



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of; the Appeal of)
PHILIP J. AND GENEVIEVE VOGEL) No. **84A-1329-GO**

For Appellants: Thomas G. Agin
Attorney at Law

For Respondent: **Lorrie K.** Inagaki
Counsel

O P I N I O N

This appeal is made pursuant to section **18593¹** of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Philip J. and Genevieve **Vogel against** proposed assessments of additional personal income tax in the amounts of **\$5,072.05, \$5,087.00, and \$7,744.00** for the years 1979, 1980, and 1981, 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 Philip J. and Genevieve Vogel

The issue presented is whether certain itemized deductions claimed by appellants for the years 1979 through 1981 were properly disallowed by respondent due to lack of substantiation.

Philip J. Vogel (hereinafter appellant) is a neurosurgeon who, along **with his** wife Genevieve, is also engaged in the operation of a ranch known as the **Lenwood Alfalfa Ranch in Lenwood, San Bernardino County, California.** On their 1979 personal income tax return, appellants indicated that, pursuant to a deed allegedly recorded January 23, 1979, they had gifted 75 acres of the **Lenwood Ranch** to the Congregational Church of Human Morality (hereinafter Church) valuing such land at \$2,500 per acre, and, reduced by certain limitations not at issue here, claimed a tax deductible charitable contribution. (Resp. Ex. A-3.) Again, on their 1980 return, appellants reported an additional gift of 1,065 acres of the **Lenwood Ranch** to the Church, valued the land at \$1,000 per acre, and, again reduced by certain limitations not at issue, claimed another tax deductible charitable contribution. (Resp. Ex. B-3.) No indication of the date of transfer **by** appellants was made on the 1980 return. While there was a loan from the Federal Land Bank outstanding on the transferred land, the liability was retained by appellants and not formally transferred to the Church. Due to the large amount of the contributions in 1979 and 1980 which resulted in certain dollar limitations as to deductions in those years, appellants claimed a charitable deduction carryover to 1981 for the excess of the transfers previously made. (Resp. Br. at 4.)

On January 20, 1980, appellants leased back from the Church some or all of the ranch land which they had transferred to it. (Resp. Ex. 0.) The terms of the lease provided that the income from the ranch would be used to defray **"all** expenses including payment on the loan to the Federal Land Bank and taxes." The lease further provided that any funds remaining would be divided equally between the Church and appellants. If a loss occurred, the parties agreed that appellants would sustain all of it. Part of appellants' lease payments made in 1980 and 1981 were made directly by appellants to the Federal Land Bank in payment for such loan. On their personal income tax returns for those years, appellants deducted such payments, including those amounts paid directly to the Bank, as rent.

Appellant also **served** as one of the directors of a nonprofit organization known as **the** Doctor's Defense

Appeal of Philip J. and Genevieve Vogel

League (hereinafter League). The Articles of Incorporation for the League indicate that it was organized in April of 1975 "pursuant to the General Non-profit Corporation Law of the State of California" (Resp. Ex. Q at 2) and that it was not organized for "pecuniary gain or profit" but was "organized solely for nonprofit purposes" and its property was irrevocably dedicated to certain "charitable, scientific, educational" purposes. (Resp. Ex. Q at 4.) These purposes encompassed "the education of licensed members of the medical profession in matters pertaining to claims, settlement, and judgments involving professional negligence . . . specifically in the fields of prevention avoidance and management of unmeritorious claims" (Resp. Ex. Q at 1.) Near the time of the League's organization, appellant co-signed a note with the League. When the League failed in 1980, appellant was required to honor that note. Appellants deducted the amounts paid on such note as ordinary and necessary business expenses incurred in 1980 and 1981, denoting such payments as representing malpractice insurance expenses.

Upon audit, respondent, while not questioning the legitimacy of the **Church as** a religious organization (Resp. Reply Br. at 3), **concluded**, that the Church was not "created or organized in the United States or in any possession thereof" as is required by section 17214, subdivision (b)(1), in order to be deductible. In addition, respondent questioned whether certain of the gifts had been made at all; if so, whether such gifts were, in **fact**, made to the Church; and whether the Church made payments towards appellants' personal obligations. (Resp. Reply Br. at 3.) Since appellants did not answer respondent's questions to its satisfaction, respondent concluded that appellants had not met their burden of proving its determination to be incorrect and, accordingly, disallowed the claimed charitable deductions at issue.

In addition, respondent determined that pursuant to the lease agreement with the Church, certain payments denoted as rent were, in fact, paid directly to the Federal Land Bank in satisfaction of the loan rather than to the purported lessor. Since the underlying liability remained in appellants' names rather than the lessor's name, respondent disallowed appellants' claimed rental expense to the extent allocable to such loan payments concluding that the substance of such payments was the satisfaction of their own personal obligation. (Resp. Reply Br. at 4.)

