BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal

of

FRANK MIRATTI, INC.

Appearances:

For Appellant: Leo T. McMahon and T. Preston Webster, Attorneys at Law

For Respondent: Burl D. Lack, Chief Counsel; Hebard P. Smith, Associate Counsel

## O P I N I O N

This appeal is made pursuant to Section 25666 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Frank Miratti, Inc., to proposed assessments of additional tax in the amounts of $41.18, $59.08, $154.23 and $91.61 for the income years 1944, 1945, 1946 and 1947, respectively. The proposed assessments were based on adjustments in income for each year, some of which are not the subject matter of this appeal.

The questions presented have been reduced to three:

1. The determination of the correct basis for certain furniture and fixtures acquired and sold by Appellant.

2. Whether certain capital stock taxes accrued in 1943, but not taken as a deduction until 1944 and 1945 and now barred, may be recouped against the resulting de-' ficiencies for 1944 and 1945.

3. Whether compensation paid to Appellant's President' for 1947 was reasonable.

Upon the determination of the first question hinges the proper allowance for depreciation, and the amount of gain on sale, of the property involved.

The facts relating to the first question are as follows:

Appellant, Frank Miratti, Inc., is a California corporation. Certain furniture and fixtures were acquired by Appellant from Mr. Frank Miratti on January 1, 1944, as a contribution to paid in surplus and were recorded on Appellant's books at a value of $10,000. This figure is based on Appellant's determination of market value at the time of transfer, The Franchise Tax Board disallowed depreciation on these items for the income years 1944, 1945 and 1946 in the amounts of $1,000, $1,000, and $518.79, respectively. The disallowance resulted from the determination of the Board that the basis of the property should be cost to the transferor, and that upon information submitted by Appellant the cost basis to Mr. Miratti was $5,000.

In 1946 Appellant sold the furniture and fixtures. As theresult of the reduction in the basis thereof from $10,000 to $5,000 the Franchise Tax Board increased the reported gain on the sale for 1946 in the amount of $2,481.21.

Section 21(a)(6)(B) of the Franchise Tax Act was in effect for the taxable years in question. It provided, in substance, that the basis of property acquired by a corporation as paid in surplus should be the same as it was in the hands of the transferor; The basis in the hands of the transferor, Mr. Miratti, was controlled by Section 17741 of the Personal Income Tax Law, as then in effect. It prescribed that the basis of property should be its cost, except where otherwise provided in the act. No evidence was presented to bring the case of Mr. Miratti under the operation of another section, so it must be concluded that the proper basis was the cost to Mr. Miratti.

It does not appear that Appellant seriously disputes this conclusion, but, relying on the contention that no records are now available of the price Mr. Miratti paid for the property, he having died the year after the transfer, it offers secondary evidence to establish that the probable cost to Mr. Miratti was $10,000. This evidence tends to show that $10,000 was the fair market value at the time of the transfer to Appellant by Mr. Miratti, and that a sale two years later was considerably above that figure. At the hearing, Appellant cited Wheeler B. Gambee, 4 BTA 1234, in support of its position that such secondary evidence is proper as an indication of cost to the transferor. In that case Gambee had built and sold houses, and the problem was to determine the cost of the houses to him as a basis for arriving at his gain on the sales. In the absence of cancelled checks and other original indicia of cost, evidence consisting of his recollections and expert testimony as to cost was allowed to overturn the assessment of the commis-

missioner. It is clear that such evidence is far more direct and forceful than the evidence submitted here.

We acknowledge the propriety of secondary evidence in the absence of primary evidence, but it must stand on its merits of persuasiveness. If it were shown that Mr. Miratti's purchase was near the time of the transfer to Appellant, the probative effect of evidence as to fair market value at that time would be strengthened, but there is no such showing. And, even so, his purchase may well have been considerably above or below market value.

The substantial gain by Appellant on its sale is intended to show that the $10,000 valuation would be a very conservative estimate of the cost to Mr. Miratti. But it could as well indicate a steadily rising market from the time of Mr. Miratti's original purchase, thus supporting Respondent as effectively as Appellant.

Further, it should be pointed out, as Respondent states, that the determination of the Franchise Tax Board is prima facie correct, and the taxpayer has the burden of proving his case. While remote conjectures. might be drawn from the evidence presented in favor of Appellant, still it cannot be said that it has sustained the burden of proof incumbent upon it.

In addition to the affirmative proof presented, Appellant denies that any information was submitted from which Respondent could determine a basis of $5,000. Appellant then concludes that Respondent's determination is incorrect. However, even assuming that no such information was submitted, at best Appellant has merely shown that the Respondent's determination was not derived from such information. It has not shown that the determination is incorrect. In Edgar M. Carnrick, 21 BTA 12, it was stated that "It is not the Commissioner's method of determination or computation which is the substance of the proceeding, for the deficiency may be correct despite a weakness in arriving at it or explaining it. [citation] 'It is immaterial whether the Commissioner proceeded upon the wrong theory in determining the deficiencies. In any event the burden was on petitioner to show that the assessment was wrong.'" See also Jacob F. Brown, et al, 18 BTA 859.

