



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }
EVERETT R. AND CLEO F. SHAW }

For Appellants: Foss and Simpson, Certified Public Accountants

For Respondent: Burl D. Lack, Chief Counsel;
A. Ben Jacobson, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Everett R. and Cleo F. Shaw to a proposed assessment of additional personal income tax in the amount of \$80.00 for the year 1953.

Appellants owned shares of capital stock of the Lucky Gold Hill Company, a gold mining enterprise, which they acquired in the years 1950, 1951 and 1953 at a cost of \$6,400. The Lucky Gold Hill Company issued stock in the total amount of \$956,357.25. The report of the annual stockholders' meeting of the company held on October 26, 1953, indicated that the company had decided to abandon its underground mining operations because of poor results and adverse physical conditions. However, there was a discussion of plans to engage in open pit operations on property adjacent to the company's, and a motion was passed "that the Board of Directors be authorized to obtain the ground referred to; to drill the ground and investigate the gravels between the surface and bedrock." Mining operations were discontinued during 1953. At the end of that year, the Lucky Gold Hill Company still retained most of its assets, consisting of machinery and equipment. A letter from the company to the Respondent, dated October 2, 1957, and an accompanying balance sheet as of September 30, 1957, show that the company still owned some assets at that time. The balance sheet showed a deficit of \$947,738.18, leaving remaining capital of \$8,619.07. This book value represents less than one percent of the stock's original cost. The company has made no distribution in liquidation to its stockholders.

Appellants filed a joint return for 1953 and claimed a loss deduction on the ground that the Lucky Gold Hill Company shares became worthless in that year. The Respondent disallowed the deduction on the ground that a loss was not sustained in 1953.

During the year in question, the Personal Income Tax Law allowed a deduction from gross income for a loss on stock

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which became worthless during the taxable year. (Section 17307 of the Revenue and Taxation Code, now 17206(g).) Appellants point out that the federal law is similar and the "The Federal courts have continually held that a loss occurs when stock becomes substantially worthless." Neither the statute nor the case law supports this as being the test. Instead, the law is that a loss is not sustained and, therefore, the deduction is not allowable unless the stock is absolutely worthless. Mere diminution or shrinkage in value, even though extensive, does not establish a loss. (875 Park Ave. Co. v. Commissioner, 217 F. 2d 699.) The enterprise in which the securities are held may be in a dire financial condition, but that in itself does not establish that the securities are a total loss. (Royal Packing Co., 13 B.T.A. 773, 779, aff'd, 38 F. 2d 180.)

The burden is upon Appellants to establish that the securities became worthless in the year for which the deduction is claimed. (Mahler v. Commissioner, 119 F. 2d 869, cert. denied, 314 U.S. 660.) The court in the Mahler case pointed out that one form of effective evidence as to whether or not securities of a company have become worthless is a balance sheet showing whether liabilities exceed assets so as to leave no equity in the stock. In the present case the balance sheet before us shows that the stock still had some value four years after the alleged loss. Another factor to be taken into consideration in this case is that at the annual meeting of stockholders of the company held on October 26, 1953, a motion was passed which authorized the directors to investigate another mining venture. This indicates an intention to continue operations, and the possibility of improved conditions. In Nelson v. United States, 131 F. 2d 301, 302, the court pointed out that even though the assets of a corporation are less than its liabilities, where there is a prospect of improved conditions, the latter gives the otherwise worthless stock a potential value and no loss is recognizable for income tax purposes until that potential value has disappeared. (See also, Joseph C. Lincoln, 24 T.C. 669, aff'd, 242 F. 2d 748.)

In light of the above authority and facts, we must conclude that the Appellants have not shown that the shares of the Lucky Gold Hill Company were worthless so as to allow the loss deduction for the year 1953.

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,

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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 Everett R. and Cleo F. Shaw to a proposed assessment of personal income tax in the amount of \$80.00 for the year 1953, be and the same is hereby sustained.

Done at Sacramento, California, this 6th day of April, 1961, by the State Board of Equalization.

John W. Lynch, Chairman

Geo. R. Reilly, Member

- Alan Cranston, Member

- Paul R. Leake - - -, Member

Richard Nevins, Member

ATTEST: Dixwell L. Pierce, Secretary