees	10-31-78	$124,393.00
Haviland V. and Frances F. Smith	1978	110,801.54
Christie P. Smith	1978	13,846.00
Donna S. Pomeroy-	1978	13,782.92

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The issues presented by this appeal are: (1) whether, under the Court Holding Company doctrine, an *exchange* of property was made by appellant Brookfield Manor, Inc. (hereinafter "Brookfield"), or by the individual appellants who were shareholders of Brookfield; (2) whether the exchange of the properties in question constituted a tax-free like-kind exchange; (3) whether additional income should be attributed to the individual appellants as a result Of the, liquidation of Brookfield; and (4) alternatively, -if the Court Holding Company doctrine does not apply, whether Brookfield and its shareholders must recognize additional income as a result of the satisfaction of corporate debts by the distribution of appreciated corporate assets.

Brookfield, until its dissolution in 1978, was a California corporation which, operated a mobile home park, The individual appellants were all of the shareholders of Brookfield. In August 1978, Brookfield began negotiations with a third party to exchange its mobile home park for another unspecified piece of property and, on August 22, an escrow was opened. On September 14, the name of Brookfield was deleted from the escrow instructions and the names of the shareholders were substituted. In addition, it was provided that the mobile home park was to be exchanged for a medical building: no other provisions of the escrow instructions were changed. On September 27, 1978, Brookfield adopted a plan to effect a one-month liquidation . On or before October 28, Brookfield purported to "distribute" the mobile home park to its shareholders with each shareholder receiving a proportionate interest in the property. Brookfield was dissolved on October 31, 1978. The exchange of properties occurred on November 9, 1978.

After examining copies Of the escrow files during an audit, the Franchise Tax Board attributed the exchange of properties to Brookfield, rather -than the shareholders, based on the U.S. Supreme Court decision in Commissioner v. Court Holding Co., 324 U.S. 331 [89 L.Ed. 981] (1945) The Franchise Tax Board determined that Brookfield negotiated-the exchange and entered into a binding agreement to effect the exchange. Thereafter, the shareholders' names were substituted on the agreement for Brookfield's, and the transaction was completed on the same terms as those negotiated by Brookfield, Under this interpretation, the gain on the exchange, which increased the corporation's earnings and profits, was taxable to the corporation, while under the one-month liquidation rules the Shareholders were also taxable on the liquidating distribution to the extent of their ratable shares of the increased

earnings and profits. A Notice of Proposed Assessment (NPA) was issued against Brookfield early in 1983. NPA's ward also issued against the shareholders.

As the California statutes and the general principles of law controlling this issue are substantially similar to their federal counterparts, the determinations of federal courts construing the applicable federal law are entitled to great weight in interpreting the corresponding state law. (See Meanley v. McColgan, 49 Cal.App.2d 203 [121 P.2d 45] (1942).)

The factual situation presented by the present case is not unlike the situation in Commissioner v. Court Holding Co., 324 U.S. 331 [89 L.Ed. 9811 (1945). In Court Holding Co., all of the shares of the closely held corporation were owned by a husband and wife. Prior to its dissolution, the corporation arranged for the sale of its property. Subsequently, the corporation discovered that if the purchase was consummated as structured, the corporation would incur a large tax liability. Consequently, the taxpayers dissolved the corporation, distributed the property, and sold the property as individuals. In ruling that the sale was properly attributed to the corporation, the Supreme Court stated that:

> the transaction must be viewed as a whole, and each step, from the commencement of negotiations to the consummation of the sale, is relevant . . . To permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities, would ser-iously impair the . . . administration of the tax policies of Congress.

(Commissioner v. Court Holding Co., supra, 324 U.S. at 334.)

After several appellate decisions, including United States v. Cumberland Public Service Co., 338 U.S. 451 [94 L.Ed. 251] (1950), refined the theory put forth in the Court Holding Company case, the Court of Appeals in Hines v. United States, 477 F.2d LO63 (5th Cfr. 1973), applied the following contemporary standard:

> Only if the corporation in fact participated in the sale transaction, by negotiation, prior agreement, post-distribution activities, or participated in any other

> significant manner, could the corporation be charged with earning the income sought to be taxed.

(Hines v. United States, supra, 477 F.2d. at 1069-70.) (Emphasis original.)

In applying these principles to the present appeal, we find that Brookfield took an active role in the exchange. Brookfield negotiated the essence of the exchange with the third party prior to Brookfield's dissolution. Eventually, the exchange was conducted under substantially the same terms as originally agreed to by Brookfield and the third party. Further, there is absolutely no evidence that the individual taxpayers conducted any negotiations on their own behalf with the third party. Finally, very little time elapsed between the corporate negotiations and the final exchange. (Cf. United States v. Cumbetland Public Service Co., supra.) Consequently, we find that the sale of the property in question must be attributed to Brookfield.

Since we have found that the sale was properly imputed to Brookfield, we next must consider whether the exchange constituted a tax-free like-kind exchange.

