

**OFFICE OF TAX APPEALS  
STATE OF CALIFORNIA**

In the Matter of the Appeal of: ) OTA Case No. 20106842  
L. IGARASHI (DEC'D) AND )  
P. IGARASHI )  
\_\_\_\_\_ )

**OPINION**

Representing the Parties:

For Appellants: Philip E. Becker, CPA

For Respondent: Brian C. Miller, Attorney

For Office of Tax Appeals: William J. Stafford, Attorney

T. STANLEY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, L. Igarashi (appellant-husband) and P. Igarashi (together, appellants) appeal actions by the Franchise Tax Board (FTB) proposing additional tax of \$327,514, plus applicable interest, for the 2014 taxable year, and additional tax of \$33,986, plus applicable interest, for the 2016 taxable year.

Appellants waived the right to an oral hearing; therefore, the Office of Tax Appeals (OTA) decides the matter based on the written record.

**ISSUES**

1. Have appellants demonstrated that they are entitled to a greater worthless stock deduction for the 2014 taxable year than FTB allowed?
2. Have appellants demonstrated that FTB's adjustments to installment sales income for the 2014 and 2016 taxable years were erroneous?
3. Have appellants demonstrated that they are entitled to a greater capital loss carryover deduction for the 2014 taxable year than FTB allowed?

## FACTUAL FINDINGS

### Worthless Stock – Taxable Year 2014

1. Appellant-husband's corporation, Rashi World, Inc. (Rashi World), manufactured and marketed golf clubs from 2002 through 2012.
2. Appellants funded some operating losses of Rashi World with personal funds that were recorded as loans on Rashi World's books and records. The loans were converted to the capital stock of Rashi World in 2014.
3. Appellants claimed a worthless stock deduction of \$1,659,662 for the 2014 taxable year for funds appellants allegedly loaned to Rashi World throughout its existence.
4. During audit and/or protest proceedings, appellants submitted a typewritten schedule of funds appellants contend they loaned to Rashi World and a handwritten list of funds appellants contend they loaned to Rashi World from 2007 through 2012. Appellants also submitted bank statements of their personal bank account and/or Rashi World business bank account from April 1, 2009, through March 31, 2013.
5. FTB determined that appellants substantiated loans from appellants to Rashi World totaling \$589,920 and disallowed the remaining \$1,069,742 worthless stock deduction.

### Installment Sale

6. Appellant-husband owned or controlled patents that were used by Sayuki Custom Cosmetics, Inc. (Sayuki), a cosmetics company.
7. Pursuant to an Asset Purchase Agreement (APA) dated July 31, 2014, a large cosmetics company purchased appellant-husband's patents, along with the assets of Sayuki, for consideration of \$11,500,000, plus earn-out amounts.<sup>1</sup>
8. The APA provided for a payment to appellant-husband of \$11,300,000 on closing, less a holdback of \$565,000, and a payment to Sayuki of \$200,000 on closing, less a holdback of \$10,000. Appellants reported a payment of \$11,310,000 on their 2014 tax return.

---

<sup>1</sup> Pursuant to the APA, earn-out payments were to be considered and reported by the parties as part of the consideration paid for Sayuki. However, nothing in OTA's records indicates that appellants received earn-out payments that would affect the taxable years at issue.

9. Section 9.6(b) of the APA provides for the holdbacks to be paid to the sellers two years after the escrow closing date.<sup>2</sup>
10. Appellants received two installments from the sale of the Sayuki patents: a payment of \$10,735,000 in 2014 and a payment of \$565,000 in 2016.<sup>3</sup>
11. On their 2014 tax return, appellants reported the sale of patents as an installment sale with a sales price of \$11,310,000. Appellants also reported \$10,950,000 as payments received during 2014.
12. Appellants reported a cost basis in the patents of \$3,118,100. At protest, appellants increased the cost basis to \$3,611,499, which included \$933,100 in claimed development costs, \$493,399 of commissions and other costs, and \$2,185,000 paid to co-developers. FTB allowed \$2,645,000 for payments to Sayuki's co-developers and \$269,875 for payments to attorneys, accountants, and/or consultants for a total cost basis of \$2,914,875. FTB disallowed the remainder due to lack of substantiation.
13. During audit and protest proceedings, FTB adjusted appellants' reported installment sale income, resulting in additional installment sale income of \$671,953 and \$419,057<sup>4</sup> for taxable years 2014 and 2016, respectively.

