

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of) -- ..  
JAMES C. COLEMAN PSYCHOLOGICAL )  
CORPORATION AND JAMES C. AND )  
AZALEA COLEMAN )

**Appearances:**

**For** Appellants: Daniel T. Sasahara  
Certified Public Accountant

For Respondent: Anna Jovanovich  
Counsel

O P I N I O N

These consolidated appeals are made pursuant to sections 25666 and 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Hoard on the protests of James C. Coleman Psychological Corporation and James C. and Azalea Coleman against proposed assessments of additional franchise and personal income tax in the amounts of \$2,026 and \$2,216 for the income years ended May 31, 1976, and May 31, 1977, respectively, and in the amounts of **\$2,403.07** and **\$2,645.39** for the years 1976 and 1977, respectively. During the course of these proceedings, appellants paid the amounts assessed, thus converting this action to an appeal from the denial of claims for refund pursuant to Revenue and Taxation Code sections 26078 and 19061.1.

Appeals of James C. Coleman Psychological Corporation and James C. and Azalea Coleman

The sole issue for determination in this appeal is whether respondent properly disallowed deductions claimed by the corporation for settlement costs, automobile expenses, and **travel expenses** and properly included part of the disallowed amounts., **as** dividends, **in** the income of the individual shareholder.

Dr. James C. Coleman (appellant) wrote two psychology textbooks in the 1950's. In 1970, he formed James C. Coleman Psychological Corporation (the corporation), transferring to the **corporation** his rights to receive royalties from the books he had written. The textbooks were written prior to appellant's marriage to his former wife, Betty Coleman. However, appellant personally owned the copyrights during his marriage to Betty Coleman. When Betty Coleman died in 1972, her estate filed a lawsuit claiming an interest in the textbooks and sought half of all past, present, and future royalty payments from the publication of the books.

In order to settle the case out of court, appellant made a direct payment to the estate. In each of the years 1976 and 1977, the corporation reimbursed appellant \$20,000 for amounts he paid to settle the lawsuit. On its tax returns for these years, the corporation deducted the reimbursed amounts as business expenses. Respondent disallowed the claimed deductions after determining that the settlement costs were personal expenses arising out of appellant's former marriage, rather than out of the **corporation's** profit-making activities.

The corporation also deducted **automobile** expenses and depreciation in 1976 and 1977 which respondent disallowed on the basis that appellant had not provided substantiation of the business use of the automobile beyond unsupported, general statements.

On its return for the income year ended **May 31, 1977**, the corporation deducted the cost of a round-trip airplane ticket for appellant's present wife, Azalea Coleman. The purpose given for Mrs. Coleman's trip to New York was to accompany appellant when he negotiated a renewal of a publishing contract. Respondent disallowed this deduction on the ground that appellant had not offered any evidence that Mrs. Coleman provided substantial services directly related to her husband's business.

Respondent regarded the expenditures for **which** deductions were disallowed as distributions of corporate

Appeals of James C. Coleman Psychological Corporation and James C. and Azalea Coleman

earnings, taxable to appellant as dividends. The parties agree that the **decision** regarding the propriety of the corporate deductions will control the decision regarding the liability of the individual taxpayers.

Appellant argues that the legal expenses were paid **or** incurred to resist action that interfered with the **business** activities of the corporation and, therefore, are deductible as ordinary and necessary business expenses. As to the automobile expenses, appellant submits that the use of the automobile was related to business purposes and that, even if respondent disallows a portion of the automobile **expenses**, it should still allow at least 75 percent of the automobile expenses under the rule expressed in Cohan v. Commissioner, 39 **F.2d** 540 (2nd Cir. 1930) and followed by this board in Appeal of Simpson's Inc., Cal. St. Bd. of Equal., Feb. 3, **1965**. Finally, appellant contends that Mrs. Coleman's trip to New York City with her husband served a bona fide business purpose; therefore, her travel expenses are deductible.

