87-SBE-077

BEFORE TEE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) No. 85A-0742-KP
ZORIK AND ARTIMIS SOULKANIAN)

For Appellant: Paul A. Pensig
Attorney at Law

For Respondent; Karen D. Smith
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 Zorik and Artimis Soulkanian against a proposed assessment of additional personal income tax in the amount of $7,192 for the year 1981.

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

The issue presented by this appeal is whether respondent properly denied a deduction for two parcels of appellants' Iranian real property that were confiscated by the Iranian revolutionary government during 1981.

Appellant Zorik Soulkanian was a general in the Iranian Air Force under the regime of the Shah. Appellant and his wife fled to this country out of fear of persecution from the revolutionary government which took control of Iran in 1979. In February 1980, the general was identified along with 144 other former military officers as being anti-revolutionary, an action which resulted in his formal expulsion from his air force position and a unanswered demand that he submit himself to the government for trial. In March 1981, the government issued a confiscation notice regarding all of appellants' property remaining in Iran. Even though appellants were living in California during that year, they still owned a three-story apartment and a villa outside of the capital city.

On their joint tax return for 1981, appellants dedudted $1,140,000 as a loss due to the expropriated properties. Respondent reviewed that return and requested further substantiation regarding the claimed losses. Upon review of the documentation provided by appellants, respondent determined that the taxpayers had failed to substantiate (1) the fact that the properties were used in a trade or business and (2) the adjusted bases of the properties. The present assessment was issued, which was subsequently upheld on protest, and this appeal followed.

Section 17206 stated, in 'relevant part, that

> (a) There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.
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> * * *
>
> (c) In the case of an individual, the deduction under subdivision (a) shall be 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; ...

As section 17206 is modeled after Internal Revenue Code section 165, federal authority interpreting the federal statute is highly persuasive as to the proper application of the comparable state statute. (Andrews v. Franchise Tax Board, 275 Cal.App.2d 653 [80 Cal.Rptr. 403] (1969).)

While we have been confronted with confiscatory loss claims in the past, those appeals have never reached the question of whether this board should adopt the established line of federal authority regarding confiscatory losses. Rather, the appeals have been decided on the failure of the taxpayers to prove the existence of their losses. (See, e.g., Appeal of Estate of Amir Natan, Deceased, and Estate of Roohi Natan, Deceased, Cal. St. Bd. of Equal., Sept. 10, 1986; Appeal of Jorge and Elena de Quesada, Cal. St. Bd. of Equal., Feb. 5, 1968.) We did note in Natan, however, that federal courts faced with similar arguments supported by the proper evidence have held that the confiscation of property not used in a trade or business by a foreign government acting under color of authority is not a deductible loss provided for by statute. (See, e.g., Farcasanu v. Commissioner, 436 F.2d 146 (D.C. Cir. 1970); Powers v. Commissioner, 36 T.C. 1191 (1961).) On the other hand, federal authority has held that if the confiscatory action was against property that the taxpayer claims he used in his trade or business or that he claims was used in a venture entered into for profit, the taxpayer may be entitled to a deduction, (See; e.g., Weinmann v. United States, 278 F.2d 474 (2d Cir. 1960); Elek v. Commissioner, 30 T.C. 731 (1958).) We find the rationale and holdings of the federal authorities persuasive with regard to confiscatory losses. Therefore, appellants will be allowed to deduct their confiscatory losses if they can demonstrate that their losses fall under either section 17206, subdivision (c)(1) or subdivision (c)(2).

> An act of confiscation has occurred when the taxpayer has been deprived of ownership of property or the normal attributes of ownership, such as receipt of income and control over the operation or use of the property, with little or no chance of being compensated therefor. (Rev. Rul. 62-197, 1962-2 C.B. 66, 69.)

To satisfy his burden of proving he is entitled to a deduction for a confiscated property, a taxpayer must prove that he owned the property in question (Rev. & Tax. Code, § 17206), that the property was used in a trade or business or a venture entered into for profit (Graham v. United States, 12 A.F.T.R.2d (P-H) ¶ 63-5072 (1963)), that he actively managed and controlled the property at the time of the confiscation (Elek v. Commissioner, supra), and that the decree -confiscation unequivocally applied against the property in question (Graham v. United States, supra). Furthermore, the burden is upon the taxpayer to establish the occurrence of the act of confiscation and its date to support the deduction. (Elek v. Commissioner, supra: Rev. Rul. 62-197, supra.) Due to the difficulty of proving a confiscatory loss in a foreign country, the date of such a loss may be established by whatever evidence is available, including circumstantial evidence. (Elek v. Commissioner, supra; Rev. Rul. 62-197, supra.) The basis for determining the amount of the deduction under 17206 is the adjusted basis of the property. (See Rev. Rul. 62-197, supra.)

We begin by applying these principles to the confiscation of the three-story building in Tehran. Appellants have produced a copy of the 1974 deed to the building certifying Mrs. Soulkanian's ownership of the building. (App. Br., Ex. A.) Furthermore, appellants have offered as proof of her continued ownership in 1981, a copy of the official decree of confiscation regarding all of appellants'. property dated March 1, 1981, which is addressed to appellants at the building in question. (App. Ltr., Mat. 23, 1987, Ex. B.) Therefore, we find that appellants have proven that they.owned the apartment in Tehran at the time of the confiscation.