#### Capital Loss Carryover

14. Appellants claimed a capital loss carryover deduction of \$809,514 on their 2014 return.
15. During audit and protest proceedings, FTB determined appellants sustained a capital loss of \$100,700 during the 2010 taxable year and utilized \$3,000 of the capital losses for each taxable year from 2010 through 2013. FTB allowed a capital loss carryover deduction of \$88,700 for the 2014 taxable year and disallowed the remainder, which totaled \$720,814.

---

<sup>2</sup> Although appellants state in their appeal letter that appellant-husband received a holdback payment of \$575,000 in the 2015 taxable year, appellant-husband's email to his CPA dated June 6, 2018, stated appellant-husband received a holdback payment of \$565,260.33 in the 2016 taxable year. The APA states appellant-husband was entitled to receive a holdback payment of \$565,000.

<sup>3</sup> Appellants also received \$10,000 in 2016 that was a holdback for Sayuki's portion of the sales price of \$200,000.

<sup>4</sup> The Notice of Proposed Assessment for taxable year 2016 included additional installment sale income of \$419,227. Subsequently, FTB issued a Notice of Action reducing the additional installment sale income to \$419,057.

Notices of Action

16. Based on the foregoing adjustments, FTB issued a Notice of Action (NOA) for the 2014 taxable year proposing additional tax of \$327,514, plus applicable interest.
17. FTB issued an NOA for the 2016 taxable year proposing additional tax of \$33,986, plus applicable interest.<sup>5</sup>
18. Appellants filed this timely appeal.

DISCUSSIONIssue 1: Have appellants demonstrated that they are entitled to a greater worthless stock deduction for the 2014 taxable year than FTB allowed?

Income tax deductions are a matter of legislative grace, and taxpayers have the burden of proving they are entitled to a deduction. (*INDOPCO, Inc. v. Commissioner* (1992) 503 U.S. 79, 84; *Appeal of Dandridge*, 2019-OTA-458P.) Unsupported assertions are not sufficient to satisfy taxpayers' burden of proof. (*Appeal of Morosky*, 2019-OTA-312P.)

When taxpayers establish that they paid or incurred a deductible expense but cannot establish the amount of the expense, a court may estimate the amount of the deductible expense, bearing heavily against the taxpayers whose inexactitude is of their own making. (*Cohan v. Commissioner* (2d Cir. 1930) 39 F.2d 540, 542-544.) This precept is named the *Cohan* rule. (*Perry v. Commissioner*, T.C. Memo. 2012-237.) For the *Cohan* rule to apply, however, taxpayers must demonstrate "some basis upon which an estimate could be made" that goes beyond mere speculation and unsupported allegations. (*Ibid.*)<sup>6</sup>

Internal Revenue Code (IRC) section 165(g)(1)<sup>7</sup> provides that, "[i]f any security which is a capital asset becomes worthless during the taxable year, the loss resulting therefrom shall . . . be treated as a loss from the sale or exchange, on the last day of the taxable year, of a capital asset." The term "security" includes "a share of stock in a corporation." (IRC § 165(g)(2)(A).) To be entitled to deduct a loss under IRC section 165(g) a taxpayer must carry the burden of proving three distinct facts. (See *Giunta v. Commissioner*, T.C. Memo. 2018-180.) Taxpayers

---

<sup>5</sup> The NOA for the 2016 taxable year included a phase-out of appellants' itemized deductions.

<sup>6</sup> The *Cohan* rule has been analyzed in terms of estimating stock losses (as well as estimating business expenses). (See *Appeal of Hakim* (90-SBE-005) 1990 WL 176081.)

