85-SBE-043

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
WILLIAM AND CHARLOTTE MARTIN)

Appearances:

For Appellants: William and Charlotte Martin, in pro. per.

For Respondent: Donald C. McKenzie Counsel

OPINION

This appeal is made' pursuant to section 18593[1/] of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of William and Charlotte Martin against proposed assessments of additional personal income tax in the amounts of $2,526.38 and $640.00 for the years 1979 and 1980,'respectively.

1/ Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the years in issue.

Appeal of William and Charlotte Martin

The sole issue is whether appellants have established that claimed business and employee expenses were for their separate business and not incurred on behalf of 'a corporation of which they were majority shareholders. Charlotte Martin is a party to this appeal because she filed joint personal income tax returns with William Martin, her husband, for the years at issue. The term "appellant" will be used herein to refer to William Martin.

Appellant is the majority shareholder in American Beryllium Corporation and is that corporation's president. The corporation engages in mining exploration and development.

On their 1979 joint personal income tax return, appellants included a Schedule C under the business name of American Beryllium Corporation. That schedule stated "no revenue in 1979" but listed expenses for corporation taxes, advertising, flying and helicopter services, machine hire, etc., totaling $21,021. Appellants deducted these expenses in arriving at their taxable income on their 1979 joint personal income tax return, which disclosed that appellant sold an unknown number of shares of American Beryllium Corporation stock that year for $25,000.

On their 1980 joint personal income tax return, appellant claimed American Beryllium Corporation employee business expense deductions for transportation, meals and lodging, car expenses, advertising, office expense, postage, telephone, office rent, and mining expenses, totaling $11,818. Appellants deducted these expenses in arriving at their taxable income on their 1980 tax return, which disclosed that appellant had sold an additional portion of his American Beryllium Corporation stock that year for $5,000.

After questioning appellant regarding the nature of the deductions, respondent disallowed them on the ground that they were unreimbursed expenses incurred and paid by the appellant in behalf of his corporation because the corporation had no funds. Thus, they were not expenses deductible on his personal income tax return. Respondent also disallowed another claimed deduction, which appellants did not contest. Respondent issued its notices of tax proposed to be assessed for the years at issue. Appellants protested. Upon consideration, respondent affirmed its assessments, This appeal followed.

In this appeal, appellant asserts that, in addition to operating American, Beryllium Corporation, he' was also engaged in mining exploration and development as a sole proprietor and that some of the expenses in question were incurred by him in exploring and developing his own mining claims rather than in exploring and developing American Beryllium Corporation's mining claims. Therefore, appellant maintains, some of the claimed deductions were actually allowable as his own trade or business expenses even though they were mistakenly attributed to American Beryllium Corporation on Schedule C for 1979 and mistakenly claimed as corporation employee business expenses for 1980.

Appellant takes the position that the claimed deductions should be allowed whether (1) they were expenses he incurred in his individual trade or business operated as a sole proprietorship (which was entirely apart from the trade or business of American Beryllium Corporation), or (2) they were expenses he incurred as the employee of American Beryllium Corporation (which were expenses distinct from expenses incurred by American. Beryllium Corporation and paid by appellant because the Corporation had no funds).

It is well settled that income tax deductions are a matter of legislative grace, and the burden is on the taxpayer to show by competent evidence that he is entitled to the deductions claimed. (Deputy v. du Pont, 308 U.S. 488 (84 L.Ed. 416] (1940); New Colonial Ice Co. v. Helvering, 292 U.S. 435 [78 L.Ed. 1348] (1934); Appeal of James C. and Monablanche A. Walshe, Cal. St. Bd. of Equal., Oct. 20, 1975.) It is equally well settled that respondent's determination that a deduction should be disallowed is presumed correct, and the taxpayer has the burden of showing error in that determination. (Appeal of John A. and Julie M. Richardson, Cal. St. Bd. of Equal., Oct. 28, 1980; Appeal of Peter F. and Betty H. Eastman, Cal. St. Bd. of Equal., May 4, 1978.)

In this appeal appellant has not actually demonstrated that any specific expenses he incurred on specific mining explorations and developments were part of his individual trade or business during the years in question. Nor has appellant actually demonstrated any specific expenses which he incurred as an employee of American Beryllium (and which were expenses distinct from the expenses of American Beryllium Corporation and paid by appellant because the corporation had no funds).

Indeed, appellant has not even demonstrated that he occupied a position of employment with American' Beryllium Corporation which constituted a trade or business apart from the trade or business of the corporation so that expenses he might incur could be ordinary and necessary expenses of earning a salary or other compensation as an employee. On the relationship between the corporation and the expenses incurred or paid by appellant, his representative first stated that: "No agreements or authorization exist between the Corporation and Mr. Martin relating to expenses incurred on behalf of the Corporation, or any other activities carried on by Mr. Martin as an individual." (Appeal Ltr. at 2.) Later, that statement was amended to distinguish between formal and informal agreements as follows:

> No formal agreement existed between the corporation and William Martin for the years in question with regard to' the payment or reimbursement of these expenses. It has always been the informal agreement between William Martin and other Director/Shareholders of the corporation that he was to personally pay all' expenses in developing Corporate owned mining claims without reimbursement by the corporation.

(App. Br. at- 1.)

In order to elucidate the relationship between the corporation and appellant for the purposes of this appeal, American Beryllium Corporation's board of directors passed two resolutions in May 1984 as follows:

> Until such time as the development of these mineral rights produces sufficient revenues to compensate William H. Martin the reasonable value of his services, he is expected to incur all reasonable costs and expenses in proceeding within the scope of his duties without reimbursement, . . .
>
> When the exploitation of these mineral rights begins producing sufficient revenues, Mr. William H. Martin will receive a salary therefrom to compensate him for his past and present efforts in an amount as to be determined by this Board to be reasonable . . . .

(App. Supp. Memo., Ex. A.)

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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 William and Charlotte Martin against proposed assessments of additional personal income tax in the amounts of $2,526.38 and $640.00 for the years 1979 and 1980, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 8th day of May, 1985, by the State Board of Equalization, with Board Members Mr. Dronenburg, Mr. Bennett, Mr. Nevins and Mr.' Harvey present.

Ernest J. Dronenburg, Jr., Chairman

William M. Bennett, Member

Richard Nevins, Member

Walter Harvey*, Member

_____, Member

*For Kenneth Cory, per Government Code section 7.9