

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition

of

ROBERT FANCHER

DECISION

for Redetermination of a Deficiency or for
Refund of Personal Income Tax under Article 22 :
of the Tax Law for the Years 1979 and 1980.

Petitioner, Robert Fancher, 107 Laural Avenue, Binghamton, New York 13905, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the years 1979 and 1980 (File No. 38878).

A hearing was held before Dennis M. Galliher, Hearing Officer, at the offices of the State Tax Commission, 164 Hawley Street, Binghamton, New York, on November 17, 1986 at 1:15 P.M., with all briefs to be submitted by January 9, 1987. Petitioner appeared by James M. Barber, Esq. The Audit Division appeared by John P. Dugan, Esq. (Deborah J. Dwyer, Esq., of counsel).

ISSUE

Whether certain monies transferred to petitioner Robert Fancher from a corporation of which he **is** president and sole shareholder should be construed as constructive dividends rather than as bona fide loans.

FINDINGS OF FACT

1. Petitioner, Robert Fancher, timely filed New York State income tax resident returns for each of the years 1979 and 1980, as well as a timely amended return for 1980, listing "bartender" **on** each of such returns as his occupation. Petitioner was also the sole shareholder and officer of a corporation

the ground floor of premises located at 201-203 State Street, Binghamton, New York ("the premises"). These premises also included upper level floors with a total of four separate apartment units, which units prior to 1980 were in need of major renovations.

2. Prior to January 29, 1980, the premises were owned by one Mr. Renda from whom Lenny's rented its space. As the result of discussions between petitioner and Mr. Renda concerning Lenny's then-expiring lease and the amount of rent sought for renewal, an agreement was reached whereby petitioner would purchase the premises for \$50,000.00 and Mr. Renda would hold a first mortgage. Petitioner had sought to obtain bank financing for the purchase, but was unable to do so.

3. It was petitioner's intent, upon purchasing the premises, to lease the ground floor premises to Lenny's and to renovate the apartment units. Ultimately, over a period of time, the apartment units were redesigned and renovated such that twelve apartment units were created in place of the original four. In addition, the ground floor was, as intended, leased to Lenny's.

4. Offered in evidence was a handwritten agreement, prepared by and in the handwriting of petitioner's counsel on the day of the closing for the purchase of the premises. This handwritten agreement, offered as evidence of a loan agreement between petitioner and Lenny's, and prepared at the suggestion of petitioner's business advisor to have evidence of a loan, provided as follows:

"L L Inc. [Lenny's Lounge, Inc.] and R F [Robert Fancher] agree in consideration of the following to a loan agreement.

RF is about to purchase a building at 201-203 State Street, Binghamton for the sum of \$50,000.00.

L L Inc. agrees to lend him the sum of \$7000.00

The terms of payment are interest only until the mortgage **on** the property due Renda is paid in full then the principal loaned shall be amortized over a 20 year period at 9% interest.

The rent of the 1st floor premises is fixed at \$850.00 per month and shall run for a period of 4 1/2 years and shall include utilities. Responsibility of repairs/maintenance shall rest **on** L L Inc.

The parties agree to apply the rent to the loan repayment and any excess **loan** repayment shall be paid by R F to L L **Inc.** monthly.

x Lennys Lounge Inc. by

President

Jan. 29, 1980

x R Fancher

James M. Barber

Landlord/borrower"

5. The \$7,852.78 amount in paragraph three of the above agreement was computed as and represents the difference between the amount of the mortgage held by Mr. Renda and the amount of money necessary to complete the closing of title on the premises. The actual transfers of money from Lenny's to petitioner occurred at various times and in various amounts during the period **in** question. The largest of such transfers was a transfer of \$20,800.00, occurring just prior to the closing, for use **in** purchasing the premises and in the planned remodelling thereof.

6. In or about the middle of June 1981, a field audit of petitioner was conducted by the Audit Division wherein it was determined that the monies advanced to petitioner by Lenny's, as well as certain expenditures made by Lenny's to pay certain expenses of a personal nature for petitioner, were in fact constructive dividends rather than loans to petitioner.

