BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
ARNOLD L. AND EDITH M. HUNSBERGER)

For Appellants: Michael E. Zadan
Attorney at Law

For Respondent: John R. Akin
Counsel

O P I N I O N

This appeal is made pursuant to section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Arnold L. and Edith M. Hunsberger against a proposed assessment of additional personal income tax in the amount of **$1,588.19** for the year 19'74.

Appellants filed a joint personal income tax return for 1974. During 1974 Mrs. Hunsberger was an unpublished author. Some time during the summer of 1974 appellants entered into an oral agreement with the Production. House Division of Loeffler and Company, Inc. (Loeffler). Loeffler is a publisher. It is what is characterized in the publishing industry as a "subsidy" or "vanity" publisher which requires the author to underwrite either a partial or total amount of the cost of publishing and promoting a book. On December 26, 1974, appellants paid $15,000 to Loeffler for the writing, development, printing and publication of a book concerning Mrs. Hunsberger's experience with cancer.

On January 15, 1975, appellants and Loeffler executed a written agreement. In the agreement Loeffler agreed to write, edit, print and market the book. -Appellants agreed to deposit $25,000 with Loeffler which was committed to the publication, advertising and sales distribution of 20,000 copies of the book. Appellants were to receive 75 percent of the profits while Loeffler was to receive 25 percent. The written agreement recited that it constituted the entire agreement between the parties and that any prior or -contemporaneous oral agreements were merged in or revoked by the agreement. Loeffler also agreed to keep .a separate accounting sheet for all charges made against appellants' advances and to mail them a copy monthly commencing February 15, 1975. On September 16, 1975, the agreement was modified to provide for an "initial investment" by appellants of $31,000 for 40,000 books. The $31,000 was broken down into: $15,000 for initial development; $14,000 for publishing; and $2,000 for promotion.

Appellants deducted the $15,000 advance to Loeffler on their 1974 Schedule C, Profit (or Loss) From Business or Profession, as "Development of Books -- cost of writing, editing, printing etc." Respondent disallowed this deduction on the grounds that it was a capital expenditure. Appellants', protest was denied and this appeal followed.

The sole issue for determination is whether respondent properly disallowed the $15,000 deduction on the basis that it was a capital expenditure.

Section 17283 of the Revenue and Taxation Code provides, in part,, that taxpayers may not deduct capital expenditures in a single taxable year. One of the exceptions to this provision is research and experimental expenditures. (See Rev. & Tax. Code, § 17223.) These provisions are essentially the same as sections 263 and 174 of the Internal Revenue Code of 1954. Accordingly, federal law is persuasive concerning the proper interpretation and application of the California provisions. (See, e.g., Meanley v. McColgan, 49 Cal. App. 2d 203 [121 P.2d 45] (1942).)

The Internal Revenue Service has ruled that a payment made to a publisher as an inducement to enter into a contract to publish a book is a capital expenditure reflecting the taxpayer's basis in the contract which must be allocated over each copy published in the first edition. (Rev. Rul. 68-194, 1968-1 Cum. Bull. 87.) In that ruling the taxpayer, who was not in the business of writing or publishing, contracted with a publisher to publish his book. The publisher agreed to publish 5000 copies and pay the taxpayer a specified amount for each book sold. As an inducement to enter into the contract and publish the book, the taxpayer agreed to pay the publisher $3,000.

In the instant appeal, appellants contracted with Loeffler to publish Mrs. Hunsberger's book. Appellants agreed to pay $31,000 to the publisher, $15,000 of which was paid in 1974, as an inducement to publish the book. In accordance with the revenue ruling, respondent's determination that appellant's $15,000 advance to Loeffler must be capitalized and is not currently deductible was proper,

