

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

in the Matter of the Appeal of)
RAYMOND CARLSON, JR.)

For Appellant: David L. Miller
Certified Public Accountant

For Respondent: James C. Stewart
Counsel

O P I N I O N

This appeal is made pursuant to section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Raymond Carlson, Jr., against a proposed assessment of additional personal income tax in the amount of \$5,500.20 for the year 1975.

Appeal of Raymond Carlson, Jr.

The issues presented in this appeal are whether appellant is entitled to the claimed deduction for worthless stock and, if so, whether that stock was section 13208 stock.

In November 1966, appellant and four other individuals formed the UTE Mountain Company (UTE) in Colorado. The business was incorporated in June 1967, and appellant purchased 50,000 shares of UTE stock for \$50,000. Apparently, the business never flourished, and appellant determined in 1979 that the stock was worthless. On his 1979 California personal income tax return, appellant claimed a \$50,000 ordinary loss deduction on his investment in UTE, contending that the stock qualified as small business stock under section 18208 of the Revenue and Taxation Code. Upon audit respondent determined that the UTE stock did not become worthless in 1979 and that the stock was not small business stock. It, therefore, issued a proposed assessment disallowing the claimed deduction. After considering appellant's protest, respondent affirmed the proposed assessment, and this timely appeal followed.

Section 17206 of the Revenue and Taxation Code allows a deduction where stock owned by the taxpayer becomes worthless during the taxable year and the loss is not compensated by insurance or otherwise. The deduction is allowed only if the stock becomes worthless during the year the deduction is claimed. (Louis C. Kirven, ¶ 77,028 P-H Memo. T.C. (1977); Appeal of Everett R. and Cleo F. Shaw, Cal. St. Bd. of Equal., April 6, 1961.) The taxpayer bears the burden of proving that the stock had value at the beginning of the year and that it had no liquidating or potential value at the end of the year. (Boehm v. Commissioner, 326 U.S. 287 [90 L.Ed. 78] (1945); Mahler v. Commissioner, 119 F.2d 869 (2d Cir. 1941).)

Appellant has failed to produce any evidence supporting his contention that the UTE stock became worthless in 1979. On the contrary, there is evidence in the record which indicates that the stock became worthless in 1975. In a letter dated November 17, 1975, James Girdwood, the president of UTE, informed the shareholders of UTE that, in order to avoid bankruptcy, UTE was going to be merged into a newly formed corporation and that the stock of that corporation was to be sold to a third company. He also stated that approval by UTE shareholders was not necessary to implement the plan and that the shareholders would be paid \$.001 per share of UTE stock. This reorganization was apparently implemented since appellant

Appeal of Raymond Carlson, Jr.

admits having received a check for \$50 in payment for the 50,000 shares of UTE stock he owned. Appellant said that he did not cash this check, since he believed the stock to be worth more than \$50. Despite appellant's refusal to accept the payment, it appears clear that UTE did not exist after the merger and that appellant realized the loss on the UTE stock in 1975 rather than 1979. Since appellant has not proven otherwise, we must find that the stock was worthless prior to 1979 and that appellant was not entitled to the deduction claimed in 1979.

Even if we were able to find that appellant's loss was incurred in 1979, we would have to disagree with his contention that the stock was section 18208 stock. Section 18208 of the Revenue and Taxation Code provides in general that a shareholder who incurs a loss in connection with certain stock may treat such loss as an ordinary loss, rather than as a loss from the sale or exchange of a capital asset. In order to qualify as section 18208 stock, stock must be common stock issued for money or other property by a domestic small business corporation. (Rev. & Tax. Code, § 18208.) In addition, stock issued prior to the January 1, 1979, amendment of section 18208 must have been issued under a written plan adopted to offer such stock for a period specified in the plan, ending not later than two years after the date the plan was adopted. (Appeal of Robert W. and Margaret H. Rector, Cal. St. Bd. of Equal., June 3, 1975.)

Appellant contends that the UTE stock was issued under a written plan with the intent that it qualify as section 18208 stock but explains that he cannot produce a copy of this plan because the corporate organizational records were lost. As evidence of the written plan, appellant has submitted a letter from the attorney who incorporated UTE in which he states "... at the time Ute Mountain was incorporated, it was my practice to put the 1244 provision in every corporation and I am sure I would have done so for this corporation." We believe that this statement is far from sufficient proof that the stock was issued under the required written plan, and, therefore, must conclude that the UTE stock was not section 18208 stock.

For the reasons set forth above, we must sustain respondent's action.

Appeal of Raymond Carlson, Jr.

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,

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 Raymond Carlson, Jr., against a proposed assessment of additional personal income tax in the amount of \$5,500.20 for the year 1979, be and the same is hereby sustained.

Done at Sacramento, California, this 12th day of September, 1984, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Dronenburg, Mr. Collis and Mr. Bennett present.

Richard Nevins _____, Chairman

Ernest J. Dronenburg, Jr. _____, Member

Conway H. Collis _____, Member

William M. Bennett _____, Member

_____, Member