87-SBE-051

BEFORE TEE STATE BOARD OF EQUALIZATION

OF TEE STATE OF CALIFORNIA

In the Hatter of the Appeal of)
) No. 83A-1324-VN
BDUARDO AND ESTELA UMANSKY)

For Appellant: Ernst & Whinney
Certified Public Accountants

For Respondent: John A. Stilwell Jr.
Counsel

OPINION

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 Eduardo and Estela Umansky against proposed assessments of additional personal income tax in the amounts of $3,560.23 and $4,016.68 for the years 1978 and 1979, 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.

Appeal of Eduardo and Estela Umansky

The issue presented for our decision is whether Eduardo and Estela Umansky are entitled to deduct losses from the exchange of foreign currency. For purposes of this opinion, only Eduardo Umansky shall be referred to as "appellant".

Sometime prior to the appeal years, appellant, while a resident of Mexico, sold certain of his business assets there and made loans to the buyers from whom he accepted promissory notes payable over several years in Mexican pesos. At that time, 12.5 Mexican pesos were worth one United States dollar on the foreign exchange market. Mr. Umansky subsequently became a California resident.

In 1978 and 1979, appellant, then a resident of this state, received Mexican pesos in payment of principal and interest on the promissory notes. In each appeal year, appellant converted these pesos into dollars. Due to devaluation, however, the Mexican peso, measured in terms of United States dollars, was now worth approximately one-half of the value it had when appellant made the loans. During the appeal years, 22 or 23 pesos were needed to buy one dollar on the foreign exchange market. On his returns for 1978 and 1979, appellant claimed loss deductions for the difference between the rate of exchange of pesos and dollars when the loans were made and when repayments were received in 1978 and 1979. The Franchise Tax Board disallowed the deductions as non-deductible personal losses.

Appellant argues that the currency exchange losses are deductible as ordinary losses since they arose from loans that were made for purposes of profit. In general, section 17206, subdivision (a), authorizes a deduction for any loss sustained during the taxable year which is not otherwise compensated for by insurance. In the case of an individual taxpayer, the deduction is limited to (1) losses incurred in a 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).) Similar provisions are found under federal law. (I.R.C. § 165(a) and (c).) Only subdivision (c)(2) of section 17206 is applicable to this appeal.

Whether a particular transaction was entered into for profit is a question of fact on which the taxpayer bears the burden of proving that his primary

intention was to make a profit. (Appeal of Clifford R. and Jean G. Barbee, Cal. St. Bd. of Equal Dec. 15, 1976; Austin v. Commissioner, 298 F.2d 583 (2d Cir. 1962), affg. 35 T.C. 221 (1960).) The taxpayer's expressions of intent, while relevant, are not controlling; rather the taxpayer's motives must be discerned from all of the circumstances in the particular case. (Johnson, Jr.v. Commissioner, 59 T.C. 791 (1973).) The primary focus in this inquiry is on the character of the property itself and the true substance of the overall transaction. (Willis v. Commissioner, 736 F.2d 134 (4th Cir. 1984), revg. ¶ 83,180 T.C.M. (P-H) (1983).)

For income tax purposes, foreign currency is frequently treated as property, rather than a medium of exchange, especially when it is converted into United States funds. (Gillin v. United States, 423 F.2d 309 (Ct. Cl. 1970); B F. Goodrich Co. v. Commissioner, 1 T.C. 1098 (1943).) Transactions in foreign currency may result in a taxable gain or deductible loss like transactions in any other property. (Willard Helburn, Inc. v. Commissioner, 20 T.C. 740 (1953), affd., 214 F.2d 815 (1st Cir. 1954).) However, where a conversion of foreign currency into United States dollars is collateral to an underlying purchase or obligation, the exchange of foreign currency should be treated as a separate transaction. (Willard Helburn, Inc. v. Commissioner, 214 F.2d 815 (1st Cir.), affg., 20 T.C. 740 (1953); Rev. Rul. 78-281, 1978-2 C.B. 204.)

It is well settled that deductions are a matter of legislative grace, and the burden is on the taxpayer to show that he is entitled to the deduction claimed. (New Colonial Ice o. v. Helvering, 292 U.S. 435 [78 L.Ed.1348](1934); Appeal of James C. and Monablanche A. Walshe, Cal. St. Ed. of Equal., Oct. 20. 1975.) Appellant contends that the loans he made to help finance the sale of his Mexican business assets were made for profit since he intended to derive interest income from them. These declarations do not prove, however, that his subsequent conversions into U.S. dollars of the Mexican pesos received in payment of those loans were transactions entered into for profit. Here, the record contains no evidence to suggest that the pesos were converted into dollars for other than appellant's personal use. Like the taxpayer in Bohm v. Commissioner, 34 T.C. 929 (19601, it appears that appellant's losses on these currency, exchanges were occasioned by his voluntary move to this country, which he has not shown to have been a profit-oriented undertaking. Since appellant has failed to

carry his burden of proving that the currency exchanges were transactions entered into for profit, we have no choice but to find that the losses therefrom were not deductible as ordinary losses under section 17206.[2/] Based on the foregoing, we find that respondent's action must be sustained.

2/ In the alternative, appellant has argued that his currency exchange losses should be deductible as capital losses. The Franchise Tax Board seemingly agrees, for it states appellant has correctly cited Revenue Ruling 74-7, 1974-1 C.B. 198, which holds that foreign currency is a capital asset and any gain or loss realized on the reconversion by a taxpayer, who is not a dealer in foreign currency, constitutes a capital gain or loss. Respondent adds, however, that capital loss treatment of appellant's currency exchange losses will not reduce his tax liability for the appeal years since he has already claimed the maximum amounts allowed by the California Personal Income Tax law. Since there is apparently no dispute between the parties on this issue, we are not required, at this time, to address the propriety of respondent's concession.

Appeal of Eduardo and Estela Umansky

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 Eduardo and Estela Umansky against proposed assessments of additional personal income tax in the amounts of $3,560.23 and $4,016.68 for the years 1978 and 1979, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 17th day of June, 1987, by the State Board of Equalization, with Board Members Mr. Collis, Mr. Dronenburg, Mr. Bennett, Mr. Carpenter and Ms. Baker present.

Conway H. Collis, Chairman

Ernest J. Dronenburg, Jr., Member

William M. Bennett, Member

Paul Carpenter, Member

Anne Baker*, Member

*For Gray Davis, per Government Code section 7.9