Appellants seek to avoid the thrust of the revenue ruling by arguing that their agreement with Loeffler created a joint venture; therefore, they were in the trade or business of publishing, As publishers, appellants continue, the expenditure in question is properly deductible as a research and development expenditure under section 17223 of the Revenue and Taxation Code. Appellants' position is based on section 2119 of the federal Tax Reform Act of 1976 (Pub. L. No. 94-455, 90 Stat. 1520, 1912 (1976)) and its state counterpart (Stats. 1977, ch. 1079, p. 3467). These sections provide that, until certain federal regulations are issued, the application of the research and development provision to prepublication expenditures incurred by a

taxpayer in the publishing business shall be administered without regard to Revenue Ruling 73-395 (1973-2 Cum. Bull. 87), and in the manner, the taxpayer applied such provision to prepublication expenditures before Revenue Ruling 73-395 was issued. Revenue Ruling 73-395 provided that publishers' prepublication expenditures must be capitalized.

Assuming that appellants' argument is valid, they must establish the existence of a joint venture. Whether the parties were joint venturers is a question of fact. The totality of the evidence and not just the written agreement must be considered in order to determine whether a joint venture was formed. The existence of a joint venture is indicated by the presence of four basic attributes: (1) a contract that a joint venture be formed; (2) the contribution of money, property or services by the venturers; (3) an agreement for joint proprietorship and control; and (4) an agreement to share the profits. (See, e.g., S & M Plumbing Co., 55 T.C. 702 (1971).) A joint venture is more than the mere financing of the operation of one party by another, even though some right to share in contemplated profits was an incentive to making the advance. (See Joe Balestrieri & Co. v. Commissioner, 177 F.2d 867 (9th Cir. 1949).)

In this appeal the only evidence offered by appellants concerning their intent to establish a joint venture is the agreement with Loeffler. This agreement does not mention the existence of a joint venture nor can one be implied from its overall contents. The agreement is very clear with respect to the requirements of each party. Appellants' only responsibilities were to advance money and furnish Mrs. Hunsberger's writings. Loeffler was to write, edit, publish and sell the end product. Appellants did not have any joint proprietorship or control over the enterprise. The only attributes of a joint venture present were the contribution of money and services and the sharing of profits. Based on these facts we cannot conclude that a joint venture existed between appellants and Loeffler. We perceive the situation merely as an agreement to finance the publication of a book.

Even if we were able to find the existence of a joint venture, it would not follow that appellants were entitled to the deduction claimed. Appellants'

initial $15,000 advance-to Loeffler would have been a capital contribution. There is no indication that any portion of this amount was expended by the "joint venture" in 1974. The written agreement of January 15, 1975, was prospective in nature and neither mentioned any 1974 activities nor specifically provided for any. The agreement recites that it constitutes the entire agreement between the parties and that any prior agreements are merged or revoked by it. Furthermore, the provision concerning the accounting of all charges against money advanced by appellants calls for monthly reporting of charges commencing in February 1975. When considered with respect to the entire agreement, this provision suggests that the venture did not incur any expenses during 1974.

In support of their contention that they were engaged in a joint venture, appellants rely on three cases. (See Snow v. Commissioner, [416 U.S. 500, 40 L. Ed. 2d 336](1974); Burde v. Commissioner, 352 F.2d 995 (2nd Cir. 1965); Cleveland v. Commissioner, 297 F.2d 169 (4th Cir. 1961).) In Snow the issue was not whether a joint venture existed since it was stipulated that the taxpayer was a limited partner in the partnership in question. Thus, Snow is not applicable to the issue before us. In both Burde and Cleveland, although some of the factors often found relevant to the existence of a joint venture were not present, the objective acts of the venturers evidenced their subjective intent to form a joint venture. Such is not the case in the present appeal where appellants had no joint proprietorship or control over the enterprise. Furthermore, in both Burde and Cleveland actual expenditures were made by, or on behalf of, the venture during the years in question. In the present appeal, there is no indication that the alleged joint venture expended any amounts during the appeal year.

For the above reasons we conclude that respondent's action in this matter was proper and must be sustained.

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 Arnold L. and Edith M. Hunsberger against a proposed assessment of additional personal income tax in the amount of $1,588.19 for the year 1974, be and the same is hereby sustained.

Done at Sacramento, California, this 8th day of January, 1980, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member