

Appeal of James Petroleum Corporation

The issue presented is whether appellant is entitled to deduct certain amounts which allegedly arose from bookkeeping errors during income year 1972.

Appellant is a California corporation engaged in **wholesale** sales of petroleum products. Its accounts are maintained on the basis of accrual accounting. Appellant retained a new certified public accounting firm to review its accounting records for the income year ended December 31, 1973 and to prepare its tax returns for that year. In the course of the review, it was discovered that numerous asset and liability accounts had incorrect balances as of December 31, 1972. The new accountant analyzed all these accounts in order to prepare adjustments to reflect correct balances as of December 31, 1973, and then made the adjustments necessary to correct all of the inaccurate accounts. Since all asset, liability and capital accounts were analyzed and adjusted where necessary to reflect their proper balances, in some instances the offset of a resulting adjustment for a 1972 accounting error had to logically flow through and affect 1972 income and expense accounts. Appellant operated at a loss for the income year ended December 31, 1972.

In the regular audit of appellant's franchise tax return for the income year ended December 31, 1973, respondent discovered, under the heading "Other Deduction;" a deduction entitled "Correction of **Prior** Year's Income," in the amount of **\$19,768.95**. This deduction was taken because of the aforementioned correction of errors made in maintaining the accounting records in 1972.. Appellant has provided the following breakdown of the deduction:

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| 1. To correct both the prepaid interest account and a note payable account to American National Bank balance as of December 31, 1972, as a result of accounting errors in 1972. | \$19,450.65 |
| 2. To correct accounts for purchase of 1968 International truck in 1972. | [1,000.00] |
| 3. To correct December 31, 1972, accumulated depreciation for automotive equipment. | 743.50 |
| 4. To correct cash in bank balances at December 31, 1972 , as a result of 1972 accounting errors. | <u>574.80</u> |
| Total | \$19,768.95 |

Appeal of James Petroleum Corporation

Appellant did not provide any further clarification of these adjustments. It was only after respondent's audit of appellant's return and respondent's subsequent inquiries that appellant alleged it was entitled to a theft loss deduction. Respondent disallowed the deduction, issued its proposed assessment, and this appeal followed.

It is alleged that during 1972 appellant's internal bookkeeper was in collusion with another of its employees to embezzle funds from appellant, and that this bookkeeper deliberately distorted the accounting records to conceal the theft. Appellant's representative maintains that the resulting net reduction of taxable income in the amount of **\$19,768.95**, "was a result of theft," discovered in 1973. Consequently, he contends that an embezzlement of that approximate amount was discovered in 1973. He urges therefore that appellant is entitled to a deduction in that sum for the income year 1973.

It is well settled that deductions are a matter of **legislative** grace and the taxpayer has the burden of proving it is entitled to the loss deduction. (Burnet v. Houston, 283 U.S. 223 [75 L. Ed. 9911 (1931)]; Mary Frances Allen, 16 T.C. 163 (1951); Henry C. Taylor, 34 B.T.A. 241 (1936); Appeal of Dan Morotti, Cal. St. Bd. of Equal., May 29, 1952.)

In the instant case, uncorroborated assertions after respondent's audit constitute the only evidence that **the** bookkeeping errors were the product of an embezzlement, or that the adjustment of **\$19,768.95** reflects the amount of the theft loss. We have consistently held that the taxpayer's unsubstantiated assertions are not sufficient to satisfy the burden of proof when claiming deductions. (See, e.g.; Appeal of James M. Denny, Cal. St. Bd. of Equal., May 17, 1962; Appeal of James C. and Monablanc A. Walshe, Cal. St. Bd. of Equal., Oct. 20, 1975; Appeal of Wing Edwin and Faye Lew, Cal. St. Bd. of Equal., Sept. 17, 1973; see also James G. Thompson, ¶64,198 P-B Memo. T.C. (1964).)

Consequently, while losses suffered as the result of embezzlement are deductible as "theft losses" in the year when the loss is discovered (Rev. & Tax. Code, § 24347; Appeal of Orlo E., Jr. and Marian M. Brown, Cal. St. Bd. of Equal., May 4, 1976), appellant clearly has not met its burden of substantiating that such a theft loss occurred.

Appeal of James Petroleum Corporation

Furthermore, it is admitted that the particular adjustments in the accounting records were made to correct erroneous balances in certain accounts as of December 31, 1972 resulting from bookkeeping errors related to the **income** year 1972. Since appellant has not established that it is entitled to a theft loss deduction, any allowable deduction would appear to relate to the income year 1972.

Therefore, on the record before us we must conclude that appellant has failed to establish it is entitled to the deduction claimed. Accordingly, respondent's action must be sustained.

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,