Appeal of Philip J. and Genevieve Vogel

Lastly, respondent determined that appellants had not established that the payments made to the League were used for malpractice payments as originally claimed or to provide legal defense for them. Accordingly, respondent disallowed appellants' deductions for such payments. 'Instead, respondent concluded that since the underlying loan was made close to the time the League was formed, such loan was likely made by appellants as investors to start a business. (Resp. Reply Br. -at 5.) On this basis, respondent allowed the payments made in the years at issue as a capital loss rather than as an ordinary and necessary business expense.

In accordance with these adjustments, respondent issued proposed assessments. Appellants protested and respondent's denial of that protest led to this appeal.

It is well settled that deductions are a matter of legislative grace and that the taxpayer must show that he is entitled to any claimed deduction. (See, e.g., New Colonial Ice Co. v. Helvering, 292 U.S. 435 [78 L.Ed. 1348] (1934).) The taxpayer must be able to point to an applicable statute and show by credible evidence, rather than mere assertions, that his claimed deduction comes within the terms of that statute. (New Colonial Ice Co. v. Helvering, supra, 292 U.S. at 440; Appeal of Linn L. and Harriett E. Collins, Cal. St. Bd. of Equal., Nov. 18, 1980.)

As indicated above, respondent contends that appellants' contributions to the Church are not deductible **because** the Church was not "created or organized in the United States or in any possession thereof" as is required by section 17214, subdivision (b)(1). Appellants have submitted the copy of a document purporting to **be a charter from the Church** of the Commandments, dated January 1, 1974, which states that a charter had been granted to a church of a similar, though not identical name, which was then located in Portland, Oregon. (See Resp. Ex. N.) However, as respondent points out, this document is self-serving and lacks the authenticity that would be expected from a bona fide charitable organization. We agree. This alleged charter, standing alone, is clearly not the type of credible evidence which is required. (See Appeal of Linn L. and Harriett E. Collins, supra.) Accordingly, based upon the record presented, we **must find** that appellants have not shown that the 'Church was "created or organized in the United States or in any possession thereof" as is required and respondent must be

Appeal of Philip J. and Genevieve Vogel

sustained with respect to this issue. Having so concluded, there is no reason to review respondent's alternative reasons for denying appellants' charitable deductions to the Church.

As indicated above, respondent also disallowed appellants' deduction of rental payments paid to the Church for the ranch land contending **that** such payments were applied, at least in part, to their own liability, being the mortgage liability to the Bank noted above. Respondent concludes that "the substance of the transaction was that appellants made repayments toward their own loan obligation, although an attempt was made to use the Church as a conduit." (**Resp.** Br. at 14.) Appellants answer that it is clear from the lease agreement that such loan payments were required to be made from income from the ranch and that they would be required to sustain all losses. (App. Br. at 2.) However, as indicated above, since the loan from the Bank was never transferred to the Church, appellants and not the Church would get the benefit of any payments made from the reduction of the liability. Accordingly, it cannot be said that the **Church benefited from any payments made to the Bank** whether denoted as rent or not and such payments could not be characterized as payments of rent to the Church. In this light, respondent's disallowance of appellants' rental payments which were applied to the loan must be sustained.

Lastly, respondent disallowed deductions for payments appellants made to the Doctor's Defense League in 1980 and 1981 which they had denoted as medical malpractice insurance payments in their returns. As indicated above, these payments resulted from the default of a loan co-signed by appellants in 1975 which appellants **were** required to honor when the League later failed. Concluding that such loans were likely made as investors to capitalize the League, respondent allowed the payments made in the years at issue as a capital loss rather than as an ordinary and necessary business expense. Appellants now argue that while the League was not in the business of paying malpractice claims (i.e., as a medical malpractice insurer), it was in **"the** business of providing for legal defense to its members and therefore qualifies as an insurance type business expense." (**App.** Br. at 2.)

It is, of course, well settled that in order to be deductible as an ordinary and necessary business expense, a taxpayer must show that such expenditure is

Appeal of Philip J. and Genevieve Vogel

profit motivated. (Appeal of Everett R. and Emeline H. Taylor, Cal. St. Bd. of Equal., June 2, 1971.) Appellants' payments to the League were clearly not for medical malpractice insurance as initially claimed in their returns. Appellants now allege that the League provided for the legal defense of its members, but no evidence of such defense has been presented. Indeed, there is nothing in the record that would establish that appellants' payments to the League were in any-way profit motivated. On this basis, we must conclude that respondent's disallowance of the payments to the League as ordinary and necessary business deductions must be sustained.

For the reasons cited above, respondent's action must be sustained.

Appeal of Philip J. and Genevieve Vogel

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 Philip J. and Genevieve Vogel against proposed assessments of additional personal income tax in the amounts of **\$5,072.05, \$5,087.00, and \$7,744.00** for the years 1979, 1980, and 1981, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 6th day of May, 1986, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Collis, Mr. Bennett, Mr. Dronenburg and Mr. Harvey present.

Richard Nevins, Chairman
Conway H. Collis, Member
William M. Bennett, Member
Ernest J. Dronenburg, Jr., Member
Walter Harvey*, Member

*For Kenneth Cory, per Government Code section 7.9

