

M e m o r a n d u m

495.0736.720

To: Mr. Fred T. Larsen

Date: September 16, 1953

From: W. W. Mangels

Subject: X-----

As I understand the facts, X----- formed the X Corporation in 1947, each contributing \$500.00 to the corporation and each receiving a \$500.00 shareholding interest. The corporation was created to engage in the business of buying and selling objects of art. X-----, during the three or four years of operation, loaned \$224, 681.00 to the X Corporation. In the fourth quarter of 1951, when dissolution of the corporation was effected, X----- received all the paintings on hand from the X Corporation valued at \$187,292.97 by the X Corporation. In his books he debited the asset "Paintings" in this amount, and debited "Bad Debts" for \$37,388.03, and, of course, credited "Accounts Receivable" for \$224,681.00. Below the entry was the following statement in X----- books: "to record receipt of paintings accepted by X----- at cost as creditor of X Corporation which dissolved 7-25-51."

I understand that X----- claimed the \$37,388.03 as a short-term capital loss deduction on his 1951 calendar year Federal Income Tax return as a non-business bad debt under Section 23(K)(4) of the Federal Internal Revenue Code.

I further understand that no assets were distributed to X----- at this time. I understand that the balance sheet at the end of 1950 was as follows:

Assets		Liabilities	
Cash	13.25	Loans Payable	\$223,819.74
Paintings	187,292.97	Capital Stock	<u>1,000.00</u>
Organization			224,819.74
Expense	449.76	Less Operating	
		Deficit	<u>37,063.76</u>
Total	<u>\$187,755.98</u>		<u>\$187,755.98</u>

X----- claims that he did not purchase the paintings, that there merely was an exempt distribution to him of his capital investment.

In my opinion the use tax should apply, there being a purchase and the sales price being \$187,292.97. Clearly the moneys transferred to the X Corporation were handled by the parties as a loan. When the paintings were transferred to X----- the transaction was handled as a transfer of title to satisfy a loan on X----- books. X----- took a deduction for a loan on his 1951 Federal Income Tax return. X----- contends that he never loaned money to the corporation, that he only invested capital and that it would be so regarded by the Federal Income Tax authorities. However, X----- did not so handle this matter on his 1951 Income Tax return. Furthermore, the entire transaction took the form of a loan followed by partial satisfaction of that loan. There was no distribution to the shareholders. In fact, there was an operating deficit.

In other words, it appears that X Corporation has transferred title to the paintings to satisfy a creditor of the corporation. this claim had to be satisfied before assets could be distributed to the two shareholders.

For the tax to apply X Corporation, of course, must be a retailer, as that term is defined in Section 6015(b) of the California Sales and Use Tax Law.

W. W. Mangels

WWM:ja