<sup>7</sup> California conforms to IRC section 165, except as otherwise provided. (R&TC, § 17201(a).)

must show: (1) that the taxpayers owned a “security” as defined by IRC section 165(g)(2); (2) the taxpayers’ “adjusted basis” in that security; and (3) that the security became worthless during the taxable year for which the deduction is claimed. (IRC, § 165(b), (g)(1), (g)(2); *Martin Ice Crem Co. v. Commissioner* (1998) 110.T.C. 189, 220.)

In relation to appellants’ worthless stock deduction, the only issue that needs to be addressed is whether appellants have established appellant-husband transferred funds totaling \$1,659,662 to Rashi World throughout its existence, such that appellants would be entitled to a worthless stock deduction of the same amount for the 2014 taxable year.

On appeal, appellants contend that the documentation they provided supports a finding that appellant-husband’s adjusted basis in the stock of Rashi World totaled \$1,659,662. During the audit and/or protest proceedings appellants submitted: (1) a handwritten listing of funds they contend were loaned to Rashi World from 2007 through 2012; (2) a typewritten schedule of funds appellants allegedly provided to Rashi World throughout its existence; and (3) bank statements of appellants’ personal bank accounts and/or Rashi World from April 1, 2009, through March 31, 2013. FTB contends that those records substantiated \$589,920 of loans by appellants to Rashi World. FTB therefore disallowed the remaining \$1,069,742 of appellants’ claimed worthless stock deduction.

On appeal, appellants have not provided any additional documentation to support the claimed loans recorded on the handwritten and typed schedules. Moreover, the bank statements do not show or provide a reasonable basis to estimate a greater amount than allowed by FTB.<sup>8</sup> OTA has no basis upon which to make a different estimate of appellants’ loans to Rashi World, so the *Cohan* rule may not be applied to increase the amount of the loans as determined by FTB. Appellants have not established that they are entitled to a worthless stock deduction for Rashi World’s stock greater than the \$589,920 allowed by FTB.

---

<sup>8</sup> Based on appellants’ bank statements, FTB allowed all claimed loans to Rashi World for taxable years 2009 through 2014, totaling \$589,920. Appellants did not provide bank statements prior to 2009, and FTB did not allow claimed loans to Rashi World prior to 2009 because of lack of substantiation.

Issue 2: Have appellants demonstrated that FTB's adjustments to installment sales income for the 2014 and 2016 taxable years were erroneous?

Under IRC section 453(a), a taxpayer generally must use the installment method to report income from an installment sale.<sup>9</sup> An installment sale is a “disposition of property where at least [one] payment is to be received after the close of the taxable year in which the disposition occurs.” (IRC, § 453(b)(1).) Using the installment method, the taxpayer recognizes a proportion of the payment received in any given year commensurate with the percentage that the gross profit bears to the total contract price. (See IRC, § 453(c); *Parker v. Commissioner*, T.C. Memo. 2012-357.) The installment method generally applies to an installment sale unless the taxpayer elects out. (IRC, § 453(d).)

As indicated above, in 2014 a large cosmetics company purchased appellant-husband's patents, along with the assets of Sayuki, for consideration of \$11,500,000, plus earn-out amounts. The APA provided for a payment to appellant-husband of \$11,300,000 on closing, less a holdback of \$565,000, and a payment to Sayuki of \$200,000 on closing, less a holdback of \$10,000. Under section 9.6(b) of the APA, the holdbacks were to be paid to the sellers two years after the APA's closing date.

On appeal, appellants argue that the selling price should not include the holdback of \$565,000. Additionally, appellants argue that FTB should not have included installment sales proceeds paid to Sayuki as a part of appellants' capital gain. Appellants do not make specific arguments with respect to FTB's reduction of their claimed basis for development costs of \$933,100 and commission and other costs of \$493,399 but challenge the “method of reporting resulting in the adjustments to income.”

The sales price was \$11,300,000.

