BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) NO. 83A-54-VN
DEAN L. AND CAROL R. HART)

Appearances:

For Appellants: Dean L. Hart, in pro. per.

For Respondent: Paul J. Petrozzi Counsel

O P I N I O N

This appeal is made pursuant to section 18593 1/ of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Dean L. and Carol R. Hart against proposed assessments of additional personal income tax plus penalties in the total amounts of $689.32 and $3,229.36 for the years 1977 and 1978, respectively.

1/ Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the years in issue;

During the years under review, appellants were directors and officers of Aerlab, Inc. (Aerlab), a California corporation engaged in the machine shop business in South El Monte. Dean L. Hart was the president and chief executive officer of the company. His spouse Carol H. Hart was the secretary and treasurer.

On their California personal income tax returns for 1977 and 1978, appellants claimed deductions for partnership losses of $50 and $10,160, respectively. Upon auditing the returns, respondent determined that the deductions should be disallowed because the alleged losses were incurred by Aerlab, not by a partnership. In addition, respondent reviewed the franchise tax returns as well as the corporate accounts, books, and payroll records of Aerlab. Following this examination and an analysis of appellants' bank deposits, respondent determined that appellants had received wages or salaries from the corporation in excess of what they had reported on their 1977 and 1978 personal income tax returns. The amount of unreported income was determined to be $9,505.00 for 1977 and $18,250.21 for 1978. After appellants failed to respond to its requests for further information, respondent issued the proposed assessments of additional taxes and penalties at issue in this appeal.

The first issue presented by this appeal is whether appellants have shown their entitlement to the claimed loss deductions. Section 17206, subdivision (a), authorized a deduction for any loss sustained during the the taxable year which was not otherwise compensated for" by insurance. In the case of an individual taxpayer, the deduction is limited to (1) losses incurred in any trade or business; (2) losses incurred in any transaction entered into for profit, though not connected'with a trade or business: and (3) certain casualty and theft losses in excess of $100. (Rev. & Tax. Code, § 17206, subd. (c).) Moreover, a taxpayer is entitled to take into account, when determining his taxable income, his distributive share of the losses of a partnership in which he has an interest. (Rev. & Tax. Code, § 17851 et seq.; see also Rev. & Tax. Code, § 17071, subd. (a)(13).)

A determination of the Franchise Tax Board to disallow a claimed deduction for partnership losses is presumptively correct, and the burden is on the taxpayer to prove that it is erroneous. (Todd v. McColgan, 89 Cal.App.2d 509 [201 P.2d 414] (1949); Appeal of Horace C. and Mary M. Jenkins, Cal. St. Bd. of Equal., Apr. 5, 1983.) The record in the present appeal clearly indicates that

Aerlab is not a partnership. For example, bank signature cards and a Statement of Domestic Stock Corporation executed by appellants clearly show it to be a corporation. Furthermore, the company had, in fact, a $4,212 profit in 1978, not a $10,160 loss. Appellants argue that the claimed loss deductions were actually attributable to a partnership called "Aerlab Machine Company." However, appellants have not presented any evidence to substantiate this allegation. We must, therefore, find that appellants have not carried their burden of proving entitlement to the claimed partnership loss deductions.

The second issue is whether respondent properly determined the amount of appellants' unreported income. Under the California Personal Income Tax Law, gross income means all income from whatever source derived, including compensation for services. (Rev. & Tax. Code, § 17071, subd. (a); see also Int. Rev. Code of 1954, § 61.) Both federal and state income tax regulations require each taxpayer to maintain such accounting records as will enable him to file an accurate tax return. (Treas. Reg. § 1.446-1(a)(4); former Cal. Admin. Code, tit. 18, reg. 17561, subd. (a)(4), repealer filed June 25, 1981 (Register 81, No. 26).) Where the taxpayer has failed to keep reliable books or records, the taxing agency is given great latitude to determine a taxpayer's taxable income by whatever method will, in its opinion, clearly reflect income. (Rev. & Tax. Code, § 17561, subd. (b); Giddio v. Commissioner, 54 T.C. 1530 (1970).) As long as some reasonable basis has been used to reconstruct income, respondent's determination will be presumed correct, and the taxpayer bears the burden to disprove the computation. (Breland v. United States, 323 F.2d 492 (5th Cir. 1963).)

