

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
DULUTH SCIENTIFIC, INC.)

For Appellant: Carroll Beason
Certified Public Accountant

For Respondent: Jean Harrison Ogrod
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 Duluth Scientific, Inc., against a proposed assessment of additional franchise tax in the amount of **\$7,183.11** for the income year ended November **30**, 1974.

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During the income year in issue, appellant constituted part of an affiliated group of corporations engaged in a **single unitary** business. In addition to appellant, the affiliated group consisted of appellant's wholly owned subsidiary in Mexico, another wholly owned subsidiary in Hong Kong (hereinafter referred to as "DSI-Hong Kong"), and a Portuguese subsidiary (hereinafter referred to as "DSI-Portugal") which had been organized by DSI-Hong Kong. The business engaged in by the affiliated group consisted of the development, manufacture, and sale of computer components. Appellant claims that on December 1, **1973**, the beginning of the income year in issue, it qualified to do business in this **state** and soon thereafter moved its headquarters to San Diego.

On its California franchise tax return for the 1974 income year, appellant reduced the amount of the unitary business income apportioned to it as California source income by a claimed **nonbusiness loss of \$87,412.00**. Appellant maintains that the claimed loss resulted from the seizure of DSI-Portugal by the Portuguese government in **1974**; the supposed expropriation of the Portuguese subsidiary purportedly rendered its stock worthless.

Upon examination of appellant's return, respondent proposed various adjustments and **subsequently** issued a notice of proposed assessment. One of the adjustments proposed by respondent, **was** the disallowance of the worthless stock loss. The basis for the disallowance was two-fold. First, respondent contends that appellant failed to satisfy its burden of establishing the existence of a claimed loss in the amount of **\$87,412.00**. Second, respondent contends that even if the existence of a worthless stock loss is established, the loss should be specifically allocated to Hong Kong, the commercial domicile of DSI-Hong Kong, **rather**, than California, appellant's commercial domicile. 1/ The rationale

1/ The parties to this appeal agree that if a worthless stock loss is established, such loss constitutes a non-business loss specifically allocable to the stockholder's commercial domicile, but disagree as to the location of that commercial domicile. For reasons subsequently expressed in this opinion, we need not resolve this dispute. Accordingly, we express no opinion as to the propriety of classifying the purported stock loss as a nonbusiness loss. (Cf. Times Mirror Co. v. Franchise Tax Board, 102 Cal.App.3d 872 [162 Cal.Rptr. 630] (1980).)

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for respondent's second contention! **is** based on its determination that DSI-Portugal was a wholly owned subsidiary of the Hong Kong subsidiary and that the latter had been responsible for the management of the Portuguese subsidiary.

Of the total **\$7,183.11** in disputed proposed additional tax, only **\$1,298.00** resulted from respondent's adjustment regarding the loss caused by the alleged Portuguese expropriation. While respondent emerged from the protest hearing under the belief that it had reached agreement with appellant as to the other adjustments, and in fact issued a revised proposed assessment reflecting a slight decrease in the original proposed assessment, appellant has informed this Board that the entire proposed assessment of **\$7,183.11 is** in dispute.

Revenue and Taxation Code section 24347, subdivision (d), provides for the deduction of an uncompensated loss resulting from "**any** security [which] becomes worthless during the income year." It is well established, however, that deductions are a matter of legislative grace, and the burden is on the taxpayer to show by competent evidence that it is entitled to any deduction claimed. (Deputy v. du Pont, 308 U.S. 488 [84 L.Ed. 416] (1940); New Colonial Ice Co. v. Helvering, 292 U.S. 435 [78 L.Ed. 1348] (1934).) Accordingly, the first question presented for our determination is whether appellant has satisfied its burden of establishing its right to the claimed loss. The secondary issue of whether the purported loss should be allocated to California or Hong Kong arises only if the answer to the **initial** inquiry is affirmative.

To establish that the claimed loss was deductible, appellant must establish: (1) that it actually sustained a deductible loss; (2) that the loss was sustained during its 1974 income year as evidenced by a closed and completed transaction and as fixed by identifiable events; (3) that the loss was uncompensated; and (4) the amount of that loss. (United States v. White Dental Mfg. Co., 274 U.S. 398 [71 L.Ed. 1120] (1927); Appeal of V.I.E. Industries, Inc., Cal. St. Bd. of Equal., June 29, 1982; Cal. Admin. Code, tit. 18, reg. 24347-1, subs. (b) & (d).) Upon careful review of the record on appeal, we believe that appellant has failed to provide the evidence needed to satisfy the latter of these requirements. Accordingly, we must conclude that it has failed to carry its burden of proving entitlement to the claimed deduction.

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In support of its entitlement to the claimed deduction, appellant has supplied statements from the former plant manager of DSI-Portugal and from **its** Portuguese accountants. The referenced statements note that the fixed assets and inventory of DSI-Portugal were either shipped to the United States, sold, scrapped, or impounded **as** a consequence of legal action brought against the company. To the extent that they make reference to the actions taken to sell and ship to the United States **DSI-Portugal's** fixed assets and inventory, these statements contradict the assertion that political events in Portugal rendered as worthless that **corporation's** stock. Respondent's determination cannot be successfully rebutted when the taxpayer fails to present any evidence relating to the issue in dispute, (Cf. Banks v. Commissioner, 322 **F.2d** 530 (8th Cir.. 1963); Estate of Albert Rand, 28 T.C. **1002 (1957)**.) Since appellant has presented no evidence with respect to the actual amount of its claimed loss, we must conclude that it has failed to satisfy its burden of proof. When, as in this appeal, the taxpayer has access to the necessary evidence **but** does not produce it, it is not in a position to complain of adverse consequences. (Stanley Rosenstein, 32 T.C. 230 (1959); Appeal of Henrietta Swimmer, Cal. St. Bd. of Equal., Dec. 10, 1963.)

Our conclusion that appellant has **failed** to establish the amount of the claimed worthless stock loss makes it unnecessary to determine in what manner to assign the purported loss. Furthermore, while appellant has stated that the full amount of the proposed **assessment, \$7,183.11**, is disputed, it has failed either to discuss the other adjustments proposed by respondent which resulted in the issuance of the subject notice of proposed assessment or to present any evidence supporting its position with regard to those adjustments. Therefore, respondent's action with regard to those adjustments shall also be sustained-

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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 protest of Duluth Scientific, Inc., against a proposed assessment of additional franchise tax in the amount of \$7,183.11 for the income year ended November 30, 1974, be and the same is hereby sustained.

Done at Sacramento, California, this 28th day of July, 1983, by the State Board of Equalization, with Board Members Mr. Bennett, Mr. Collis, Mr. Dronenburg, Mr. Nevins and Mr. Harvey present.

William M. Bennett, Chairman

Conway H. Collis, Member

Ernest J. Dronenburg, Jr., Member

Richard Nevins, Member .

Walter Harvey*, Member

*For Kenneth Cory, per Government Code section 7.9