BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Hatter of the Appeal of)
)
FRANKLIN E. and)
BARBARA R. WALKER)

Appearances:

For Appellant: Franklin E. Walker, in pro. per.

For Respondent: John A. Stillwell, Jr. 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 Franklin E. and Barbara R. Walker against proposed assessments of additional personal income tax in the amounts of $1,152.88, $1,714.64, $1,596.84, $2,596.71 for the years 1975, 1976, 1977, and 1978, respectively.

The issues for decision are as follows: (1)(a) whether appellant has established that he engaged in inventing (1977, 1978) and writing activities (1976, 1977) for the purpose of making a profit; (1)(b) if so, whether appellant has properly substantiated the amounts so expended for such activities; (1)(c) if appellant's inventing activities are found to have been engaged in for profit, whether appellant has established error in respondent's capitalization of his expenses in obtaining patents; (2) whether appellants have substantiated other claimed deductions in excess of the amounts allowed by respondent; (3) whether appellant has established his entitlement to a deduction for a casualty loss.

During the years at issue, appellant-husband (hereinafter "appellant") was employed at the Lawrence Livermore Laboratory as a chemist while appellant--wife was a housewife, In addition to that employment, appellant wrote and published books, invented technical devices, invested in real estate and operated a consulting service. On their personal income tax returns for the years at issue, appellants claimed numerous deductions for expenditures associated with these activities. Respondent treated appellant's inventing activities as being eng.aged in for profit for 1975 and 1976, but not for 1977 and 1978. However, respondent did not allow any deductions of expenditures associated with such inventing activities in 1975 and 1976 due to lack of substantiation of amounts expended. Apparently, respondent disallowed all expenses associated with appellant's writing activities contending that this endeavor was not engaged in for profit-making purposes at any time. Respondent also disallowed other deductions for lack of substantiation. Appellant suffered. damage to his automobile in 1978. Although he had insurance coverage for the loss, he did not file a claim. On his personal income tax return for that year, appellant claimed a casualty loss for the damage to the automobile. Respondent disallowed that deduction contending that the loss did not result from the casualty, but from his election-not to collect from his insurance company. In addition., respondent disallowed various charitable contributions claimed by appellant.

It is, of course, well settled that income tax deductions are a matter of legislative grace and the burden of proving the right thereto is upon the taxpayer. (New Colonial Ice Co. v. Helvering, 292 U.S. 435 [78 L.Ed. 1348] (1934); Deputy v. du Pont, 308 U.S. 488 [84 L.Ed. 416] (1940).) In order to sustain that burden, the

taxpayer must be able to point to an applicable deduction statute and show that he comes within its terms.

Addressing the first issue, we note that certain expenses, such as taxes, are deductible without regard to whether or not an activity is engaged in for profit. (Rev. & Tax. Code, § 17233, subd. (b).) However, deduction of other expenses is permitted only if the activity is engaged in for profit. (Rev. & Tax. Code, § 17233, subd. (c); Appeal of Clifford R. and Jean G. Barbee, Cal. St. Bd. of Equal., Dec. 15, 1976.) The disposition of this issue, involving section 17233, subdivision (c), deductions, turns on whether appellant's inventing and writing activities were engaged in primarily for profit, rather than for personal or recreational purposes. (Appeal of Paul R. Josemary Henneberry, Cal. St. Bd. of Equal., May 21, 1980; Appeal of F. Seth and Lee J. Brown, Cal. St. Bd. of Equal., Aug. 16, 1979.)

