67-SBE-019

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
WALTER J. AND SHEILA D. COYNE)

Appearances:

For Appellants: John E. Schaeffer
Attorney at Law

For Respondent: Peter S. Pierson
Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Walter J. and Sheila D. Coyne against a proposed assessment of additional personal income tax in the amount of $1,137.81 for the year 1961.

Appellant Sheila D. Coyne appears as a party herein only by virtue of the filing of a joint income tax return. Her husband, Walter J. Coyne, will be referred to hereafter as "appellant."

In 1961 appellant, sole stockholder and chief executive officer of Coyne Tempered Glass Products and Marin County Glass Co., Inc., spent $10,483.53 for travel, entertainment, and general business expenses on behalf of the corporations. During that year the two corporations together lost more than $85,000. At that time appellant's only occupation was the promotion and management of those two business enterprises, which processed and sold specialized glass products. Appellant drew no salary in 1961. No attempt was made by appellant to secure reimbursement from either company because this would have further damaged the companies' already tenuous credit standing and, according to appellant, would have injured his reputation as promoter and manager of such enterprises. Appellant deducted the amount expended as an ordinary and necessary business expense. Respondent Franchise Tax Board disallowed the deduction.

Appellant contends that the expenditures are deductible under section 17202 of the Revenue and Taxation Code or, in the alternative, under section 17252 of that code. Section 17202 provides, in part, that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred in carrying on any trade or business. Section 17252 provides, in part, that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income.

We shall assume, without deciding, that the expenses were ordinary and necessary business expenses of the corporations, properly deductible by them if appellant were reimbursed. However, in construing the federal counterparts of the above statutory provisions, it has been held that unreimbursed payments made by a stockholder in behalf of the corporation for travel, entertainment, and other business expenses, are not "ordinary" expenses insofar as the stockholder is concerned, and, therefore, the stockholder may not deduct them. (Harry Kahn, 26 T.C. 273; H. William Ihrig, 26 T.C. 73; Harry A. Worth, T.C. Memo., Dkt. No. 78891, Feb. 17, 1961; William Ockront, T.C. Memo., Dkt. No. 1231-65, March 22, 1966; Jacob M. Kaplan, 21 T.C. 134; Andrew Jergens, 17 T.C. 806; Hal E. Roach Studios, 20 B.T.A. 919. See also Deputy v. du Pont, 308 U.S. 488 [84 L. Ed. 416].) In H. William Ihrig, supra, the stockholder made expenditures on behalf of the corporation but had no expectation of reimbursement because corporation funds were not available. In Harry A. Worth, supra, the stockholder had expected to be reimbursed but was not because the corporation was not in a financial position to repay him. In William Ockront, supra, reimbursement was sought but the corporation was unable to pay. In Harry Kahn, supra, the corporation was also in a shaky financial position. In all of these cases the deductions were disallowed.

In Charles J. Dinardo, 22 T.C. 430; Cubbedge Snow, 31 T.C. 585; Lutz v. Commissioner, 282 F.2d 614; Fall River Gas Appliance Co., 42 T.C. 850, aff'd on another issue, 349 F.2d 515, all cited by appellant, the taxpayer's business or business in which the taxpayer was a partner was directly benefited and directly protected or preserved separately and distinctly from the benefit to the corporation to which financial assistance was given. Therefore, unlike appellant, those taxpayers were entitled to a deduction under the federal counterpart of section 17202.

While appellant also cites Foss v. Commissioner, 75 F.2d 326, as authority for the view that he was engaged in a trade or business for which these expenditures were properly deductible under section 17202, that case is readily distinguishable. The vast extent of the activities of the taxpayer in that case, the number of corporations in which he invested and in which he was an officer or director, or otherwise active, and his maintenance of an office to manage the investments contrasts Foss' situation with appellant's.

Appellant cites Trust of Mary Lily Bingham v. Commissioner, 325 U.S. 365 [89 L. Ed. 1670], and William P. Toms, T.C. Memo., Dkt. No. 7417, March 13, 1946, for the position that appellant's expenses were deductible under section 17252. The Bingham case involved legal fees paid relating to contesting taxation of the appreciated value of securities held in trust and fees paid for legal advice concerning payment of a particular legacy and other considerations relating to distribution. William P. Toms was concerned with legal expenses in defending a breach of contract suit to sell stock. Again, those factual situations are not in the least parallel to appellant's situation.

Appellant further contends that the acts and obligations of the corporations here may properly be recognized as those of appellant and vice versa, thereby enabling the expenditures to be deductible. He refers to a legal principle that the corporate entity may be disregarded if a corporation is not only influenced and governed by a particular person but there is further such a unity of interest and ownership that the separateness of the corporation has never existed, or has substantially ceased to exist, and the facts are such that adherence to the fiction of separate existence would promote unfairness or injustice. However, we know of no case applying this principle merely because a stockholder owning all of a corporation's stock pays expenses on behalf of the corporation.

Lastly, appellant maintains that the reasoning which underlies one of the principal authorities relied upon by respondent, i.e., that the expenses incurred by a principal stockholder in behalf of a corporation cannot be deducted by the stockholder because there is no relationship between his income and the corporate income, does not preclude such deductions where, as here, there has been an election to report the corporate income for federal income tax purposes under the provisions of subchapter S of the Internal Revenue Code of 1954. Subchapter S (Int. Rev. Code, §§ 1371-1377) was added to the Internal Revenue Code in 1958. In general, its sections permit the stockholders of a closely held corporation to elect to pay personal income tax on the corporation's earnings, whether or not they are distributed, thereby exempting the corporation itself from corporate income tax. Thus, the income is taxed essentially as if the business were operated as a partnership. (William Pestcoe, 40 T.C. 195.) There is no comparable California legislation, however, and an election under subchapter S does not, at the state level, alter the status of the corporation or its shareholders or affect the tax consequences of transactions between them. (Appeals of David W. and Marion Burke, et al., Cal. St. Bd. of Equal., Oct. 27, 1964.)

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 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Walter J. and Sheila D. Coyne against a proposed assessment of additional personal income tax in the amount of $1,137.81 for the year 1961, be and the same is hereby sustained.

Done at Sacramento , California, this 24th day of April , 1967, by the State Board of Equalization.

Paul R. Leake, Chairman

John W. Lynch, Member

[signature], Member

[signature], Member

________________, Member

ATTEST: [signature], Secretary