We next consider whether the building was used in a trade or business engaged in by appellants. Appellants have claimed that the top two stories of the three-story building in Tehran were used as rental. property while they occupied the bottom floor of the building. The rental and management of a building amounts to the trade or business of the owner. (Elek v. Commissioner, supra.) As evidence of the usage of the building as a rental, appellants submit a contract for sale of the property dated January 1, 1980, wherein the property is described as being owner-occupied on the first floor with the top two floors being rented. Appellants have also produced a property tax bill dated December 6, 1980, which was based upon the total amount of rent received

during that year. We find that this evidence is sufficient to prove that appellants were in the business of renting out the top two floors of the apartment building in Tehran.

It is also evident that appellants kept control of the apartment through a relative/agent while appellants were residing in California. All of the tax bills and receipts issued in 1980 and 1981 were in the name of Mrs. Soulkanian. Besides appellants' stated claims that they left the apartment under the control of relatives, the cash payment made to satisfy the property tax assessment on January 12, 1901, was paid by a Mr. Mohammed. Keyvan, Mrs. Soulkanian's "representative - living at Khavaran Avenue (the address of the apartment building)." (App. Ltr., Dec. 19, 1986, Ex. E.) Consequently, we find that appellants have satisfied the requirement proving their continued control of the property through their agent at the time of the confiscation. (Cf. Elek v. Commissioner, supra.)

Finally, upon a close reading of the confiscation note of March 1, 1981, it is evident that all of appellants' property was being expropriated. While the apartment building was not specifically mentioned, the notice was addressed to appellants at the apartment itself. It is unrealistic to believe that the apartment building, which was obviously known to the revolutionary government, would have been excluded from such a broad order. Therefore, we find that appellants have satisfied their burden of proving that they owned the apartment in question, that they used the apartment in the trade or business of renting property, that they maintained control of the apartment even while expatriated, and that the property was confiscated without compensation on March 1, 1981. Our next consideration is the proper amount of the deduction.

While there appears to be confusion on the part of the parties as to when the property was purchased, a careful, review of the provided documents reveals a contract stating that Mrs. Soulkanian purchased the property on October 1, 1974. (App. Ltr., Mar. 23, 1987, Ex. A.) While the cost of the land was specifically

stated in the contract as 3,400,000 rials, or approximately $42,500,[2] the construction costs are a source of some speculation as there are no construction receipts available.

From memory, General Soulkanian submitted a partial list of expenses which totalled 8,410,000 rials, or $105,125. (App. Br., Ex. I.) At a later date, appellants submitted a letter from a contractor who claimed that he built the apartment for $240,000. Appellants' records do fall short of the desired standards for complete substantiation of the repair expenses claimed. We believe, however, that this is a proper case for application of the so-called "Cohan rule," which provides for the making of an approximation of expenditures of the type at issue where it is readily apparent that "something was spent" but where the taxpayer's records are inadequate to the extent that it is impossible to make an accurate determination of how much was spent for deductible business purposes. (Cohan v. Commissioner, 39 F.2d 540 (2d Cir. 1930).) While appellants' estimation and the contractor's approximation are not a truly accurate record of the costs, we note that the two estimations are not inconsistent. Therefore, taking into consideration the cost of the land and due to the difficulty of obtaining the construction records from Iran, we find that the contractor's estimation of the building costs is not unreasonable and it shall be accepted as the cost of building. Adding the estimated cost of the building to the known cost of the land results in a total basis of $282,500.

This figure, however, is not the adjusted basis that appellants may deduct. As appellants admit that they lived on the first floor of the building, only two-thirds of the building was used in their rental trade or business. (See Weinmann v. United States, supra.) Therefore, only two-thirds of the cost of the building may be considered in determining the adjusted basis of the property. Furthermore, appellants have failed to

2/ This figure is based upon an exchange rate of 80 rials to one dollar as agreed to by appellants. This figure is rounded-off from a March 30, 1986 world currency quotation from an Iranian newspaper which stated that one U.S. dollar was worth 81.3 rials. While an exchange rate for 1986 does not properly reflect the exchange rate for 1974, 1977, or 1978, no other figure has been submitted for our consideration.

take into account depreciation of the rental property as provided-for in section 17208. In determining the final adjusted basis figure, respondent shall determine the amount of depreciation to be subtracted from the two-thirds cost described above by the straight-line method of depreciation over the useful life of the building. The useful life shall be determined by the 1978 Internal Revenue Service rules regarding real property depreciation. Furthermore, depreciation shall be accounted for from 1978, the date the building was completed, to 1981, the time of the confiscation.

While we agree with appellants that they may deduct their apartment building as a loss incurred in their trade or business, we must deny a deduction for the basis of the villa in its entirety. There is no evidence presented which substantiates appellants' claim that the villa was used in the trade or business of renting property. Appellants' evidence only establishes ownership, not usage, and ownership alone is not sufficient to support a confiscatory loss deduction. (See Farcasanu v. Commissioner, supra; Powers v. Commissioner, supra.)

In summary, respondent must modify its assessment to allow a deduction for the adjusted basis of the apartment building in the manner prescribed above. In all other respects, however, respondent's determination must be upheld.

Appeal of Zorik and Artimis Soulkanian

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 thtref or,

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 Zorik and Artimis Soulkanian against a proposed assessment of additional personal income tax in the amount of $7,192 for the year 1981, be and the same is hereby modified in accordance with this opinion.

Done at Sacramento, California, this 3th day Of December , 1987, by the State Board of Equalization, with Board Members Mr. Collis, Mr. Dronenburg, Mr. Carpenter, and Ms. Baker present.

Conway H. Collis, Chairman

Ernest J. Dronenburg, Jr., Member

Paul Carpenter, Member

Anne Baker*, Member

_____, Member

*For Gray Davis, per Government Code.section 7.9