

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
SHERWOOD C. AND ETHEL J. CHILLINGWORTH)

For Appellants: Arthur **Blech**
Certified Public Accountant

For Respondent: Bruce W. Walker
Chief Counsel

Kathleen M. Morris
Counsel

O P I N I O N

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 Sherwood C. and Ethel J. Chillingworth against a proposed assessment of additional personal income tax in the amount of \$3,785.61 for the year 1970.

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Appellants are husband and wife. For convenience hereinafter, reference to "appellant" means appellant Sherwood C. Chillingworth. Appellant entered private law practice in 1968 and was delegated responsibility to seek out investment opportunities for himself and his law firm partners. He also sought personal investments, and formed a collection agency known as General Financial Corporation.

Winston Foster, hereinafter referred to as "Foster", was hired by appellant as a financial adviser and consultant. According to appellant, Foster provided investment analysis for appellant and his associates, and served as an officer in two companies in which appellant was a major stockholder, i.e., General Financial Corporation and Dunn Properties. Foster received salaries from both of these companies and the law firm. In addition to his official corporate duties, Foster allegedly provided analysis of appellant's personal investments, for which services he received from appellant a lump sum compensation in the amount of \$53,000 under the terms of a contract dated May 30, 1968. On his 1970 personal income tax return, appellant deducted \$53,000 for "consulting services re mergers and acquisition per contract."

The issue to be decided is whether appellant may properly **deduct the payment to Foster of \$53,000, either as a business expense or** as an expense incurred for the production of income.

Deductions are a matter of legislative grace and are allowable only where the conditions established by the Legislature have been satisfied. (New Colonial Ice Co. v. Helvering, 292 U.S. 435 [78 L. Ed. 1348] (1934).) Respondent's determination that a deduction should be disallowed is presumed correct (Welch v. Helvering, 290 U.S. 111 [78 L. Ed. 212] (1933); Appeal of Robert V. Erilane, Cal. St. Bd. of Equal., Nov. 12, 1974), and appellant must prove his entitlement to the claimed deductions. (Appeal of James M. Denny, Cal. St. Bd. Of Equal., May 17, 1962.)

Section 17202 of the Revenue and Taxation Code allows as a deduction "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business." Respondent disallowed the deduction under this section. Clearly, appellant was not engaged in a trade or business for purposes of section 17202. It is well established that management

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of one's personal investments does not constitute a "trade or business." (Higgins v. Commissioner, 312 U.S. 212 [85 L. Ed. 783] (1941); Commissioner v. Smith, 203 F.2d 310, cert. den., 346 U.S. 816 [98 L. Ed. 343] (1953); Appeal of Jerome I. and Catherine Bookin, Cal. St. Bd. of Equal., March 26, 1974; Appeal of Estate of Samuel Cohen, et al., Cal. St. Bd. of Equal., Nov. 17, 1964; Appeal of John and Eliza Gallois, Cal. St. Bd. of Equal., Dec. 10, 1963.)

Nor can it be said that appellant, as a lawyer, was engaged in the business of managing investments; this was not the regular activity of the law firm. (See Ditmars v. Commissioner, 302 F.2d 481 (2d Cir. 1962).) We conclude therefore that respondent's disallowance of the deduction as a business expense was correct.

We now turn to section 17252 of the Revenue and Taxation Code, which provides:

In the case of an individual, there shall be allowed as a deduction, all the ordinary and necessary expenses paid or incurred during the taxable year--

(a) For the production or collection of income;

(b) For the management, conservation, or maintenance of property held for the production of income

Fees for services of investment counsel are deductible under this section only if they are ordinary and necessary, considering the type of investment and the taxpayer's relation to the investment. (Cal. Admin. Code, tit. 18, req. 17252, subd. (g).) Clearly, Foster was to provide investment advice under the above-described contract: what is not clear is to whom the service was to be rendered. The only activity of Foster's which appellant has specifically described is Foster's evaluation of the books of Dunn Properties in preparation for a corporate merger. Appellant argues that this was an expense incurred by appellant for the production of personal income. We do not agree.

Expenses which are attributable to efforts to increase the value of stock are neither ordinary nor proximately related to appellants' income. (Appeal of John and Eliza Gallois, supra.) Such expenditures must be viewed as having been incurred on behalf of the corporation, and any incidental benefit appellant might

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receive as a shareholder would be too **remote** to be considered proximately related to his own **income** or property. (Harry Kahn, 26 T.C. 273; Jacob M. Kaplan, 21 T.C. 134.) Thus the fee for the review of Dunn's **books** was not deductible by appellant as a personal expense for the production of income.

We do not doubt that Foster rendered the services for which he was compensated by appellant. The fact remains, however, that the record **does** not enable us to distinguish between those duties **of** Foster which related to corporate entities and those which concerned appellant's personal investments. Appellant may not claim a deduction for an expense which is properly attributable to the corporations; any allowable deduction would have belonged to the corporations **had** they reimbursed appellant for Foster's fees. (Charles W. Nichols, 1163,148 P-H Memo. T.C.)

Because appellant has failed to prove what amount, if any, of the claimed deduction was attributable to the production of his personal income, respondent's action **in** this matter 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 Sherwood C. and Ethel J. Chillingworth against a proposed assessment of additional personal income tax in the amount of **\$3,785.61** for the year 1970, be and the same is hereby sustained.

Done at Sacramento, California, this **26th** day of July, **1978**, by the State Board of Equalization.

George P. Jurek, Chairman
Robert C. Jurek, Member
William B. Bennett, Member
James S. Sweeney, Member
_____, Member