Section 24941 provides that no gain or loss shall be recognized "if property held for productive use in trade or business or for investment ...is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment." To qualify for nonrecognition under the statute, both the property transferred and the property received must be held either for productive use in a trade or business or for investment. (Bolker v. Commissioner, 81 T.C. 782 (1983), affd. 760 F.2d 1039, 1045 (9th Cir. 1985); Treas. Reg. § 1.1031(a)-1(a).) The holding requirement cannot be satisfied by an intent to liquidate the newly acquired property. (Cf. Bolker v. Commissioner, supra; Magneson v. Commissioner, 81 T.C. 767 (1983), affd. 753 F.2d 1490 (9th Cir. 1985).)

Appellants reliance on Bolker v. Commissioner, supra: and Magneson v. Commissioner, supra, is misplaced. In Bolker a corporation liquidated and distributed its major asset, a tract of land, to its shareholder who, in turn, exchanged the land for other real property. The tax court first held that the shareholder, and not the corporation, was the party to the exchange. (Bolker v. Commissioner, supra, 81 T.C. at 801.) The taxing authority then argued that the shareholder did not

hold the property for either business or idvestment purposes since the intent was to immediately exchange the property for other property, *a* purpose inconsistent with a nontaxable exchange. The court of appeals rejected the governments position, holding that if the taxpayer does not intend to *liquidate* or to use the newly acquired property for personal pursuits he is "holding" that property "for productive use in trade or tusiness or for investment. within the meaning of the statute. (Bolker v. Commissioner, supra, 753 F.2d at 1045.) The intent to exchange property for like-kind property satisfies the holding requirement because it is not an intent to liquidate the investment *or to* use it for personal pursuits. (Id.) In the present appeal, to the contrary, Brookfield intended to, and, in fact, did liquidate the property, therefore, disqualifying the exchange.

In Magneson, the taxpayer entered into a like-kind exchange and then contributed the newly acquired property to a partnership. Each. transaction, viewed separately, was admittedly tax free, but viewed in combination they raised the question whether immediate contribution of the newly acquired property to a partnership satisfies the holding requirement. The court of appeals found that it did, holding that the contribution to the partnership was merely a change in form of ownership not the relinquishment of ownership. (Magneson v. Commissioner, supra, 753 F.2d at 1492-97.) The holding in Magneson is distinguishable *from* this appeal where Brookfield relinquished its ownership interest in the newly acquired property when it'distributed that property to the shareholder.

Therefore, since the holding requirement of section 24941 was not satisfied, we conclude that Brookfield's exchange was not tax free. Accordingly, the realized gain must be recognized in the income year ended October 31, 1978, the year in which the transaction was consummated.

Since Brookfield's property exchange was a taxable event, the final question is the proprierty of the Franchise Tax Board's determination that additional income should be attributed to the individual appellants as a result of the liquidation of Brookfield.

Under the one-month liquidation rules contained in section 17402, subdivision (e), each shareholder must recognize gain realized on the distribution of property in liquidation as ordinary dividend income to the extent of his or her ratable share of earnings and profits as determined at the close of the *month* of liquidation. Brookfield's earnings and profits *were*

increased by the amount of recognized gain from the exchange reduced by the amount of additional taxes accrued to the corporation as a result of that gain (see Rev. & Tax. Code, SS 24484024497.) Appellants have not offered any argument or evidence to offset the Franchise Tax Board's determination with regard to the amount of taxes owed by the individual appellant/ shareholders. Consequently, we must uphold the determination. (See Appeal of Guild Savings and Loan Association, Cal. St, Bd. of Equal., Feb. 5, 1985.)

As we find for the Franchise Tax Board on the first three issues on appeal; there is no need to address the alternative argument presented by the fourth issue. Accordingly, the actions of the Franchise Tax Board in this matter must be sustained,

Appeals of Brookfield Manor, Inc., Taxpayer, and Christie F. Smith, Haviland V. Smith, Frances F. Smith, Donna S. Pomeroy, Assumers and/or Transferees and Haviland V. and Frances F. Smith, et al.

ORDER

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 protests of Brookfield Manor, Inc., Taxpayer, and Christie F. Smith, Haviland V. Smith, Frances F. Smith, Donna S. Pomeroy, Assumers and/or Transferees and pursuant to section 18595 from the action of the Franchise Tax Board on the protests of Haviland V. and Frances P. Smith, Christie F. Smith, and Donna S. Pomeroy against proposed assessments of additional franchise tax and personal income tax in the amounts and for the income year ended or taxable year as follows:

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be and the same is hereby sustained.

Done at Sacramento, California, this 11th day of January, 1989, by the State Board of Equalization, with Board Members Hr. Carpenter, Mr. Collis, Mr. Bennett, and Mr. Davias present.

Paul Carpenter, Chairman

Conway H. Collis, Member

William M. Bennett, Member

John Davies* **, Member

, Member

*For Gray Davis, per Government Code section 7.9

**Abstained