Respondent apparently bases its conclusion that these activities were not engaged in primarily for profit upon the assertions that (1) appellant had no prior experience in inventing or writing, (2) these activities were not run in a businesslike manner, and (3) during the appeal years, no income was derived from these activities. However, at the oral hearing before this board, appellant presented evidence indicating that prior to the years at issue, he had written and published numerous articles and that his inventions involved various chemical discoveries in areas in which he was well trained. In addition, letters between appellant and his publisher and his patent attorney indicate that these activities were carried out in a businesslike manner. Lastly, since the fruition of financial rewards in inventing and writing necessarily takes time, we find that lack of income from these activities during the years at issue is not determinative of the outcome. Accordingly, based upon the evidence presented at the oral hearing, we find that appellant engaged in writing and inventing during the years at issue for profit. To the extent the records which he has presented document such expenditures (e.g., publishing costs, patent attorney fees), we find that appellant has adequately substantiated such expenditures. We note, however, since Treasury regulation section 1.167(a)-6(a) requires that the "cost or other basis of a patent... be depreciated over its remaining life," all expenditures associated with obtaining patents must be capitalized and depreciated over the life of such patents.

As indicated above, the second issue for determination is whether appellants have substantiated that they were entitled to certain other deductions in excess of the amounts allowed by respondent. These deductions cover such items as legal fees involving appellants' personal residence, charitable contributions, and interest deductions. Respondent's determination is presumptively correct and in order for appellants to prevail, they must demonstrate that such determination is erroneous. (See e.g., Appeal of Ambrose L. and Alice M. Gordos, Cal. St. Bd. of Equal., March 31, 1982; Appeal of James Lucas, Jr. Cal. St. Bd. of Equal., April 8, 1980.) Except as noted in the next paragraph dealing with appellants' casualty loss, we find no evidence to support appellants' contention that they were entitled to deductions in excess of the amounts allowed by respondent and., accordingly, respondents' action in disallowing these deductions must be sustained.

The last issue for determination is whether appellants have established their entitlement to a casualty loss deduction for a loss covered by insurance where appellants elected not to collect from the insurer. Revenue and Taxation Code section 17206, subdivision (a), allows as a "deduction any loss sustained ... and not compensated for by insurance ...." Respondent contends that where a valid claim against a solvent insurance company could have been made, but was not, the taxpayer's loss did not arise from a casualty, but instead arose from taxpayer's deliberate election not to collect the insurance claim. (See Bartlett v. United States, 397 F.Supp. 216 (1975).) However, in making this argument, respondent has, in effect, expanded the meaning of "not compensated for by insurance" to encompass losses not covered by insurance. Respondent recognizes that recent tax court decisions have prohibited such expansion. (See Henry L. Hills, 76 T.C. 484, 486 (1981), affd., 691 F.2d 997 (11th Cir. 1982); William J. O'Neill, Jr., ¶ 83,583 P-H Memo. T.C. (1983); Dixon F. Miller, ¶ 81,431 P-H Memo. T.C. (1981).) However, respondent argues that the Hills case was decided by the Eleventh Circuit and a Ninth Circuit Court, the Circuit to which a tax court decision involving a California taxpayer would be appealed, might decide differently. Respondent's argument is without merit. Respondent appears to misunderstand the Golsen rule. (Jack E. Golsen, 54 T.C. 742 (1970), affd., 445 F.2d 985 (10th Cir. 1971), cert. den., 404 U.S. 940 [30 L.Ed.2d 254] (1971).) In Golsen, the tax court stated that it is obligated to follow any decision squarely on point where the court to which an

appeal lies has passed on an issue before it. Since there is no case squarely in point involving the Ninth Circuit, the Golsen rule, even if it were applicable to this board which it is not, would not apply to the instant situation. In any case, it is our judgment that the better statutory construction of section 17206, subdivision (a), requires us to grant appellants' casualty loss deduction as properly documented. Accordingly, respondent's action on this issue must be reversed.

For the foregoing reasons, respondent's action in this matter must be modified as noted above.

Appeal of Franklin E. and Barbara R. Walker

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 Franklin E. and Barbara R. Walker against proposed assessments of additional personal income tax in the amounts of $1,152.88, $1,714.64, $1,596.84, and $2,596.71 for the years 1975, 1976, 1977, and 1978, respectively, be and the same is hereby modified in accordance with this opinion. In all other respects, the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 12th day of September, 1984, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Dronenburg, Mr. Collis and Mr. Bennett present.

Richard Nevins, Chairman

Ernest J. Dronenburg, Jr., Member

Conway H. Collis, Member

William M. Bennett, Member

_____, Member