According to the terms of the APA, appellant-husband was entitled to receive consideration of \$11,300,000, plus an unspecified earn-out amount. Sayuki was entitled to receive consideration of \$200,000, plus an unspecified earn-out amount. Appellants' return for 2014 reported a sales price of \$11,310,000. FTB's protest officer, however, found that the sales price should have been reported as \$11,300,000. The APA is the best evidence of the total sales

---

<sup>9</sup> IRC section 453 is generally incorporated into California law at R&TC sections 17551(a) and 17560.

price, and appellants have not provided evidence showing that it should be reduced from \$11,300,000 to match the sale proceeds received by appellants in 2014.

Appellant-husband received sale proceeds of \$10,735,000 in the 2014 taxable year.

The APA provided for a payment to appellant-husband of \$11,300,000 on closing, less a holdback of \$565,000, and a payment to Sayuki of \$200,000 on closing, less a holdback of \$10,000. Appellants' 2014 return reports that appellant-husband received a payment of \$10,950,000 during the 2014 taxable year. Although FTB notes that appellants provided evidence of receiving \$10,735,000, FTB accepted the larger \$10,950,000 figure, as reported on the return because FTB found "the amount was reasonable since the auditor was unable to verify if Sayuki reported the \$190,000 payment."<sup>10</sup>

As noted above, in the absence of other evidence, the APA provides the best evidence of the gross proceeds received by appellants in 2014. Appellants and Sayuki are separate taxpayers; appellants are individuals, and Sayuki was a corporation. OTA, therefore, finds that appellants, as individuals, received gross proceeds from the sale of patents of \$10,735,000 rather than \$10,950,000 as determined by FTB. This finding is consistent with the APA, which reflected: (1) a sale price for appellant-husband's patents of \$11,300,000; (2) appellant-husband was to receive a payment on closing equal to this amount less a holdback of \$565,000, which was to be paid to appellant-husband two years later ( $\$11,300,000 - \$565,000 = \$10,735,000$ ); and (3) the \$200,000 sales price related to the Sayuki assets was to be paid directly to Sayuki.

Appellant-husband received a holdback payment of \$565,000 in the 2016 taxable year.

The record includes conflicting information about the amount of the holdback payment received. Appellants' appeal letter states that appellant-husband received a holdback payment of \$575,000.00 in the 2015 taxable year. FTB provides an email from appellant-husband dated June 6, 2018, wherein he states he received a holdback payment of \$565,260.33 in the 2016 taxable year. The applicable holdback payment listed in the APA is \$565,000, which was to be held in a money market mutual fund. The difference is nominal and may be attributable to interest earned on the money market funds. Appellants have offered no evidence to the contrary.

---

<sup>10</sup> The APA indicates that in addition to the \$11,300,000 sales price to be paid to appellants, \$200,000 would be paid to Sayuki, with a holdback of \$10,000, which results in a 2014 payment of \$190,000.

Appellants have not substantiated development costs of \$933,100.<sup>11</sup>

Appellants contend that appellant-husband incurred development costs of \$933,100 in obtaining the patents. FTB, however, allowed zero development costs. On appeal, appellants have not provided credible evidence (e.g., receipts, schedules, etc.) substantiating the disallowed development costs of \$933,100. In short, appellants have not established error in FTB's disallowance of claimed development costs.

Appellants have not substantiated commissions and other costs of \$493,399.<sup>12</sup>

Appellants contend that appellant-husband paid commissions and other costs of \$493,399 in obtaining the patents. FTB, however, allowed zero commissions and other costs. On appeal, appellants have not provided credible evidence (e.g., receipts, schedules, invoices, etc.) substantiating the disallowed commissions and other costs of \$493,399. In short, appellants have not established error in FTB's disallowances of such claimed commissions and other costs.

Calculation of appellants' installment sales income for taxable years 2014 and 2016.

Appellants contend, in a general manner, that FTB erred in its method of calculating appellants' installment sales income for taxable years 2014 and 2016. As discussed above, OTA's appeal record reveals that a modification is warranted for appellants' installment sale receipts in taxable year 2014.

