BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) No. 82A-892-PD
ROGER D. AND MARY MILLER)

For Appellants: Steven A. Burn
Attorney at Law

For Respondent: Karen D. Smith
Counsel

O P I N I O N

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 Roger D. and Mary Miller against a proposed assessment of additional personal income tax and penalty in the total amount of $5,226.73 for the year 1978.

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

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The issues are (1) whether appellants demonstrated error in respondent's partial disallowance of their claimed theft loss and (2) whether respondent properly imposed a penalty for failure to file a timely return.

Appellants are entertainers. They do not purport to have any knowledge of the filing responsibilities with respect to state income taxes. They relied upon a certified public accounting firm to handle their income tax filing responsibilities. They understood that their federal and state personal income tax returns for 1978 would be filed under requests for extensions of time to file. No request for an extension of time to file the California personal income tax return for 1978 was filed with respondent. On October 15, 1979, six months late, appellants filed their original California return for 1978; it had been prepared by the accounting firm. On January 4, 1980, appellants filed an amended California return for 1978: it had been prepared by a management company, which replaced the accounting firm as appellants'. tax consultant and business manager. The amended return was filed to report a purported $62,786 loss from. a jewelry theft which took place while they were on a business engagement in Reno, Nevada. During a subsequent audit, respondent disallowed $34,989 of the loss on the ground that the cost of the stolen jewelry had not been substantiated and assessed the 25 percent late filing penalty specified by section 18681. Appellants protested. Respondent affirmed its assessment. This appeal followed.

It is well settled that tax deductions are a matter of legislative grace and that the taxpayers bear the burden of proof that they are entitled to a particular deduction claimed. (New Colonial Ice Co. v. Helvering, 292 U.S. 435 [78 L.Ed. 1348] (1934); Appeal of Joseph A. and Marion Fields, Cal. St. Bd. of Equal., May 2, 1961.) California Revenue and Taxation Code section 17206 is substantially similar to section 165 of the Internal Revenue Code, so federal case law and regulations are persuasive as to the proper interpretation of that California statute. (Holmes v. McColgan, 17 Cal.2d 426 [110 P.2d 428] (1941); Meanley v. McColgan, 49 Cal.App.2d 203 [121 P.2d 45] (1942).)

Treasury Regulation section 1.165-7(b)(1) provides that the amount of a theft loss which may be taken is the lesser of either an amount equal to the fair market value of the property immediately prior to its theft of an amount equal to the adjusted basis of the property. Generally, the adjusted basis of that property would be its cost. (See Rev. & Tax. Code, § 18042.)

Respondent has explained that appellants supplied invoices, receipts, and canceled checks totaling $6,867.18. Not all the receipts and canceled checks identified that they were for jewelry. Also, appellants supplied an appraisal of $33,000 for two pieces of jewelry. The appraisal was dated February 10, 1978, but did not identify the date the items had been purchased or their original cost. Respondent's position is that appellants have substantiated less than 10 percent of the actual cost (adjusted basis) of the items they reported as stolen and have not shown that the appraised value of the two items was their fair market value-immediately prior to the theft and was also less than the original cost of those items (adjusted basis).- Respondent argues that jewelry generally appreciates with time, so that its original cost would generally be the lesser (deductible) value rather than its fair market value immediately before a theft. Notwithstanding the minimal substantiation submitted by appellants, respondent allowed $27,797 (45 percent) of the claimed loss.

Appellants' position is that they cannot reasonably be expected to secure purchase receipts for every item they buy, or to secure purchase receipts from donors of every item they have been given, or to maintain those receipts indefinitely for the purpose of substantiating a possible future theft loss.

Appellants cite Wallach v. Commissioner, ¶ 51,129 T.C.M. (F-H) (1951), as authority for the proposition that fair market value prior to the loss may be used to determine the deduction if that value is not demonstrably in excess of the stolen property's cost, and cite Jenny v. Commissioner, ¶ 77,142 T.C.M. (P-H) (1977), for the proposition that the fair market value was accepted when the taxpayer's estimate was higher due to replacement value. Actually, the court in Wallach found that, as a matter of fact, the amount of a jewelry appraisal, made shortly before the jewelry was stolen, was not in excess of the cost or adjusted basis of the jewelry and so could be used to determine the loss for tax purposes. There is no evidence in this appeal which would allow us to reach a similar conclusion. In Jenny, after noting the applicable rule that the proper measure of the theft loss was the lesser of (1) the fair market value of the property immediately before the theft or (2) the adjusted basis of the property, the court found that the total value of the stolen property was a specific amount. That amount was far less than the total amount of the taxpayer's estimates of the property's fair market value. We do not find this case helpful to appellants' situation.

With respect to appellants' burden of proof, we conclude that they cannot sustain their burden of demonstrating error in the amount of respondent's assessment by arguing that the production of documentary proof of the cost or basis of the stolen items is unreasonable. Such an argument does not make the slightest. demonstration that the assessment is in error. Accordingly, we conclude that respondent's assessment must be upheld.

Next, we must consider whether the penalty for failure to file a timely return was properly assessed. As we noted above, appellants relied on their accountant to file their return which was filed six months late. Section 18681 provides in relevant part:

> (a) If any taxpayer fails to make and file a return required by this. part on.or 'before the due date of the return or the due date as extended by the Franchise Tax Board, then, unless it is shown that the failure is due to reasonable cause and not due to willful neglect, 5 percent of the tax shall be added to the tax for each month or fraction thereof elapsing between the due date of the return and the date on which filed, but the total penalty shall not exceed 25 percent of the tax.

The United States Supreme Court has held that a taxpayer's reliance on professional assistance to prepare and file a timely tax return does not constitute "reasonable cause" under the statute. (United States v. Boyle, 469 U.S. -- [83 L.Ed.2d 622] (1985).) Under the circumstances, we must conclude that respondent's assessment of a late filing penalty was correct and must be upheld.

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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 Roger D. and Mary Miller against a proposed assessment of additional personal income tax and penalty in the total amount of $5,226.73 for the year 1978, be and the same is hereby sustained.

Done at Sacramento, California, this 4th day of March, 1986, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Collis, Mr. Dronenburg and Mr. Harvey present.

Richard Nevins, Chairman

Conway H. Collis, Member

Ernest J. Dronenburg, Jr., Member

Walter Harvey*, Member

________________, Member

*For Kenneth Cory, per Government Code section 7.9