



BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
J&J FILM SERVICES, INC. )  
)

Appearances:

For Appellant: Maurice J. Morrissey

For Respondent: **Kendall E. Kinyon**  
**Counsel**

O P I N I O N

This appeal is made pursuant to section 25666 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of J & J Film Services, Inc. against proposed assessments of additional franchise tax in the amounts of **\$2,074.54**, \$900.28 and \$554.64 for the income years ended December 31, 1970, 1971, and 1972, respectively.

Appeal of J & J Film Services, Inc.

The issue raised by this appeal is whether deductions for embezzlement losses may be taken in years other than the year the embezzlement is discovered.

In 1973 appellant discovered that its accountant had embezzled a total of \$52,286.10 during the years 1968 through 1973. The defalcations were concealed by duplicating the expense entries during the years when the embezzlements occurred. As a result, appellant's income was underreported for those years.

An Internal Revenue Service audit verified this and proposed deficiency assessments were issued for the years in question. The I. R. S. allowed appellant to deduct the entire embezzlement loss in 1973, the year of discovery. The net tax effect for the appeal years was reduced by the carryback of appellant's net operating loss from 1973 to prior years.

In regard to appellant's state taxes, respondent issued proposed deficiency assessments for the income years 1970 through 1972 based on the federal audit reports. The embezzlement loss deduction was allowed for only 1973, which did not benefit appellant since it already had a net loss for that year. Appellant also failed to benefit from the deduction for the appeal years, since California does not provide for net operating loss carrybacks. Respondent denied appellant's protest of the proposed assessments and this timely appeal followed.

California Revenue and Taxation Code section 24347 states in relevant part:

- (a) There shall be allowed as a deduction any loss sustained during the income year and not compensated for by insurance or otherwise.

\* \* \*

- (c) For purposes of subsection (a), any loss arising from theft shall be treated as sustained during the income year in which the taxpayer discovers such loss.

The regulations for the quoted section define "theft" to include embezzlement. (Cal. Admin. Code, tit. 18, reg. 24347, subd. (h)(3). ) They also specify that "a theft loss is not deductible

Appeal of J & J Film Services, Inc.

under Section 24347(a) for the income year in which the theft actually occurs unless that is also the year in which the taxpayer discovers the loss. " (Cal. Admin. Code, tit. 18, reg. 24347, subd. (h)(1)(B). )

There is no dispute that the embezzlement was discovered in 1973. Since California has no carryback provision for net operating losses similar to section 172 of Internal Revenue Code of 1954, the loss may not be applied to the appeal years.

Appellant argues that the application of these rules to its situation is especially harsh since the full amount of income earned during the appeal years was not available for its use due to the embezzlement. Appellant suggests that the embezzled income should be "applied" to the year the embezzlement was discovered. However, Revenue and Taxation Code section 24661 requires that items of gross income be included in the income year in which they are received by the taxpayer. Therefore, this income is properly reflected in the income years of the appeal, not in 1973. (See Donohue v. Commissioner, 323 F. 2d 651 (7th Cir. 1963). )

Although we are sympathetic to appellant's contention that it receives no benefit under California law from the 1973 embezzlement loss, we note that several factors may mitigate the effect of our decision here, although they do not affect the appeal years. First, appellant already had the benefits of the **erroneous** double expense deductions for the income years 1968 and 1969, which are not affected here. Furthermore, appellant had the opportunity to qualify for deferment of at least a portion of the embezzlement loss until the income year in which it was ascertained whether or not reimbursement would be received. (Cal. Admin. Code, tit. 18, reg. 24347, subd. (h)(1)(b) and reg. 24347, subd. (a)(4)(C).) Finally, appellant did recover approximately **\$44,900.00** of the embezzled funds.

For the reasons set forth above, we sustain respondent's action.

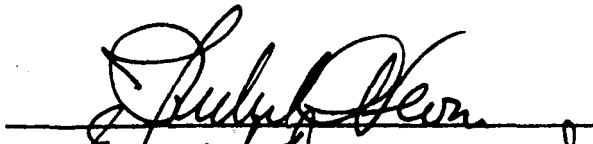

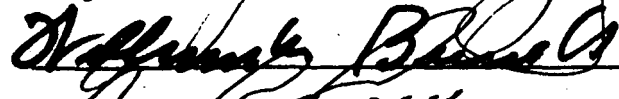
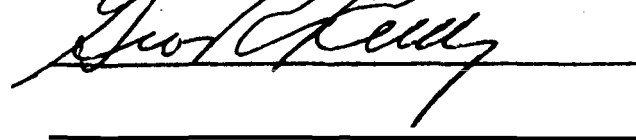
O R D E R

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

Appeal of J & J Film Services, 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 J & J Film Services, Inc. against proposed assessments of additional franchise tax in the amounts of \$2,074.54, \$900.28 and \$554.64 for the income years ended December 31, 1970, 1971, and 1972, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 30th day  
of June, 1980, by the State Board of Equalization.

 , Chairman  
 , Member  
 , Member  
 , Member  
\_\_\_\_\_. Member