In the instant matter, respondent determined the amount of appellants' unreported income by examining appellants' bank deposits and the corporate books and records of Aerlab. Appellants do not contest the reasonableness of respondent's method of income reconstruction nor do they deny that they received the money from the company in the appeal years. What appellants dispute is respondent's characterization of these funds as income. Appellants contend that these receipts constituted repayments of loans made by them to the corporation to facilitate its purchase of machinery. In support of their position, appellants have submitted copies of canceled checks made payable to and cashed by Aerlab. Some of the checks have the notation "loan" written on them.

In general, the determination whether or not advances to a closely held corporation represent loans depends on the particular facts of each case. (Gilbert v. Commissioner, 248 F.2d 399 (2d Cir. 1957); Appeal of Richard M. Lerner, Cal. St. Bd. of Equal., Oct. 28, 1980.) To establish that advances were, in fact, loans, a taxpayer must show that there was a valid and enforceable obligation for a fixed sum of money for which he had a reasonable expectation of repayment. (Appeal of Donald E. and Judith E. Liederman, Cal. St. Bd. of Equal., Oct. 26, 1983; Appeal of Robert H. and Carole R. Jenkins, Cal. St. Bd. of Equal., May 10, 1977.) Here, appellants have not submitted any credible evidence demonstrating that they had made loans to Aerlab at an earlier time. The record does not contain proof of a promissory note or agreement creating a debtor-creditor relationship between the parties nor copies of any corporate minutes.or resolutions authorizing the alleged indebtedness. The canceled checks are not sufficient proof of any loans since the mere form of a transaction is not determinative. (Johnson v. Commissioner, 86 F.2d 710 (2d Cir. 1936).) Finally, appellants have failed to establish that the money received constituted repayments on loans. Appellants explain that they do not have access to the records of Aerlab, but is is well settled that respondent's determination cannot be successfully rebutted when the taxpayer fails to substantiate his assertions with credible,- competent, and relevant evidence. (Appeals of George H. and Sky G. Williams, et al., Cal. St. Bd. of Equal., Jan. 5, 1982; Appeal of Linn L. and Harriett E. Collins, Cal. St. Bd. of Equal., Nov. 18, 1980; Appeal of Otto L. Schirmer, et al., Cal. St. Bd. of Equal., Nov. 19, 1975.) We thus have no choice but to find that appellants have not established error in respondent's determination that they received additional unreported income from Aerlab in 1977 and 1978.

The third issue is whether respondent properly imposed'the penalties in this appeal. Appellants have not made any arguments nor offered any evidence in opposition to the penalties. Where a taxpayer has not even attempted to refute the imposition of penalties, this board must assume'that the penalties apply. (Appeal of Valley View Sanitarium and Rest Home, Inc., Cal. St. Bd. of Equal., Sept. 27, 1978; Appeal of Woodview Properties, Inc., Cal. St. Bd. of Equal., Oct. 10, 1984.)

Based on the foregoing, we find that appellants have not shown respondent's determinations to be erroneous.

Accordingly, respondent's action in this matter 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,

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 Dean L. and Carol R. Hart against proposed assessments of additional personal income tax plus penalties in the total amounts of $689.32 and **$3,229.36** for the years 1977 and 1978, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 4th day of February , **1986**, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Collis, Mr. Bennett, Mr. Dronenburg and Mr. Harvey present.

Richard Nevins , Chairman

Conway H. Collis , Member

William M. Bennett , Member

Ernest J. Dronenburg, Jr. , Member

Walter Harvey* , Member

*For Kenneth Cory, per Government Code section. 7.9