Appellants' gain from sale of the patents is revised as follows:

	<u>Revised Per FTB Protest</u>	<u>Revised on Appeal</u>
Sales price	\$11,300,000	\$11,300,000
Cost Basis		
Development Costs	\$0	\$0
Payments to Co-Developers	\$2,185,000	\$2,185,000
Add Pmts. to Co-Developers	\$460,000	\$460,000

---

<sup>11</sup> At protest, appellants argued that they incurred development costs of \$933,100. On appeal, appellants do not clearly state whether they are still disputing FTB's disallowance of development costs of \$933,100. OTA addresses the matter in an abundance of caution.

<sup>12</sup> At protest, appellants argued that they incurred commissions and other costs of \$493,399. On appeal, appellants do not clearly state whether they are still disputing FTB's disallowance of commissions and other costs of \$493,399. OTA addresses the matter in an abundance of caution.



Attorney/Accountant/Etc.	\$269,875	\$269,875
Commissions & Other Costs	<u>\$0</u>	<u>\$0</u>
Total Cost Basis	<u>\$2,914,875</u>	<u>\$2,914,875</u>
Gross Profit	\$8,385,125	\$8,385,125
Contract Price	\$11,300,000	\$11,300,000
Gross Profit Percentage	0.7420	0.7420
Payment Received in 2014		\$10,735,000
Installment sales income in 2014 [ $\$10,735,000 \times 0.7420 = \$7,965,370$ ]		<u>\$7,965,370</u>
Installment sales income reported by appellants on their 2014 return		\$7,453,456
Installment sales adjustment for 2014 [ $\$7,965,370 - \$7,453,456 = \$511,914$ ]		<u>\$511,914</u>

In summary, appellants received installment sales income of \$7,965,370 in 2014. Except with respect to adjustments to installment sales income received by appellants in 2014, appellants have not established with evidence that any further adjustments are warranted.

Issue 3: Have appellants demonstrated that they are entitled to a greater capital loss carryover deduction for the 2014 taxable year than FTB allowed?

As noted above, appellants reported a capital loss carryover deduction of \$809,514 on their 2014 return. During audit and protest proceedings, FTB determined that: (1) appellants had sustained a capital loss of \$100,700 during the 2010 taxable year, (2) appellants had properly utilized \$3,000 of that \$100,700 capital loss for each of the taxable years 2010 through 2013, and (3) appellants had an available capital loss carryover of \$88,700 for the 2014 taxable year. Based on the foregoing, FTB allowed a capital loss carryover deduction of \$88,700 for the 2014 taxable year and disallowed the remainder (\$720,814).

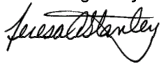
On appeal, appellants only make the general assertion that “[a] review of [appellants’] records supports the claimed capital loss carryover.” However, nothing in OTA’s record substantiates the capital loss carryover amount claimed on appellants’ 2014 tax return. Appellants have not provided any evidence to demonstrate that they are entitled to a capital loss deduction for the 2014 taxable year greater than the \$88,700 that FTB allowed.

HOLDINGS


1. Appellants have not demonstrated that they are entitled to a greater worthless stock deduction for the 2014 taxable year than FTB allowed.
2. FTB's proposed assessment for the 2014 taxable year is modified to reflect that appellants received installment sales income of \$7,965,370 in 2014.
3. Appellants have not demonstrated that they are entitled to a greater capital loss deduction for the 2014 taxable year than FTB allowed.

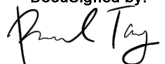
DISPOSITION

FTB's action for the 2014 taxable year is modified to reflect the holding above. Otherwise, FTB's actions for the 2014 and 2016 taxable years are sustained.

DocuSigned by:  
  
0CC6C6ACCC6A44D...  
Teresa A. Stanley  
Administrative Law Judge

We concur:

DocuSigned by:  
  
88E35E2A835348D...  
Ovsep Akopchikyan  
Administrative Law Judge

DocuSigned by:  
  
F8E81582726E448...  
Richard Tay  
Administrative Law Judge

Dated: 3/21/2024