



76-SBE-052

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
ORLO E. , JR., AND)
MARIAN M. BROWN)

Appearances:

For Appellants: Orlo E. Brown, Jr., in pro. per.

For Respondent: Bruce W. Walker
Chief Counsel

Jack E. Gordon
Supervising Counsel

OPINION

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Orlo E. , Jr. , and Marian M. Brown against proposed assessments of additional personal income tax in the

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amounts of \$754.15 and \$189.67 for the years 1968 and 1969, respectively, and pursuant to section **19059** of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of Orlo E. , Jr. , and Marian M. Brown for refund of personal income tax in the amount of \$889.09 for the year 1968.

Sometime in 1967, Robert Elliott, a bonded account executive, induced appellants to advance him funds to finance the purchase of a mercury mine for a partnership. From 1967 until 1971, appellants advanced a total of \$52,000 to Elliott and to others in connection with the alleged "partnership". Late in 1970, appellants discovered that the "partnership" was a fraudulent scheme perpetrated by Elliott and that he had appropriated to his own use all, or nearly all, of the funds they had advanced. In 1971, appellants were required to discharge an additional \$2,576 in liabilities to third parties arising out of the fraudulent mining venture.

Upon discovering Elliott's swindle in 1970, appellants apparently filed amended federal and state personal income tax returns for the years in issue claiming embezzlement losses. Appellants' records were audited by the Internal Revenue Service, which determined that appellants were entitled to embezzlement losses of approximately \$52,000 in 1970. The Internal Revenue Service also allowed appellants to carryback a portion of those losses to prior years. On the basis of the federal action, respondent also allowed the embezzlement losses for 1970, but it disallowed any such losses for the years in issue. Respondent also denied appellants' claim for refund based on a carryback of the losses discovered in 1970. However, respondent did allow the \$2,576 out-of-pocket expense which appellants incurred in 1971 as a business expense deduction for that year.

The issue for determination is whether respondent properly disallowed embezzlement loss and loss carryback deductions for the years in question.

Losses suffered as the result of embezzlement are deductible as "theft" losses pursuant to section 17206, subdivision (c)(3) of the Revenue and Taxation Code, the counterpart to section

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165(c)(3) of the Internal Revenue Code of 1954. (See Edwards v. Bromberg 232 F. 2d 107.) Prior to the enactment of the 1954 Code, embezzlement losses were deductible for the year in which they were incurred. However, in Alison v. United States, 344 U. S. 167 [97 L., Ed. 186], the United States Supreme Court held that, upon a proper factual showing, such losses might be taken in years other than those in which incurred. Since this rule was considered vague, the Internal Revenue Code of 1954 adopted the present rule requiring that embezzlement losses be deducted only in the year in which the loss was discovered. (Asphalt Industries, Inc. v. Commissioner, 411 F. 2d 13; Curtis Gallery & Library v. United States, 241 F. Supp. 312, Perry A. Nichols, 43 T. C. 842; Int. Rev. Code of 1954, § 165 (c)(3).) Here, there is no dispute that appellants discovered the embezzlement loss in 1970. Therefore, the loss was deductible in 1970 and not the years in issue.

Next, appellants maintain that they are entitled to carryback the 1970 embezzlement loss to prior years. Under California law a deductible loss is allowed as a deduction only in the year for which the loss is sustained. There is no provision in the California Revenue and Taxation Code similar to the provision for carryover or carryback of net operating losses contained in section 172 of the Internal Revenue Code of 1954. (See Appeal of Jorge and-Elena de Quesada, Cal. St. Bd. of Equal. , Feb. 5, 1968.) Therefore, appellants' embezzlement loss was deductible only in 1970, the year it was discovered, and could not be allowed as a loss carryback for either of the years in issue.

Appellants contend that certain isolated transactions not associated with the mine swindle resulted in embezzlement losses which were deductible during the years in issue. They also argue that certain out-of-pocket expenses should have been deductible as business expenses during the appeal years. However, appellants have failed to prove that the alleged embezzlement losses were discovered during the years in question or that the out-of-pocket expenses were not actually allowed as a deduction in the appropriate year.

For the reasons set out above, we believe that respondent's action in this matter was proper and must 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 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Orlo E. , Jr. , and Marian M. Brown against proposed assessments of additional personal income tax in the amounts of \$754. 15 and \$189.67 for the years 1968 and 1969, respectively, and pursuant to section 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of Orlo E., Jr. , and Marian M. Brown for refund of personal income tax in the amount of \$889.09 for the year 1968, be and the same are hereby sustained.

Done at Sacramento, California, this 4th day of May, 1976, by the State Board of Equalization.

William E. Gaudin, Chairman
George E. Spence, Member
Robert A. Smith, Member
_____, Member
_____, Member

ATTEST: *W. W. Dunlop*, Executive Secretary