

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
BUSINESS EXCHANGE, INC. )

For Appellant: M. J. McConnell  
President

For Respondent: Bruce W. Walker  
Chief Counsel

Paul J. Petrozzi  
Counsel

O P I N I O N

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the **protest of** Business Exchange, Inc., against a proposed assessment of additional franchise tax in the amount of **\$4,172.24** for the income year ended July 31, 1972.

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Appellant, a California corporation, is a cash basis taxpayer. On its return for the income year ended July 31, 1972 (hereinafter referred to as the income year in question), appellant claimed a \$21,057.11 deduction for legal and accounting expenses which it apparently paid during the income year ended July 31, 1971. In addition, appellant claimed a \$10,708.05 deduction for legal and accounting fees paid in connection with its plan to raise additional capital from a public offering of its stock.

After conducting an audit of appellant's return, respondent disallowed the \$21,057.11 deduction on the ground that appellant, as a cash basis taxpayer, may deduct expenses only for the year in which they are paid. Also, respondent disallowed the \$10,708.05 deduction on the ground that expenses related to the issuance of corporate stock do not constitute ordinary and necessary business expenses. Finally, on the basis of certain information revealed during its audit, respondent determined that appellant received \$25,000 of unreported income during the income year in question.

The first issue we must decide is whether, for the income year in question, appellant is entitled to deduct legal and accounting expenses which it apparently paid during a prior income year. At the outset, we note that appellant has submitted no evidence or argument in support of the claimed deduction. Consequently, we must accept as correct respondent's determination that the expenses were paid prior to the income year in question. (See Appeal of Tool Research and Engineering Corp., Cal. St. Bd., of Equal., Dec. 17, 1974,)

Generally, a cash basis taxpayer may deduct expenses for a particular year only if the expenses are actually paid during that year. (Rev. & Tax, Code, § 24681; Cal. Admin. Code, tit. 18, reg. 24651.) Since appellant is a cash basis taxpayer, we must sustain respondent's action in disallowing for the income year in question the \$21,057.11 deduction for expenses paid during a prior income year,

The next issue presented for our decision is whether appellant is entitled to deduct legal and accounting expenses incurred in connection with its plan for a public offering of its stock. Apparently, a major portion of the expenses was paid for an investigation of the feasibility of registering appellant's stock with the Securities and Exchange Commission (SEC). However,

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sometime prior to the close of the income year in question, appellant completely abandoned its plan for a public offering of its stock.

Respondent is correct in its assertion that expenses incurred by a corporation in issuing or **reselling its** stock are not deductible as ordinary and necessary business expenses. Such expenditures are considered capital outlays which merely reduce the proceeds derived from the sale of the stock. (Consumers Water Co. v. United States, 369 F. Supp, 939,944 (S.D. Me. 1974); Skaggs Companies, Inc., 59 T.C. 201, 206 (1972); Commercial Investment Trust Corp., 28 B.T.A. 143, 148 (1933).) **However**, we do not agree with respondent's conclusion that application of this principle precludes deduction of such expenses in cases where the corporate plan for a public offering of its stock is abandoned.

Section 24347 of the Revenue and Taxation Code provides for the deduction of "**any** loss sustained during the income year and not compensated for by insurance or otherwise." In this respect, section 24347 is identical to its federal counterpart, section 165(a) of the Internal Revenue Code of 1954. Therefore, federal court decisions construing the federal statute are entitled to great weight in applying the corresponding state law. (Meanley v. McColgan, 49 Cal. App. 2d 203, 209 [121 P.2d 45] (1942); Appeals of Cioco Union Stores, Inc., et al., Cal, St. Bd. of Equal., Oct. 6, 1976,)

The federal courts have uniformly held that expenses incurred by a corporation in connection with abandoned plans for reorganization or recapitaliation are deductible in the year of **abandonment**. (Tobacco Products Export Corp., 18 T.C. 1100, 1104 (1952); Sibley, Lindsay & Curr Co., 15 T.C. 106, 110 (1950); Doernbecher Manufacturing Co., 30 B.T.A. 973, 986 (1934), **affd.**, 80 F.2d 573 (9th Cir. 1935).) <sup>1/</sup> Furthermore, specific expenditures for legal and accounting services in connection with an abandoned plan to issue and sell corporate

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<sup>1/</sup> The cited cases do not specify the particular section of the Internal Revenue Code pursuant to which the deductions were allowed, **However**, recent authority clearly indicates that such deductions fall within the purview of section 165(a). (See Robert B. Haspel, 62 T.C. 59, 72 (1974); Rev. Rul. 73-580, 1973-2 Cum., Bull. 86,)

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stock registered with the SEC have been held deductible. (Addressograph - Multigraph Corp., ¶ 45,058 P-H Memo. T.C. (1945).) Accordingly, we must reverse respondent's action in disallowing the deduction of expenses paid by appellant in connection with its abandoned plan for a public offering of its stock.

The final issue presented for our resolution involves appellant's sale of a "franchise" during the income year in question. Although the record is far from clear as to the details of the transaction, it appears that appellant agreed to sell or exchange the "franchise" for 100 acres of land located in Utah. The minutes of a meeting held by appellant's directors for the purpose of approving the sale indicate that "Business Exchange, Inc., agreed to accept 100 acres of land in Utah that had been appraised at over \$1,000 an acre in lieu of \$25,000 in cash in exchange for the franchise." (Emphasis added.) Also, an "Inventory of Real Property" prepared for appellant on May 31, 1973, listed the cost of the 100 acres as **\$25,000**. On the basis of this evidence, respondent determined that appellant failed to report **\$25,000** of income derived from the sale of the "franchise". 2/

Appellant contends that the land in question was worth only \$25 per acre at the time it was acquired in exchange for the "franchise". Appellant submitted a letter written by the purchaser of the "franchise" which tends to support appellant's contention. **However**, appellant fails to adequately explain why it accepted land allegedly worth only \$2,500 "in lieu of \$25,000 in cash in exchange for the franchise." The record on appeal contains no other evidence, other than appellant's unsupported assertions, that the property in question was worth **less** than \$25,000. Accordingly, on the basis of the record before us, we have no alternative but to conclude that appellant has failed to sustain its burden of proving error in respondent's determination. (See Appeal of Penn Co., Ltd., Cal. St. Bd. of Equal., Feb. 19, 1974; Appeal of Wrlcombe Corp., Cal. St. Bd. of Equal., Sept. 1, 1966.)

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2/ It is not clear from the record whether the unreported **income** should be treated as **ordinary** income or as capital gains. (See, e.g., Devine v. Commissioner, 558 F.2d 807 (5th Cir. 1977).) **However**, the parties have not raised the issue on appeal; therefore, we shall not address it.


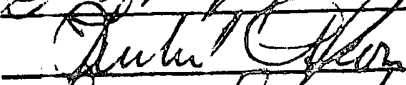

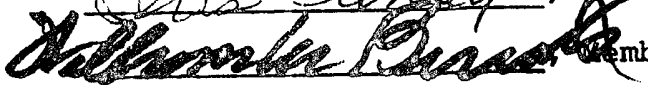
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Pursuant to ~~the~~ views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

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 Business Exchange, Inc., against a proposed assessment of additional franchise tax in the amount of **\$4,172.24** for the income year ended July 31, 1972, be and the same is hereby modified in accordance with the views expressed in this opinion. In all other respects the action of the Franchise Tax Board is sustained.

Done at **Sacramento**, California, this 11th day of January, **1978**, by the State Board of Equalization.

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