Appellant argues that the legal expenses in question were not personal in nature because the lawsuit filed by Mrs. Coleman's estate was aimed directly at obtaining a half-interest of the royalty income owned by the corporation. The books were written in the late **1950's** prior to his marriage to Betty Coleman in 1960 and thus **were** the sole separate property of Dr. Coleman when they were transferred to the corporation in 1970. The lawsuit filed by the beneficiaries of the estate of Betty Coleman claimed the beneficiaries should be the recipient of one-half of the interest in the present and future royalty income owned by the corporation. Though appellant asserts that the corporation had good grounds for winning the lawsuit, he states that a decision was made to settle out of court in order to avoid a costly and potentially lengthy legal proceeding and to protect the only income-producing asset owned solely by the corporation. Appellant further asserts that if the lawsuit had not been settled, the corporation's **very** existence would have been threatened since the lawsuit was aimed at its primary source of revenue.

Section 24343 of the **Revenue** and Taxation Code permits the deduction of all ordinary and necessary business expenses. Deductions, however, are a matter of legislative-grace and the burden is on **the taxpayer to** prove that the expenses are within the terms of the

Appeals of James C. Coleman Psychological Corporation and James C. and Azalea Coleman

statute. (New Colonial Ice Co. v. Helvering, 292 U.S. 435 [78 L.Ed. 1348] (1934).)

Sections 24343 and 24349 of the Revenue and Taxation Code are substantially similar to sections 162 and 167 of the Internal Revenue Code of 1954. Accordingly, the interpretation and effect given the federal provisions are highly persuasive with respect to the proper application of state law. (Holmes v. McColgan, 17 Cal.2d 426, 430 [110 P.2d 428] cert. den., 314 U.S. 636 [86 L.Ed. 510] (1941); Rihn v. Franchise Tax Board, 131 Cal.App.2d 356, 360 [280 P.2d 893] (1955).)

Although we can find no case that is factually identical to the present appeal, the question of whether legal expenses incident to a divorce are personal in nature or a legitimate business expense has been thoroughly examined by this board and by the United States Supreme Court. (See Appeal of Curtis H. Lee, Cal. St. Bd. of Equal., July 26, 1978; United States v. Gilmore, 372 U.S. 39 [9 L.Ed.2d 570] (1963); United States v. Patrick, 372 U.S. 53 [9 L.Ed.2d 580] (1963).) As we stated in the Appeal of Curtis H. Lee, supra, the pivotal question in both Gilmore and Patrick was whether the taxpayer's legal costs were a "business" expense rather than a "personal" expense. The characterization of the litigation costs of resisting a claim as "business" or "personal" depends on whether or not the claim arises in connection with the taxpayer's profit-seeking activities. It does not depend on the consequences that might result to a taxpayer's income-producing property from a failure to defeat the claim. In Gilmore, the court determined that the wife's claims stemmed entirely from the marital relationship and not from any income-producing activity. Since the expenses were "personal" and not "business," the court concluded that none of the husband's legal expenses were deductible under the federal counterpart of section 17252, subdivision (b).

In denying a similar claim, the Patrick court found that the claims asserted by the wife in the divorce action arose from the marital relationship and were, therefore, the product of the parties' personal or family lives, not the husband's profit-seeking activity. The court could find no distinction in the fact that the legal fees were paid for arranging a stock transfer, leasing real property, and creating a trust rather than for conducting litigation. These matters were incidental to litigation brought by the wife, whose claims arising

