

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
WILLIAM C. AND SANDRA M. SCOTT) **No . 82A-658-AJ**

For Appellants: **James M. Allen**
Attorney at Law

For Respondent: **Eric J. Coffill**
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 William C. and Sandra M. Scott against a proposed assessment of additional personal income tax in the amount of **\$1,652.93** for the year 1976.

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 losses claimed from transactions in London silver options were the result of bona fide transactions. If so, the additional issue presented is whether the transactions in London silver options were activities engaged in for profit.

On their 1976 personal income tax return, appellants reported gain and loss allegedly resulting from the purchase and sale in London of option contracts to buy (a "call" option) or sell (a "put" option) silver. Appellants contend that they entered into nine transactions which involved either November or September 1976 puts and calls and were always in the form of a straddle, that-is, appellants simultaneously held a contractual right to purchase silver in one delivery month and a right to sell the same commodity in a different delivery month.^{2/} On their 1976 joint personal income tax return, appellants claimed a short-term loss of \$34,838.94 incurred as a result of the September 1976 puts and calls.^{3/} Respondent disallowed this deduction, contending that the transactions were not bona fide and that, even if they were, they were not engaged in for profit. Respondent issued a proposed assessment reflecting this determination which it affirmed after considering appellants' protest. This timely appeal followed.

The first issue we must address is whether appellants established that the silver option transactions were bona fide.

Section 17206 allowed a deduction for certain losses sustained by an individual during the taxable year and not compensated for by insurance or otherwise. (See I.R.C. § 165 for the corresponding federal statute.) Treasury Regulation section 1.165-1(b), which is

2/ For a general explanation of the income tax objectives of tax straddles in silver, see Smith v. Commissioner, 78 T.C. 350, 363-366 (1982).

3/ Appellants also claimed in connection with the November contracts a short-term capital loss of \$32,422.50. This was balanced by a reported short-term capital gain of \$32,397.75 resulting from the silver transactions. Neither of these items is involved in this appeal.

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applicable here (see Holmes v. McColgan, 17 Cal.2d 426, 430 (110 P.2d 428), cert. den., 314 U.S. 636 [86 L.Ed. 510] (1941)), specifies that in order to be deductible, "a loss must be evidenced by closed and completed transactions, fixed by identifiable events, and . . . actually sustained during the taxable year." The only evidence submitted by appellants to establish that they actually sustained the loss in question were copies of confirmations of contracts issued by Competex S.A. (Competex), of Geneva, Switzerland, the brokerage company which allegedly handled the transactions. Respondent contends, and we agree, that this evidence is not sufficient.

The Internal Revenue Service has addressed the question of what type of evidence is required to establish the existence of a loss through futures transactions carried out on a foreign exchange through a foreign broker. (Rev. Rul. 80-324, 1980-2 C.B. 340.) That ruling involved a taxpayer who invested money with a foreign investment firm in a foreign country. The money was to be used in certain transactions involving futures contracts. To substantiate the investment, the taxpayer provided the investment prospectus of the foreign investment firm, a canceled check made payable to the firm which was said to have been used to open the taxpayer's trading account, and confirmation certificates issued by the foreign firm. The Service concluded that because the transactions were carried out on a foreign exchange not subject to regulatory supervision such as exist in the United States by an investment firm whose records were not available for examination by the Service because of the foreign country's secrecy laws, the Service was not required to assume the existence of those transactions merely because the taxpayer produced some documentation (e.g., investment prospectus, canceled checks, and confirmation statements) purporting to evidence such transactions. We believe that the facts of the instant appeal justify this board displaying the same skepticism shown by the Service in that revenue ruling.

Appellants' transactions were carried out on the London Metal Exchange, a private metal commodity market, which is not subject to regulation by the United States. In addition, since the brokerage firm was located in Switzerland, we presume that its records are not subject to scrutiny by any United States taxing authority; Finally, although respondent requested additional documentation, including copies of contracts between appellants and Competex, proof of money appel-

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lants paid to or received from Competex, copies of monthly statements from Competex, and information regarding the trading rules governing the transactions, appellants have refused to submit any information other **than** the confirmation certificates. We believe that, in this situation; those certificates are not sufficient to establish that appellants actually sustained **a bona fide** loss from the silver transactions. -Therefore, we must conclude that respondent properly disallowed the claimed deduction.

Since we have decided the first issue in respondent's **favor**, there is no need for this board to address the issue **of** whether appellants entered into the transactions-primarily for profit. (See, Smith v. Commissioner, supra, 78 T.C. at 390-394 holding that the taxpayers lacked the requisite economic profit objective necessary to enable them to deduct their commodity tax straddle losses.) For the above reasons, respondent's action must be sustained.

