

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
E. L. REITZ COMPANY)

For Appellant: Hugh J. Ritchie and John C. McCall,
Attorneys at Law

For Respondent: Burl D. Lack, Chief Counsel;
Peter S. Pierson, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of E. L. Reitz Company against a proposed assessment of additional franchise tax in the amount of \$825.79 for the income year 1959.

Appellant, a corporation dealing in lumber, acquired a boat in 1956 at a cost of \$95,978.92. In 1959, the boat was sold for \$62,000.00. During the appellant's ownership of the boat it was used for business purposes approximately 55 per-cent of the time. The remainder of the time appellant's sole shareholder, E. L. Reitz, used the boat for personal reasons.

In computing the loss it sustained on the sale, appellant allocated the original cost and the sales price between the use made of the boat for business reasons and the personal use made of it by Mr. Reitz. Depreciation attributable to the business use was \$8,423.16, and that amount was deducted from the portion of the cost basis which represented appellant's business use of the boat. The difference between the adjusted basis and the selling price was \$25,555.76. In its franchise tax return for the income year 1959, appellant deducted \$10,541.37, the amount attributable to its business use of the boat, as a capital loss resulting from the sale of a

Appeal of E. L. Reitz Company

depreciable asset. Appellant, also deducted the remainder, \$15,014.39, as a capital loss from the sale of a nondepreciable asset.

Respondent contends that no portion of a loss which is allocable to the personal use of a corporate asset by a shareholder may be deducted as a loss of the corporation. Appellant, on the other hand, argues that all losses incurred by a corporation are deductible pursuant to section 24347 of the Revenue and Taxation Code, which, unlike the loss provision for individuals (Rev. & Tax. Code, §17206), does not expressly limit the deduction to certain types of losses. Section 17206, allows individuals to deduct, in addition, to casualty and theft, losses, only those losses incurred in business or in transactions, for profit.

The United States Internal Revenue Code is similar to our law in limiting loss deductions by individuals and not specifically limiting loss deductions, by corporations. (Int. Rev. Code of 1954, §165(a) and (c), formerly Int. Rev. Code of 1939, §23(e) and (f).)

The federal authorities have held that only that part of a loss resulting from the sale of property used for both personal and business purposes that can be allocated to the business portion of the property constitutes a loss to an individual within the meaning of the federal law. (Rev. Rul. 286, 1953-2 Cum. Bull. 20; Share v. United States, 199 F. Supp. 743, aff'd per curiam, 303 F. 2d 783.)

We have discovered only one case dealing directly and at some length with the question of whether a corporation may deduct a nonbusiness loss. In that case, the Tax Court held that a corporation could not deduct a loss which was unrelated to its business. (James E. Caldwell & Co., 24 T.C. 597, rev'd on other grounds, 234 F.2d 660.) The court, at page 611, quoted the following statement made by Congressman Hull, a member of the Ways and Means Committee, in explaining the 1913 counterpart of section 23(f) of the Internal Revenue Code of 1939:

As to losses, these provisions primarily contemplate allowance for losses growing out of the trade or business from which the taxable income is derived, and generally

-Appeal of E. L. Reitz Company

termed trade losses, as distinguished from losses of capital or principal or losses incurred entirely apart from business **trans-**actions from which income is derived ...

Normally, of course, all losses of a corporation, unlike those of an **individual**, are connected with business **and** are not personal in nature. Where the loss is related to corporate-assets used by a **shareholder** for personal **purposes, however**, an unwarranted premium would be placed on corporate form if a loss deduction were permitted upon sale of the asset.

Appellant has argued that its stockholder paid for **his** personal use of the boat through disallowed depreciation and expense which **were** charged to him, making the situation equivalent to renting the boat to a third party. But this argument only focuses upon the impropriety of allowing the deduction sought by appellant. Where a stockholder uses a corporate asset for personal reasons, depreciation and expenses related to the use are disallowed as deductions by the **cor-**poration. (American Properties, Inc., 28 T.C. 1100, aff'd, 262 F.2d 150.) The disallowed expenses and the value of the use, which may be considered equivalent to **the disallowed** depreciation, are charged to the stockholder as income. (Bardahl Mfg. Corp., T.C. Memo., Dkt. No. 73285, Oct. 20, 1960.) If, upon sale of the asset, the corporation were to deduct a loss attributable to the stockholder's use it would **effectively** gain the unjustifiable advantage of deducting **the** accumulated depreciation*

Following the principle of James' E. Caldwell & Co., supra, 24 T.C. 597, together with that of Sharp v. United States, supra, 199 F. Supp. 743, we conclude that the portion of the 'loss attributable to the personal use of appellant's boat is not deductible.,',

ORDER!

Pursuant to the views expressed in the opinion of the board on file in this proceeding, 'and good cause appearing-' therefor;

Appeal of E. L. Reitz Company

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 protest of E. L. Reitz Company against a proposed assessment of additional franchise tax in the amount of \$825.79 for the income year 1959, be and the same is hereby sustained.

Done at Sacramento, California, this 3d day of February.;;, 1965, by the State Board of Equalization.

John W. Lynch, Chairman
Robert H. H. H., Member

Robert H. H. H., Member
Robert H. H. H., Member
Robert H. H. H., Member

ATTEST: Robert H. H. H., Secretary