BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
SIMPSON'S, INC.)

Appearances:

For Appellant: Donald D. Boscoe, Attorney at Law

For Respondent: Peter S. Pierson, Associate Tax Counsel

OPINION

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 Simpson's, Inc., against proposed assessments of additional franchise tax in the amounts of $201.70, $390.72, $821.40, $546.14, $641.30 and $686.36 for the income years ended July 31, 1954, 1955, 1956, 1957, 1958 and 1959, respectively.

Appellant was incorporated under California law on September 5, 1947, by Jack W. and Ruth Simpson, president and vice president, respectively, of the corporation. Appellant is the sole owner of 8 chain of individually incorporated retail jewelry stores located in Northern California. The stores are in Stockton, Napa, Sacramento, Pittsburg, Lodi, San Jose, Modesto, Richmond, Oroville and Turlock. Appellant does the buying and accounting and performs other managerial functions for the subsidiary corporations. The annual gross receipts of appellant and its subsidiaries are approximately $1,000,000.

Mr. Simpson spent a considerable amount of appellant's funds in traveling among the stores in the chain several times a month, on trips to suppliers in the East about three times a year and on buying trips to Southern California; He extensively entertained the officers and employees of the suppliers on his trips to their headquarters as well as on occasions when they came to the West Coast. The primary purpose of this entertainment was to facilitate obtaining merchandise on credit far in

excess of normal trade practices. Mr. Simpson and his wife, who was the buyer of various items sold in the jewelry stores, sometimes joined the president. of the principal supplier and his family for a week or two in such locations as Southern California, Florida and Las Vegas, Nevada. *On these* occasions, all expenses for both families were paid by appellant.

Staff meetings of 15 to 25 employees were'held about 10 times a year, sometimes in the Simpson home, where dinner and refreshments were served and'a maid and caterer were employed, and at other times in hotels or restaurants. Each year, a summer picnic and Christmas party were attended by from 75 to 150 employees. On his trips among the stores in the chain, it was Mr. Simpson's practice to take employees of the stores to lunch or dinner. Whenever employees traveled. with Mr. Simpson, appellant paid all of their bills as well as those of suppliers and other jewelry store owners entertained in their presence. On many trips, Mrs. Simpson joined her husband and her expenses were likewise paid by appellant,

After auditing appellant's returns respondent disallowed large portions of the travel and entertainment expense deductions for lack of substantiation. Certain expenses incurred by Mr. Simpson in the securing of new leases were disallowed as ordinary and necessary business expenses on the ground that such'expenditures were capital in nature. In addition, respondent disallowed approximately 60 percent of all automobile expenses claimed by appellant.

The following schedule shows the travel and entertainment expense deductions claimed for each income year and the amounts finally allowed by respondent:

	Amount claimed'	Amount allowed
Income year ended 7/31/54	$ 7,074.17	$ 2,957.33
Income year ended 7/31/55	12.273.27	4,892.10
'Income year ended 7/31/56	20,034.44	[illegible]
Income year ended 7/31/57	13,714.15	5,561.79
Income year ende/57/31/	18,761.23	83386.79
Income year ended 7/31/59	15,892.32	8,230.98
Total	$87,749.58	$36,353.31

Appellant maintained monthly travel and entertainment expense vouchers which allegedly reflected Mr. Simpson's expenditures for those purposes on behalf of the corporation, *The* vouchers Indicate the name of the payee, the amount of the

expense, and its general nature, e.g., hotel, entertainment of employees, travel, Usually no further explanation of the expenditure was given in the voucher entry, and repeated entries indicate only a cash disbursement to Mr. Simpson. Appellant contends that cash was used in order to impress suppliers, and that, as a result, receipts were not generally obtained. Other evidence of the expenditures is a series of letters from suppliers and employees of the chain who were among the recipients of Mr. Simpson's hospitality during the period in question. All state that they were entertained lavishly by the Simpsons on numerous occasions.

Respondent contends that these monthly vouchers and the statements of suppliers and employees of appellant's stores are insufficient to substantiate the total alleged expenditures for travel and entertainment as ordinary and necessary business expenses,

Section 24343, subdivision (a) of the Revenue and Taxation Code allows as a deduction all "ordinary and necessary expenses paid or incurred during the income year in carrying on any trade or business." A tax deduction is a matter of legislative grace, and the burden is on the taxpayer to prove he is entitled to it. (New Colonial Ice Co. v. Helvering, , 292 U.S. 435[78 L. Ed. 1348].)

Appellant's records fall short of the desired standards for complete substantiation of such expenses. As we have previously stated, "Truly adequate records will establish the business nature of the expenditure; the date, place and amount of the expenditure; the recipient of the funds expended; and the nature of the product or service received." (Appeal of National Envelope Corp., Cal. St. Bd. of Equal., Nov. 7, 1961.) Appellant's voucher entries did *not* furnish this information, and it does not appear that any contemporaneous memoranda were made by Mr. Simpson.

We believe, however, that this is a proper case for application by us of the so-called "Cohan rule;" which provides for the making of an approximation of expenditures of this type where it is clear that 'something was spent' but where the taxpayer's records are so inadequate that it is impossible to determine with *any* accuracy just how much was spent for business purposes. (Cohan v. Commissioner, 39 F.2d 540. See also, Stanley C. Olson, T.C. Memo., Dkt. Nos. 64836-64838, April 9, 1958.)

The letters from suppliers and employees of appellant's stores which appear in the record reinforce the conclusion that substantial amounts were paid out for travel and entertainment, although it has not been established that all of

the items claimed were ordinary and necessary expenses of the business, The record does not permit an exact apportionment, but we are persuaded that appellant is entitled to deduct more than has been allowed by respondent. Making what appears to be a reasonable estimate, taking into consideration the gross receipts of the business and the number and extent of the trips, staff meetings and office functions involved, we conclude that appellant is entitled to deduct 75 percent of the travel and entertainment expenses claimed each year, exclusive of expenses Involved in securing new leases. It is well settled that all expenses involved in acquiring a leasehold are capital in nature, and are to be amortized over the life of the lease.' (Bonwit Teller & Co. v. Commissioner, 53 F.2d 381, cert. denied, 284 U.S. 690 [76 L. Ed. 582]; Arthur T. Galt, 19 T.C. 892, aff'd on other grdunds, 216 F.2d 41.)

We must sustain respondent in its disallowance of approximately 60 percent of the automobile expenses claimed by appellant as ordinary and necessary business expenses. Respondent states that the disallowance was based on a -finding that an estimated 60 percent of the auto expenses were incurred in the use of automobiles by Mrs. Simpson and. her son. Appellant has failed to introduce any evidence whatever to prove that such expenditures by members of Mr. Simpson's family were in any way related to the business.--In the absence of such proof, respondent's determination as to this item must stand.

ORDER.

'pursuant to the views expressed in the opinion of the board on file In this proceeding, and good cause appearing therefor, . . .

Appeal of Simpson's, Inc.

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 Simpson's, Inc., to proposed assessments of additional franchise tax in the amounts of $201.70, $390.72, $821.40, $546.14, $641.30 and $686.36 for the income years ended July 31, 1954, 1955, 1956, 1957, 1958 and 1959, respectively, be and the same is hereby modified in accordance with the opinion of the board.

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

Dan W. Lynch, Chairman

Richard Nevins, Member

_____, Member

Geo. R. Reilly, Member

_____, Member.

Attest _____, Secretary