7. **On** June 17, 1982, the Audit Division issued a Notice of Deficiency to petitioner, asserting additional personal income tax due from petitioner for 1979 and 1980 in the amount of \$4,038.58, plus interest. A Statement of Personal

provided information with respect to the amounts deemed constructive dividends, as follows:

"EXPLANATION;	<u>1979</u>	<u>1980</u>
Personal items paid for by Lenny's Lounge, Inc. are held to be a dividend.	700.00	511.00
Corporate distributions on your behalf are held to be dividends	3570.00	28772.00
Less Dividend Exclusion	<u>(100.00)</u>	<u>(100.00)</u>
Net Adjustment	4170.00	29183.00
Taxable Income Previously Stated	<u>12629.00</u>	<u>10261.00</u>
Corrected Taxable Income	<u>16799.00</u>	<u>39444.00</u>
Tax on Corrected Taxable Income	1039.90	4082.00
Minimum Income Tax (See attached IT-220)		
Add: New York City Tax		
Less: Credits Household Credit	<u>35.00</u>	<u>0</u>
Corrected Tax Due	1004.90	4082.00
Tax Previously Computed	<u>615.32</u>	<u>433.00</u>
Total Additional Tax Due	389.58	3649.00"

8. The amounts considered as payments for items of petitioner's personal expense during each year comprised a number of relatively small amounts, some of which were recurring, paid to, among others, "Little Venice", "Broadway Theatre League", "Cider Mill Theatre", etc. No explanation concerning these payments was offered by petitioner at the hearing.

9. The amounts deemed dividends rather than loans to petitioner were reflected in Lenny's ledger sheets as "notes receivable" from petitioner. The advances were made at various times and in varying amounts,¹ Some of the

1 There is no specific loan of \$7,852.78 reflected on the ledger sheets. Rather, as noted, such amount was calculated as the amount needed to consummate the closing on the day of the closing.

entries reflected a notation of "for rental building" and "9% interest", while others reflected "auto" and "no interest stockholder". Still other entries reflected no notation at all.

10. No notes were provided with respect to the alleged loans, other than the handwritten January 29, 1980 agreement (see Finding of Fact "4"). There is no record of corporate minutes authorizing the loans nor was a schedule of repayments established. The ledgers do not reflect any repayments and, in fact, the only repayments ever made were interest payments of \$400.00 (in April 1986) and \$3,883.00 (in May 1986), the latter of which represented the payment of imputed interest made to conform to United States Treasury Regulations.² Petitioner asserted that repayments were not made because of the existence and pendency of the deficiency at issue herein.

11. It is petitioner's assertion that the amounts in question were, in fact, loans to him from Lenny's and, as such, should not properly be deemed constructive dividends subject to personal income tax.

CONCLUSIONS OF LAW

A. That the Internal Revenue Code does not define what constitutes a loan. One common thread appearing in the repeated decisions, however, is that there must be an intent to repay the advance at the time it **is** made. (Genito v. United States, 80-2 USTC 119771 [1980]. The question of whether advances from a corporation to its shareholder(s) constitute dividends rather than loans is one of fact. (Wiese v. Commissioner, 93 F2d 921 [1938].)

B. That criteria in determining whether withdrawals of corporate funds by a sole stockholder constitute dividends or loans include treatment of the

withdrawals as loans or receivables on the corporate books, execution of notes evidencing the loans, availability of sufficient earned surplus to cover the withdrawals, evidence of some repayments, financial ability of the borrower to repay the withdrawals and personal guarantees or collateralization of the loans. (Purdy v. Commissioner, 26 TCM 409 [1967].) Additional criteria include the control of the corporation, its dividend history, size of the advances, whether the corporation imposed a ceiling on the amounts that might be borrowed and attempts to force repayment. (Dolese v. United States, 605 F2d 1146 [10th Cir], cert denied, 445 US 961 [1979].) Where, as here, a sole shareholder entirely controls the corporation, close scrutiny of the situation is warranted (Elliott J. Roschuni, 29 TC 1193 [1958], affd per curiam 271 F2d 267 [5th Cir 1959]).

C. That given the facts and circumstances presented, petitioner has not sustained the burden of proving that a bona fide debtor-creditor relationship was intended and created and was the primary purpose in mind at the times the various advances were made (see Katherine R. Lane, 28 TCM 890). In this regard, it is noted, inter alia, that the advances were made at varying times and in varying amounts, that no schedule of repayments was set, and that, other than the two interest payments, repayments were not made.

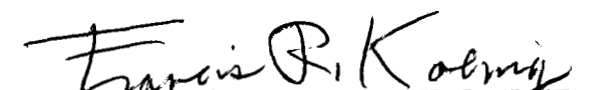
D. That the petition of Robert Fancher is hereby denied and the Notice of Deficiency dated June 17, 1982 is sustained.

DATED: Albany, New York

STATE TAX COMMISSION

APR 06 1987


PRESIDENT


COMMISSIONER