



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
DAVID C. AND JUNE DORWARD)

For Appellants: David C. Dorward, in pro. per.

For Respondent: Crawford H. Thomas
Chief Counsel

Peter S. Pierson
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 protests of David C. and June Dorward against proposed assessments of additional personal income tax against David C. Dorward, individually, in the amount of \$92.19 for the year 1962, and against David C. and June Dorward, jointly, in the amount of \$99.17 for the year 1963.

Appellants are husband and wife. In 1962 they sold their entire stock interest in Dorward & Sons, Inc. to Dorward Terminals, Inc., and sustained a loss. David C. Dorward's brother, Fred M. Dorward, owned all of the stock of Dorward Terminals, Inc. As a result of the acquisition of appellants' stock in Dorward & Sons, Inc., as well as the stock interests of two other unrelated individuals in that company, Fred M. Dorward became its sole stockholder,

Appellants filed separate California personal income tax returns for 1962. In those returns each appellant reported one-half of their joint income. Mrs. Dorward deducted one-half of the loss sustained on the sale of the Dorward & Sons, Inc. stock in her separate return, and David C. Dorward reported one-half in his separate return.

Appeal of David C. and Jane Dorward

Appellants filed a joint return with respondent for 1963. In that return they claimed a capital loss carry-forward relating to their 1962 stock loss.

Respondent ultimately allowed Mrs. Dorward's loss deduction in her separate return for 1962, and her share of the loss carried forward and claimed in the joint return which she and her husband filed for 1963. The additional assessments resulting from disallowance of the loss deductions claimed by David C. Dorward were affirmed on the ground that the loss was sustained on a sale between family members. This appeal was taken from that action.

Section 17287 of the Revenue and Taxation Code provides, in part:

No deduction shall be allowed--(a) In respect of losses from sales or exchanges of property ... directly or indirectly; between persons specified within Section 17288.

Section 17288 defines the "persons" referred to in section 17287 to include:

(a) Members of a family, as defined in Section 17289 (d);

(b) An individual and a corporation more than 50 percent in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual

For purposes of determining the ownership of stock in applying section 17288, section 17289 provides;

(b) An individual shall be considered as owning the stock owned, directly or indirectly, by or for his family;

* * *

(d) The family of an individual shall include only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants

The sale of stock in the instant case was between appellants and a corporation which was wholly owned by appellant David C. Dorward's brother, Fred M. Dorward. Under the above quoted portions of section 17289, David C. Dorward

Appeal of David C. and June Dorward

must be considered as constructively owning the stock owned by his brother, since a brother is a member of an individual's "family." A loss on a sale between an individual and a corporation which that individual controls, either directly or indirectly through the constructive ownership provisions, is not deductible. (Rev. & Tax. Code, §§ 17287, subd. (a) and 17288, subd. (b).) These sections thus preclude the loss deduction claimed by appellant David C. Dorward in his 1962 return and carried forward into 1963.

In support of their contention that the loss sustained was a proper deduction appellants argue that the sale was an "arm's length" transaction, and that the other two unrelated individuals who simultaneously sold their stock interests in Dorward & Sons, Inc. to Dorward Terminals, Inc. also sustained losses. These circumstances are nevertheless of no avail to appellants, It is well established under federal law that the federal counterpart of section 17287 states an absolute prohibition against the allowance of losses on sales between certain specified persons. (McWilliams v. Commissioner, 331 U.S. 694 [91 L. Ed. 1750]; Caplan v. United States, 270 F. Supp. 203.) The fact that the sale may have been a bona fide "arm's length" transaction is of no moment. (Nieman v. Commissioner, 33 T.C. 411.)

Since the law expressly precludes the deduction of appellant David C. Dorward's share of the loss, respondent's action in this matter must be sustained,

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,

Appeal of David C. and June Dorward

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 protests of David C. and June Dorward against proposed assessments of additional personal income tax against David C. Dorward, individually, in the amount of \$92.19 for the year 1962, and against David C. and June Dorward, jointly, in the amount of \$99.17 for the year 1963, be and the same is hereby sustained.

Done at Sacramento, California, this 12th day of December, 1967, by the State Board of Equalization.

Paul R. Leach, Chairman
Robert H. ..., Member
John W. ..., Member
Paul ..., Member
_____, Member

ATTEST: R. H. ..., Acting Secretary