88-SBE-008

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BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) No. 79J-416-RO
)
MICHAEL S. LUFT)

For Appellant: Larry R. Bemis
Attorney at Law

For Respondent: Grace Lawson
Counsel

'OPINION

This appeal is made pursuant to section 18646[1] of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the petition of Michael S. Luft for reassessment of a jeopardy assessment of personal income tax in the amount of $8,341.80 for the period January 1, 1978, through November 27, 1978.

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

There are four issues in this case. These issues are:

1. Whether the respondent properly characterized as ordinary income the proceeds from the auction sale of certain items of celebrity memorabilia?

2. Whether sales commissions paid on auctioned property were properly deductible by the appellant-seller when such property was purchased for the appellant by his nominees?

3. Whether the respondent properly disallowed all but $1,442 for automobile expenses claimed by the appellant?

4. Whether the respondent's inclusion of unreported income of $33,994.61 was proper?

The appellant was formerly married to the late Judy Garland. As a result of a divorce, appellant settled his property rights with her by a property settlement. Appellant later contracted with C. B. Galleries, Inc., to conduct a public auction of Ms. Garland's memorabilia. The memorabilia placed for auction consisted, in part, of musical arrangements, scripts, photographs, scrapbooks, tapes and letters. A public auction was held to sell the memorabilia. The appellant, through "nominees", bid on and.purchased certain items put up for auction. As a consequence, the appellant paid sales commissions on these items-in the amount of $9,397.50. In view of appellant's prior state income tax problems, the respondent sent an employee to the auction who determined that the auction produced gross receipts of approximately $185,000. Fearing a delay would jeopardize collection of appellant's 1978 personal income tax, respondent issued a jeopardy assessment.

When the appellant filed his 1978 California personal income tax return he reported a total tax liability of only $227. His return also reported capital gains of $50,000 generated by the auction. On schedule C, appellant reported income of $45,783 and deductible expenses of $33,410. The claimed expenses included $6,981 as deductible automobile expenses*

As a result of .an audit, respondent made the following determinations:

1. That appellant erroneously characterized income from the sale of certain items, namely (1)scrapbooks,(2)arrangements, (3)tapes, (4)letters, (5)invitations, (6)photographs and (7)scripts, at auction as capital gains income;

2. That appellant incorrectly took a deduction for the $9,397.50 in sales commissions generated by the sales to his nominees as a sales expense arising from the auction;

3. That appellant failed to report $33,994.61 as additional income on his 1978 income tax return; and

4. That appellant was only entitled to claim automobile expense deductions of $1,442.

As a result of the audit, respondent issued a proposed assessment. Appellant petitioned for reassessment. Subsequently, the respondent issued a notice of action which affirmed the assessment.of $8,341.80 and this appeal followed.

As to the'first issue, the appellant incorrectly argues that section 18161, subdivision (c), is inapplicable. This section provides that certain types of property cannot be classified as capital assets in the following terms:

> (c) A copyright, a literary, musical or artistic composition, a letter or memorandum, or similar property, held by ---
>
> (1) A taxpayer whose personal efforts created such property,
>
> (2) In the case of a letter, memorandum, or similar property, a taxpayer for whom such property was prepared or produced, or
>
> (3) A taxpayer in whose hands the basis of such property is determined, for the purposes of determining gain from a sale or exchange, in whole or in part by reference to the basis of such property in the hands of a taxpayer described in paragraph (1) or (2);

Thus, there is a two-tiered test to.determine if section 18161, subdivision (c), applies. First, is this the type of property that falls within the purview of the statute? Second, is the appellant the type of "taxpayer", as described in subdivision (c)(3)?

In this instance, the appellant does not dispute that the (1)scrapbooks, (2)arrangements, (3)tapes, (4)letters, (5)invitations, (6)photographs and (7)scripts are the type of property that falls within the purview of the statute. However, appellant does dispute the application of section 18161, subdivision (c)(3).

The second test of exclusion requires that the appellant's basis in the disputed memorabilia, for purposes of determining gain from a sale or exchange, be determined in whole or in part by reference to the basis of such property in the hands of the creator or previous owner, as described-in subdivision (c)(1) or (c)(2), respectively, of section 18161. In this instance, if there is such reference to the basis the late Ms. Garland' had in the property, then both tests are met. The appellant denies that his basis in the memorabilia is the same as that of Judy Garland contending.that he acquired virtually every asset for consideration. (Appeal Ltr. at 3.)

There is no evidence in the record to support appellant's contentions as to his basis in the memorabilia. The burden is on the taxpayer to prove that the additional tax assessment is incorrect. (Appeal of Richard A. and Virginia R. Ewert, Cal. St. Bd. of Equal., Apr. 7, 1964.) Mere allegations by appellant are insufficient to carry his burden of proof. (Appeal of Marcel C. Robles, Cal. St. Bd. of Equal., June 28, 1979.) Therefore, since appellant has failed to carry-his burden of proof on the issue, the respondent's position that the memorabilia are not capital assets must be sustained.

With respect to the second issue, the respondent properly disallowed the $9,397.50 expense deduction claimed for auction commissions paid on auctioned property purchased by appellant's nominees. According to section 17252:

In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year--

(a) For the production or collection of income;

(b) For the management, conservation, or maintenance of property held for the production of income; or

(c) In connection with the determination, collection or refund of any tax.

The federal counterpart to section 17252 is section 212 of the Internal Revenue Code of 1954. Since the statutes are virtually identical federal court interpretations of section 212 of the Internal Revenue Code of 1954 are persuasive as to the proper interpretation of section 17252. (Rihn v. Franchise Tax Board, 131 Cal.App.2d 356, 360 [280 P.2d 893] (1955).)

Expenses of acquiring or 'recovering title to property, or of perfecting title are capital expenditures which constitute a part of the cost or basis of the property and are not deductible currently as ordinary or necessary expenses. (Spangler v. Commissioner, 323 F.2d 913, 919 (9th Cir. 1963); see also Davis v. Commissioner, 4 T.C. 329, affd., 151 F.2d 441, 443 (8th Cir. 1945) and Ward v. Commissioner, 20 T.C. 332, affd., 224 F.2d 547, 555 (9th Cir. 1955); Treas. Reg. § 1.212-1(k).) The appellant's payment of sales commissions related directly to the recovery of certain items of memorabilia. Therefore, the expenditures are related to the acquisition of an asset and not a current expense.

A close look at the contract appellant had with the auctioneer reveals that appellant had no other means to control the risk of ultimate loss of the property he transferred to the auctioneer, other than by bidding on the property at auction. Under the contract, the appellant had no right to withdraw an item from auction, no right to a minimum bid and no right to a return of unsold items,, except for the automobile. The appellant was contractually obligated to let the auctioneer sell the memorabilia. Appellant received a $50,000 advance from the auctioneer and gave the auctioneer a lien on the memorabilia. Appellant could not prevent the auctioneer from selling the memorabilia at auction since there was a binding contract and possession of the memorabilia' was transferred to the auctioneer. Appellant's act of successfully bidding on the memorabilia he recovered amounts to the recovery and perfection of title of assets, free of lien, which he would

have otherwise lost. Therefore, the respondent's disallowance of the deductions for sales commissions are an expense must be sustained.

The third issue is whether the respondent properly disallowed all but $1,442 in automobile expenses claimed by the appellant. The burden is on the taxpayer to show by competent evidence that he is entitled to the deductions claimed. (New Colonial Ice Co. v. Helvering, 292 U.S. 435 [78 L.Ed. 1348] (1934); Appeal of James C. and Monablanche A. Walshe, Cal. St. Bd. of Equal., Oct. 20, 1975.)

In this instance, after adjustment by the respondent, appellant was allowed automobile expense deductions of only $1,442. Appellant contends he is entitled to an additional $1,500 for automobile expense deductions. Respondent's adjustment of the appellant's automobile deductions is based on respondent's determination of a thirty-three and one-third percent (33-1/3%) business use of the appellant's automobile. Appellant contends the proper percentage which should-have been applied was sixty-six and two-thirds percent (66-2/3%).

Appellant has failed to carry his burden of proof that he is entitled to any further deductions for automobile expenses, other than the $1,442 the respondent allowed. The taxpayer is required to maintain such accounting records as may be necessary to support his return; (Cal. Admin. Code, tit. 18, reg. 17561, Subd. (a).) The record contains no evidence to support the appellant's claim for $1,500 in additional automobile expense deductions. Appellant's general allegations are insufficient to carry his burden. (Appeal of Marcel C. Robles, supra.) Under these circumstances, we must sustain respondent's position.

The remaining issue is whether the entire sum of $33,994.61 discovered by the respondent, as a result of audit, is taxable as unreported income in appellant's 1978 income tax return. Appellant concedes that approximately $23,995 of that sum should be included. Appellant, however, denies that the remaining balance, approximately $10,000, is also taxable as unreported income,.

Since 1980 the appellant' has had 'an opportunity to substantiate that the sum in dispute does not represent income to the taxpayer. The record contains no evidence to substantiate that the disputed sum represents loans, bank transfers or other- nontaxable receipts. (Appeal Ltr.

at 2.) An assessment is presumed to be correct and it is necessary for the taxpayer to show that it is erroneous. (Todd v. McColgan, 89 Cal.App.2d 509, 514 [201 P.2d 4141 (1949); Appeal of Richard A. and Virginia R. Ewert, Cal. St. Bd. of Equal., April 7, 1964).)

The appellant has offered no evidence to the contrary other than his unsupported allegations. The appellant cannot meet his burden of proof by giving an uncorroborated self-serving statement. (Hoefle v. Commissioner, 114 F.2d 713 (6th Cir. 1940); Appeal of Robert C. Sherwood, Deceased, and Irene Sherwood, Cal. St. Bd. of Equal., Nov. 30, 1965.) Accordingly, the respondent's determination that the entire $33,994.61 is taxable as unreported income must be sustained.

Appeal of Michael S. Luft

ORDER

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 in denying the petition of Michael S. Luft for reassessment of a jeopardy assessment of personal income tax in the amount of $8,341.80 for the income period of January 1, 1978 through November 27, 1978, be and the same is hereby sustained.

Done at Sacramento, California, this 1st day of April, 1988, by the State Board of Equalization, with Board Members Mr. Dronenburg, Mr. Collis, and Mr. Davies present.

Ernest J. Dronenburg, Jr., Chairman

Conway H. Collis, Member

John Davies*, Member

____________________, Member

____________________, Member

*For Gray Davis, per Government Code section 7.9