

BEFORE THE STATE BOARD OF EQUALIZATION  
**OF** THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
 ) No. **84A-811-AJ**  
 RICHARD W. CASSADY )

Appearances:

For Appellant: Richard W. Cassady,  
 in pro. per.

For Respondent: Grace Lawson  
 Counsel

O P I N I O N

This appeal is made pursuant to section **185931** of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Richard W. Cassady against a proposed assessment of additional personal income tax in the amount of \$2,049 for the year 1980.

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

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The first issue presented by this appeal is whether appellant has established his basis in certain stock. If he has, the additional issue of whether that stock qualified as small business stock is presented.

In 1980, appellant sold 350 shares of stock in San Francisco Sardi, Inc., formerly **Seelig Distributing Co., Inc.**, (hereinafter referred to as "**Sardi's**") for \$1,400. On his 1980 personal income tax return, appellant claimed an ordinary loss of \$34,000 in connection with that transaction. Appellant contends that he purchased the stock for \$35,000 and that the stock qualified as small business stock under section 18208.

Respondent determined that appellant had not established his basis in the stock; therefore, it assigned the stock a zero basis and **disallowed** the entire claimed loss. It also determined that appellant had not established that the stock qualified under section 18208. Respondent issued a proposed assessment which it affirmed after considering appellant's protest. This timely appeal followed.

The question of a taxpayer's cost basis is an issue of fact. (Vaira v. Commissioner, 444 F.2d 770 (3d Cir. 1971).) The determination of the taxing agency is prima facie correct, and the taxpayer **bears** the burden of establishing a different cost basis. (Moore v. Commissioner, 425 F.2d 713 (9th Cir. 1970); Appeal of Frank Miratti, Inc., Cal. St. Bd. of Equal., July 23, 1953.) When the cost basis cannot be determined because of lack of evidence, the taxing agency may assign a zero basis. (Spurgeon v. Commissioner, ¶ 77,326 T.C.M. (P-H) (1977).)

In the instant appeal, the Franchise Tax Board assigned a zero basis to appellant's shares, citing his failure to provide "cancelled checks, copies of stock certificates or a promissory note executed by the corporation." (Resp. Br. at 9.) While it is true that appellant did not provide such evidence, we believe he has presented sufficient evidence to support a finding that his cost basis in the stock was \$35,000.

Where primary evidence of cost basis such as canceled checks is not available, secondary evidence is proper as an indication of cost to the taxpayer. (Gambee v. Commissioner, 4 B.T.A. 1234 (1926).)

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In the instant appeal, appellant testified that in 1974 he was approached by a friend to invest in Sardi's and that he paid \$35,000 for 35 shares of Sardi's stock. He further testified that, at some later date, these 35 shares were converted to 350 shares and that, in 1980, he sold these shares to another stockholder for \$1,400.<sup>2/</sup> In an attempt to corroborate his testimony, appellant has presented various evidence, including letters from the attorney and accountant for Sardi's. While this evidence does not establish when or how appellant's initial 35 shares were converted to 350 shares, each piece of evidence supports appellant's testimony that he invested \$35,000; that he owned 35 percent of Sardi's outstanding stock before and after the conversion of his 35 shares into 350 shares; and that he sold his entire interest *in* the corporation in 1980.

Respondent argues that there is confusion as to whether appellant paid \$35,000 cash for the stock or whether he received the stock in exchange for cancellation of a \$35,000 debt owed to him by the corporation. This is not relevant to the determination of appellant's cost basis in the stock, since, under the **particular** facts of this case, his basis would be \$35,000 whether he paid cash or agreed to a cancellation of indebtedness. At one point, respondent speculated that the indebtedness could have arisen as a result of appellant working for **Sardi's**, in which case, his basis in the indebtedness would be zero, as would be his basis in the stock received upon cancellation of that indebtedness. While that may be legally correct, there is absolutely nothing in the record indicating that appellant ever worked for Sardi's and appellant's testimony that he paid Sardi's \$35,000 in cash is uncontradicted. We believe it would be unreasonable to decide this appeal upon such an unsupported and contradicted speculation.

We find that appellant has presented sufficient evidence to establish that his basis in the Sardi's stock sold in 1980 was \$35,000. Since respondent agrees that appellant sold his stock for \$1,400 in 1980, appellant has suffered a loss upon the sale of a capital asset and is entitled to take into account that loss to the extent provided by section 18162.5.

2/ Respondent does not contest the fact that appellant sold his Sardi's stock in 1980 for \$1,400.

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The second issue presented is whether appellant's stock qualified as "small business corporation stock" under section 18208, thereby entitling him to an ordinary rather than capital loss. (Rev. & Tax. Code, § 18204.) Section 18208, as in effect when appellant purchased his stock, defined "small business corporation stock" as common stock issued for money or other property (other than stock or securities) by a domestic "small business corporation" under a plan adopted to offer such stock for a period specified in the plan, ending not later than two years after the date the plan was adopted. The burden of proving that stock qualified as section 18208 stock is upon the taxpayer. (Malinowski v. Commissioner, 71 T.C. 1120 (1979); Appeal of Raymond Carlson, Jr., Cal. St. Bd. of Equal., Sept. 12, 1984.) **Sardi's** adopted a plan to issue small business corporation stock between August 1, 1973, and August 1, 1974. Thus, in order to establish that his stock was section 18208 stock, appellant would have to show that his stock was issued pursuant to this plan. We believe that appellant has failed to do this. As discussed previously, the 350 shares of stock appellant sold were apparently not the shares originally issued to him by the corporation. We have no information concerning when or how the original 35 shares were converted to the 350 shares sold. Therefore, **we do not have sufficient information to determine** whether the stock qualified as section 18208 stock and must assume that it did not. Appellant is, thus, not entitled to an ordinary loss deduction under section 18204.

Since respondent disallowed the total loss claimed by appellant, and appellant has established that he is entitled to a capital loss deduction under section 18162.5, respondent's action must be modified.

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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 Richard W. Cassady against a proposed assessment of additional personal income tax in the amount of \$2,049 for the year 1980, be and the same is hereby modified in accordance with the foregoing opinion. In all other respects, the action of the Franchise Tax Board is hereby sustained.

Done at Sacramento, California- this 10th day Of June , 1986, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. **Collis**, Mr. Bennett, Mr. Dronenburg and Mr. Harvey **present**.

_____	, Chairman
Conway H. <b>Collis</b>	, Member
William M. Bennett	, Member
Ernest J. Dronenburg, Jr.	, Member
Walter Harvey*	, Member

\*For Kenneth Cory, per Government Code section 7.9