Appeals of James C. Coleman Psychological Corporation and James C. and Azalea Coleman

from the taxpayer's, personal and family life **were the** origin of the property arrangements. In the instant **case**, we can find no basis to support appellant's argument that the lawsuit was against the principal income source of the corporation and not aimed at control and preservation of an interest of a stockholder as in the Gilmore and Patrick cases. In fact, the action by Mrs. Coleman's estate was **to** determine her rights to income generated during her marriage to appellant and was a personal **claim** against appellant. We also find it significant that appellant has, to date, been unwilling or unable to provide copies of the **actual** claims filed by Betty Coleman's estate. As noted by respondent, a review of the actual claims would undoubtedly shed more light on their origin and nature. The failure to provide evidence which is within appellant's control gives rise to the presumption that, if provided, the evidence would be unfavorable. (O'Dwyer v. Commissioner, - 266 **F.2d** 575 (4th **Cir.**) cert. den., 361 U.S. 862 [**4 L.Ed.2d** 1021 (1959).]) Accordingly, we conclude that the legal expenses in question were in fact personal in nature and were properly disallowed by respondent as deductions by the corporation.

We do agree with respondent that appellant's records with regard to his automobile expenses fall short of the desired standards for complete substantiation of such expenses. Appellant did present some evidence of his business travel as including: transportation of publishing executives to and from Los Angeles International Airport; meetings with his attorney; trips to libraries for research projects; trips to Camarillo State Hospital and California State Polytechnic University in San Luis Obispo. (App. Br. at 6.) As such, we cannot agree with respondent's position that the lack of records should result in a denial of any deduction for automobile expenses. Instead, we believe that this is a proper case for application of the so-called **"Cohan rule,"** which provides for the making of an **approximation** of expenditures of this type where it is clear that "something was spent" but where the taxpayer's records are so inadequate that it is impossible to determine with any accuracy just how much was spent for business purposes. (Cohan v. Commissioner, supra; see also Appeal of Simpson's Inc., supra.) The record does not permit an exact apportionment, but we are persuaded that appellant should be entitled to deduct some portion of his automobile expenses. Making what appears to be a reasonable estimate, taking into consideration the information appellant did furnish concerning the use of his

Appeals of James C. Coleman Psychological Corporation and James C. and Azalea Coleman

automobile for various business trips, we conclude that appellant is **entitled** to deduct 35 percent of his automobile expenses and depreciate the automobile a like percentage for the years in question.

We turn next to the question of whether respondent properly disallowed the deductions made for Mrs. Coleman's travel expenses to New York. Respondent contends that no evidence has been presented which tends to show that Mrs. Coleman's presence was necessary. Appellant submits that Mrs. **Coleman's presence** in New York was essential and invaluable-and offers as evidence a letter from the corporation's New York counsel, Ms. Harriet F. Pilpel. The purpose of the business trip in question was to negotiate a contract for the corporation with Scott, **Foresman** and Company, a New York publisher. As secretary of the corporation, Mrs. Coleman's purpose for traveling to New York was to assist Dr. Coleman and **Ms. Pilpel** in negotiating this contract. According to the facts presented, Mrs. Coleman attended all sessions of the contract negotiations and was intimately involved with all decision and details of the contract proceedings.

Respondent cites Weatherford v. United States, 418 **F.2d** 895 (9th Cir. **1969**), for the proposition that a wife's traveling expenses are not deductible unless it is shown that she provided substantial services directly and primarily related to the carrying on of her husband's business. In Weatherford, supra., the wife's traveling expenses were disallowed after a showing that while the wife was interested in her husband's business, she had no specific business purpose in making the trip. She did not work on the ranch, was not a partner in the ranch business, and was not engaged in public relations for either the ranch or the wheat industry. We find the facts in the instant case to be quite different. Mrs. **Coleman** was an officer in her husband's corporation. She was involved in the negotiations **and** has offered proof of this involvement. Accordingly, we conclude that Mrs. **Coleman's** travel expenses should properly have been allowed..

In accordance with our foregoing analysis, it is our conclusion that respondent properly disallowed any deduction for legal expenses but should properly have allowed the deduction taken for travel expenses and 35 percent of the deduction claimed for automobile expense. The disallowed amounts should be considered distributions **of corporate** earnings taxable to appellant as dividends.

