

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
OILWELL MATERIALS & HARDWARE CO., INC. )

Appearances:

For Appellant: Leonard T. Cain  
Attorney at Law

For Respondent: John D. **Schell**  
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 protests of **Oilwell Materials & Hardware Co., Inc.**, against proposed assessments of additional franchise tax in the amount of \$33.00 for each of the taxable years 1962, 1963, 1964, 1965, and 1966.

Appellant is a California corporation engaged in the business of selling retail hardware and oil well equipment. It was incorporated August 7, 1962, as **successor to a sole proprietorship doing business under** the same name. All of appellant's stock is owned by Jack A. and Norma E. Dole, who are appellants in a companion case also decided today. Jack **Dole** is president and director of appellant and controls its operations. Norma Dole is vice president and director, and Leonard T. Cain is appellant's secretary-treasurer as well as attorney for both appellant and the Doles.

The issue presented on this appeal is the propriety of respondent Franchise Tax Board's disallowance of **\$600.00** of the business expense deductions claimed by appellant in each of the appeal-years. Respondent determined that this portion of the claimed deductions in

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each year represented expenditures for the personal benefit of appellant's stockholders rather than expenditures for ordinary and necessary business expenses which are deductible under section 24343 of the Revenue and Taxation Code. During the years at issue, appellant claimed the following expenses :

<u>Year</u>	<u>Auto Operations</u>	<u>Travel and Entertainment</u>	<u>Advertising</u>
1962	\$ 643.77	\$1,540.26	\$1,726.93
1963	1,769.00	2,929.10	2,314.09
1964		2,661.46	2,372.09
1965	1,680.64	3,194.42	2,435.28

Apparently through oversight, the figures for 1966 do not appear in the record.

Respondent's determination was the result of appellant's failure to keep detailed records to substantiate the business nature of deductions taken for automobile operations and certain "travel and entertainment" expenses. In 1966 this latter category included charges for single meals at local restaurants, liquor purchases, duck blind rentals, hunting trip expenses, and box seat tickets for San Francisco Giant baseball games at Candlestick Park. Apparently there were no receipts or itemized accounts identifying the nature of the expenses claimed in the earlier years involved in this appeal. After affording appellant several opportunities to produce the substantiating records which its representatives claimed to have, respondent's auditor used all the information at his disposal to arrive at an approximation of how much of the claimed expenses was properly deductible. His judgment was that \$600.00 per year was spent for the personal benefit of the Doles and was not properly deductible by appellant.

Appellant's sole contention on appeal is that respondent's determination must be reversed because the auditor's approximation of deductible expenses was completely arbitrary and without foundation in fact. Respondent replies that appellant must settle for a reasonable approximation of the business expenses as a consequence of its failure to keep and produce adequate records.

Respondent's position is well taken. As we said under similar circumstances in Appeals of Joseph A. and Marion Fields, Cal. St. Bd. of Equal., May 2, 1961:

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Appellant contends that the disallowances were arbitrary. However, such an estimate was necessary because Appellants failed to produce any records or other evidence to substantiate the deductions claimed. The Franchise Tax Board recognized that some of the expenses claimed are deductible and has, under the rule of Cohan v. Commission., 39 F.2d 540, disallowed only a portion of the deductions claimed. Deductions from gross income are a matter of legislative grace and are allowable only where the conditions that have been established by the legislature have been met and satisfied. (New Colonial Ice Co. v. Helvering, 292 U.S. 435.) Accordingly, the taxpayer has the burden of proving that he is entitled to the deduction. (Welch v. Helvering, 290 U.S. 111.)

In the case of travel and entertainment expenses, this burden of proof may be satisfied by records which 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 has made no effort to produce such records at any time, and the evidence which appellant has presented does no more than establish what respondent has never denied -- namely, that some of the claimed expenses are properly deductible.

Since there is no evidence upon which we can base a different or greater approximation of the amount of deductible expenses, respondent's determination on that issue must be sustained. (Neils Schultz, 44 B.T.A. 146.) Appellant also has failed to prove that the disallowed expenses were not incurred for the personal benefit of its shareholders. The disallowed expenditures must therefore be regarded as distributions of corporate earnings which are not deductible by appellant but are taxable to the Doles as dividends. (Appeal of A. K. Thanos Co., Cal. St. Bd. of Equal., Nov. 13, 1962; Appeal of Continental Lodge, Cal. St. Bd. of Equal., May 10, 1967.)

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 Oilwell Materials & Hardware Co., Inc., against, proposed assessments of additional franchise tax in the amount of \$33.00 for each of the taxable years 1962, 1963, 1964, 1965, and 1966 be and the same is hereby sustained.

Done at Sacramento, California, this 6th day of November, 1970, by the State Board of Equalization.

Geoffrey S. Kelly, Chairman  
John W. Lynch, Member  
Robert R. [unclear], Member  
Richard A. [unclear], Member  
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ATTEST: [Signature] Secretary