It is unfortunate to reach a decision upon a failure to meet the burden of proof, but possibly not so unfortunate in this case as it might be in others. The desired information was peculiarly within the grasp of the Appellant. It was incumbent upon the Appellant to determine the proper basis

at the time of the transfer. The lack of available records is due to its own default. It cannot now be allowed to fall back upon its original dereliction to sustain its case.

Having failed to upset the basis affixed by the Franchise Tax Board, both the disallowance for depreciation based thereon, and the resulting gain on the sale as determined by Respondent must be sustained.

The second question presented concerns the application of the doctrine of recoupment. Appellant is on the accrual basis. Capital stock taxes in the amount of $500 accrued in 1943. Appellant' did not take a deduction for the amount in that year. In 1944 and 1945 Appellant paid the taxes and took the deductions in the amounts of $125 and $375 for those years, respectively, Respondent disallowed the deductions. Appellant does not dispute the disallowance of the deductions but contends it is entitled to recoupment of the overpayment for the year 1943. No refund claim was filed by Appellant and a refund or credit is barred by the statute of limitation unless Appellant is entitled to recoupment against the deficiencies for the years 1944 and 1945.

The allowance of a deduction is a matter of legislative grace (New Colonial Ice Co. Inc. v. Helvering 292 U.S. 435; White v. U. S., 305 U. S. 281) and it is incumbent upon the taxpayer, at least in the absence of estoppel, to take advantage of it within the limits of the statute. The failure of the taxpayer to claim the deduction in the year in which it is allowable, or to file a timely claim for refund of the overpayment, does not present a case for recoupment. Longyear Realty Corporation v. Kavanagh, 156 Fed. 2d 462. We conclude, accordingly, that the Appellant is not entitled to credit for its overpayment in 1943 against the deficiency for the years 1944 and 1945.

The third question involved in this appeal is whether the salary Appellant paid its president and sole stockholder, Mrs. Emma Miratti, for the year 194'7 was reasonable. Section 8(a) of the Franchise Tax Act, then in effect, permitted a deduction of "a reasonable allowance for salaries or other compensation for services actually rendered.?!

Mrs. Miratti's husband died in 1945. Before that time Mrs. Miratti and her husband had been actively engaged in the operation of a hotel business through Appellant, a family owned corporation. As sole stockholder and president of Appellant, Mrs. Miratti continued to operate the hotel until 1946. In that year the operating assets of Appellant were sold,

During the year 1947 Appellant paid Mrs. Miratti a salary of $7,200. This was the same compensation as that paid to her for 1946. Appellant asserts, however, that a

portion of the 1947 salary was compensation for services performed in prior years, particularly the advantageous disposal of the hotel operation in 1946. Mrs. Miratti's activities in 1947 included the disposal of approximately $13,000 worth of liquor, the defense of a suit against the corporation, the collection of accounts in an amount not stated and a search for a future location of the business.

While the Franchise Tax Board points out that salary allowed an owner and officer of a corporation demands close scrutiny (T. P. Taylor & Co. v. Glenn, 62 Fed. Supp. 4951, and that the burden of proof is on Appellant (Avery v. Commissioner; 22 Fed. (2d) 6; Greengard v. Commissioner, 29 Fed. (2d) 502), the claimed deduction must, nevertheless, be allowed if the compensation paid to Mrs. Miratti was reasonable in the light of the particular curcumstances involved. In determining the reasonableness of the compensation services performed for the corporation by Mrs. Miratt! in prior years may properly be taken into account. Lucas v. Ox Fibre Brush Co., 281 U. S. 115.

Upon due consideration of Mrs. Miratti's business experience, her services to the corporation prior to 1947 and the nature of her services in 1947, we think Appellant has sustained the burden of proving that the salary paid to Mrs. Miratti in 1947 did not exceed a reasonable compensation for services actually rendered.

## 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 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of Frank Miratti, Inc., to proposed assessments of additional franchise tax in the amounts of $41.18, $59.08, $154.23 and $91.61 for the income years 1944, 1945, 1946 and 1947, respectively, be and the same is hereby modified as follows: The Franchise Tax Board is hereby directed to allow as a deduction for the income year 1947 the amount of

$7,200 paid by Frank Miratti, Inc., to Mrs. Emma Miratti as compensation for services; in all other respects the action of the Franchise Tax Board is hereby sustained.

Done at Sacramento, California, this 23rd day of July, 1953, by the State Board of Equalization.

Wm. G. Bonelli, Chairman

J. H. Quinn, Member

Geo. R. Reilly, Member

Paul R. Leake, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary