



88-SBE-021

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

In the Matter of the Appeal of)
MITZI BRIGGS SMITH) No. 84A-229-KP
)

For Appellant: Richard A. Mullens
Attorney at Law

For Respondent: Eric J. Coffill
Counsel

O P I N I O N

This appeal is made pursuant to section 18593¹/₁ of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Mitzi Briggs Smith against a proposed assessment of additional personal income tax in the amount of \$858,858.49 for the year 1975.

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 issue presented by this appeal is whether **appellant** is entitled to **claimed losses** incurred from transactions in silver straddles.

Sometime during late 1974, and the first few months of 1975, appellant became concerned with the low rate of return from her Stauffer Chemical Company stock which she had inherited. In **early 1975**, appellant liquidated **her interest** in Stauffer **for** a capital gain of over **\$11,000,000**. Between June 19, 1975, and September 17, 1975, appellant invested **\$6,400,000** of that gain in stock in the corporation which **owned** the Tropicana Hotel in Las Vegas, Nevada. **Due** to the fact that the Tropicana Hotel operated a casino, appellant's investment **had** to be approved by the Nevada Gaming Commission. During its investigation of appellant, the Commission notified Ms. Briggs that the Tropicana had over **\$9,000,000** in gamblers' "markers" (gambling debts), many of which may not have been collectable. Accordingly, appellant, as controlling shareholding, was **told** that she might have to make additional investments in the Tropicana.

Between November 5, 1975, and December 1, 1975, appellant entered into a series of silver commodity future contracts. These contracts **were** evenly divided between contracts to buy silver at a future date (a **"long"** position) and contracts to sell silver at a future date (a **"short"** position), although the **dates for sale and delivery** varied. Such a balanced position between an equal number of long and short contracts is called a straddle. The purpose of purchasing the same number of long and short contracts was to minimize the investor's risk in the **venture since** the contract values always **moved in** opposite directions depending upon the rise or fall of the value **of** the underlying commodity. Due to the contracts' **opposite** movements, a trader would theoretically never suffer a loss, although he would also never **realize** a gain. If properly administered, a silver straddle could create a capital loss of enormous proportions one year, and a capital gain **of the same** proportions in the following **year.^{2/} This same scheme could then be employed the following year to again defer the tax on capital gains. **"In fact,** if petitioner's analysis of the tax law **is correct,** nothing but commission costs and death would prevent a taxpayer from perpetually straddling, achieving perhaps the ultimate goal of permanent **deferral of taxation of an initial ... capital gain.**" (Smith v. Commissioner, 78 T.C. 350, 365 (1982).)**

^{2/} For a complete description **of** the mechanics and tax benefits of **silver** straddles, see Smith v. Commissioner, 78 T.C. 350 (1982).

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Apparently, appellant's broker was quite successful in his efforts to create a capital loss as appellant claimed a deduction of **\$11,395,285** on her 1975 California personal income tax return for 1975, thereby offsetting her capital gains realized through the Stauffer Chemical stock sale. The Franchise Tax Board (**FTB**) audited appellant's 1975 return and determined that at all times appellant maintained "balanced" straddle positions which minimized risk, and as a result, she never entered into the straddles with the intent of making a profit. The present assessment was issued, appellant's subsequent protest was denied, and this appeal followed.

Section **17206** provided, in pertinent 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.

* * *

(c) In the case of an individual, the deduction under subsection (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 . . .

The question of whether the use of silver straddles is a legitimate method for avoiding taxes is an issue of first impression before this board.³¹ Therefore, we will look to similar laws and cases in other jurisdictions for guidance in interpreting this situation. We note that section 17206 was based upon **and was substantially** similar to section 165 of the Internal Revenue Code (**I.R.C.**) of 1954. Accordingly, federal interpretations and regulations of I.R.C. section 165 are highly persuasive regarding proper interpretation of section 17206. (See Rihn v. Franchise Tax Board, 131 Cal.App.2d 356 (280 P.2d 893) (1955); Meaney v. McColgan, 49 Cal.App.2d 203 (121 P.2d 451 (1942)).)

3/ While we were faced with a factually **similar** situation in the Appeal of William C. and Sandra M. Scott, decided September 10, 1986, our decision **did** not reach the merits of the **taxpayers'** case as the taxpayers did not satisfy their burden of proving that they actually engaged in silver straddle **transactions**.

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Treasury Regulation 1.165-1, subsection (b), in relevant part, states that:

To be allowable as a deduction under section 165(a), a loss must be evidenced by closed and completed transactions, fixed by identifiable events, and . . . actually sustained during the taxable year. Only a bona fide loss is allowable. Substance and not mere form shall govern in determining a deductible loss.

In Smith v. Commissioner, supra, the court determined that while properly documented silver straddle transactions met the closed and completed transactions test enunciated in regulation 1.165-1, it was a question of fact as to whether the taxpayer actually entered into the transactions with a bona fide expectation of making a profit. (Smith v. Commissioner, supra, 78 T.C. at 390.) As stated by the court:

The mere fact that petitioners may have had a strong tax avoidance purpose in entering into their commodity tax straddles does not in itself result in the disallowance of petitioners' losses under section 165(c)(2), provided petitioners also had a nontax profit motive for their investments at the time Such hope of deriving an economic profit aside from the tax benefits need not be reasonable so long as it is bona fide However, the existence of a nontax profit objective is a question of fact on which the petitioners bear the burden of proof In ascertaining petitioners' subjective intent, this Court is not bound by the taxpayer's uncontradicted assertions of proper motive made . . . years after the events in issue. (Citations omitted.)

(Smith v. Commissioner, supra, 78 T.C. at 391.)

We find the reasoning and determinations of the court in Smith v. Commissioner, supra, compelling. Consequently, we adopt the law and holdings put forth in that decision. As both parties in the present case agree that the transactions in question occurred, and there is no issue as to the amount of losses incurred by those trades, the only issue left to be decided is whether appellant had the proper profit motive in entering into the silver straddles in question.

Appellant contends that the loss claimed in 1975 and the deferral of gain into a later year by the use of: the

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transactions in silver commodities straddles 'was part of an overall "for profit" venture **plan** involving appellant's substantial investment in the Tropicana Hotel. Furthermore, appellant contends that the transactions in the **commodities** futures themselves **were** entered into on their own profit motive basis.

We will first consider whether appellant has proven that she entered into her silver straddle transactions with a bona fide belief that she would generate a profit from those transactions themselves. Appellant argues that since she invested in more straddles than she needed to generate the loss for 1975, **she has** shown. **that** she had more **than simple** tax avoidance in mind when she entered the futures-contracts. Appellant **also points** out that if certain gains had not been generated **by her straddle** account during 1975, she would have lost an additional **\$2,000,000**. Accordingly, appellant contends that those gains demonstrate the appropriate profit motive. Finally, appellant points to several sales of straddles which resulted in profits.

We do not find appellant's arguments compelling. First, appellant admits that she **was** in need of a tax shelter to protect **her** profits from the sale of the Stauffer stock. Second, all of the literature describing the straddles offered **as** evidence by appellant emphasized the tax deferral aspects of the investment **and** downplayed the profit motive. (See also Smith v. Commissioner, **supra**.) Third, individual trades can always be manipulated to show a profit, the important aspect of **this case is** that in the aggregate appellant achieved her **stated goal** of deferring the tax on her gain from the sale of Stauffer stock to a later year. Finally, the number of straddles entered into is irrelevant. There is no evidence to show **that a** large number of straddle transactions would be more likely to **produce a** profit, for the admitted desire of the plan was to defer taxes. Rather, a large number of transactions handled in the manner described in appellant's exhibits would have the sole **benefit** of reaching the target capital loss faster than a lesser number of transactions. Consequently; we find that appellant has failed to prove that she entered into her silver straddle transactions with a bona fide intent of making a profit. Rather, **appellant** has produced evidence which would indicate she entered into those transactions with the sole intent of avoiding taxes on her capital gains for the year in question.

Appellant's alternative argument would have us declare the **focus** of the word "transaction" in section 17206, subdivision **(c)(2)**, to encompass a taxpayer's money-making ventures as a whole rather than having each venture judged on

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its individual merit. It is appellant's contention that the silver straddle transactions were specifically designed to protect her investment in the Tropicana Hotel. Therefore, appellant concludes, the two investments are really one transaction.

It is appellant's burden to prove that several separate transactions were actually part of one "total" transaction. (Estate of McGlothlin v. Commissioner, 370 F.2d 729 (5th Cir. 1967).) While articulating her position well, appellant fails to provide evidence linking the two transactions. (Compare Owen v. United States, 99 F.Supp. 855 (D.Neb. 1951); Davock v. Commissioner, 20 T.C. 1075 (1953).) Objectively, there is no evidence to connect the stock and the straddles. There was no contemporaneous purchase of the Tropicana Hotel stock and the silver straddles; the stock was purchased in mid-1975 while the straddles were entered into in November and December of that year. There is no contemporaneous writing which would show any interdependence between the two transactions.

Despite her protests to the contrary, appellant's situation is objectively, no different than the taxpayers in Smith. In fact, rather than being a case of first impression, appellant's apparent situation is one in which all users of tax shelters are involved. Appellant, like all similarly situated taxpayers, found herself facing a large tax bill as a result of her stock transactions. Appellant, like all similarly situated taxpayers, wanted to shelter that income from tax. Appellant, like the taxpayers in Smith, found that silver straddles could generate the losses necessary to shelter the income in question. To rule as appellant asks would open the door for a linking of all tax shelters to all profit-making ventures simply because the ventures were owned by the same individual. There must be a factual showing that the transactions in question are indeed inexorably linked as one whole "transaction." (See Estate of McGlothlin v. Commissioner, supra; Owen v. United States, supra; Davock v. Commissioner, supra.)

As appellant has failed to satisfy her burden of proving her transactions in silver straddles were entered into with a bona fide profit motive, respondent's action in this matter will be sustained.

