

Appeal of Spiro T. and Elinor I. Agnew

The issue presented in this appeal is whether appellant,^{2/} a former U.S. Vice President and Governor of Maryland, is entitled to deduct on his 1982 California income tax return monies paid during that year to the State of Maryland in satisfaction of a civil judgment - monies which the Maryland courts found that appellant had received as bribes while holding state office.^{3/} Appellant deducted \$142,500 as a "refund of prior year's income," \$126,128 as interest paid on the judgment, and legal fees of \$11,322 for his defense. Respondent disallowed the claimed deduction for refund of prior year's income and for the legal fees associated with it because appellant had concededly received the income prior to establishing California residency and had not been taxed on the income by this state. Appellant paid additional California income tax in the amount of \$24,197.18 under protest, disavowed his earlier characterization of the payment to the State of Maryland as a refund of prior year's income, and then contended that it was deductible as a "payment in satisfaction of a civil judgment." The FTB disallowed the claim for refund, and appellant made this timely appeal.

Appellant no longer contests the denial of a deduction for legal fees (see Haldeman v. Franchise Tax Board, 141 Cal.App.3d 373 [190 Cal.Rptr. 1551 (1983)], and respondent concedes the deductibility of the interest on the judgment, despite the prohibition in section 17285 against deduction of expenses relating to tax-exempt income. (See Howard v. Franchise Tax Board, 243 Cal.App.2d 482 [52 Cal.Rptr. 547] (1966); but see Appeal of Signal International, Cal. St. Bd. of Equal., Jan. 4, 1966.) Therefore, the only issue before this board is the deductibility of the amount expended in satisfaction of the principal on the judgment.

2/ All references to "appellant" describe Spiro T. Agnew. His wife, Elinor I. Agnew, is a party to this action by virtue of having filed a joint return with her husband.

3/ Appellant did not testify in his own defense. The court found on the basis of uncontested evidence that engineering consultants contracting for public work projects had paid appellant a total of \$147,500 on three separate occasions. The court found that appellant held the monies in constructive trust for the people of Maryland and ordered him to pay restitution to the state for breach of his fiduciary duty.

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It is axiomatic that deductions from taxable income are a matter of legislative grace, and the burden is upon the taxpayer to show entitlement thereto. (New Colonial Ice Co. v. Helvering, 292 U.S. 435 [78 L.Ed. 1348] (1934); Appeal of Elbert B. Poppell, Cal. St. Bd. of Equal., Aug. 18, 1987.) A determination by respondent that a deduction should be disallowed is supported by a presumption that it is correct. (Appeal of Nike M. Kamrany, Cal. St. Bd. of Equal., Feb. 15, 1972.)

Appellant has utterly failed to cite to any statute authorizing him to deduct the restitutionary payments he made to the State of Maryland from his California taxable income.

A taxpayer's payment of a civil judgment only results in a deductible expense or loss if it can be characterized as fitting within a category of expense specifically deductible by law, as ordinary and necessary expenses of carrying on a trade or business (section 17202) or as expenses incurred in the production of income (section 17252).

Appellant does not contend that repayment of the bribes constituted an ordinary and necessary expense of carrying on his trade or an expense incurred in the production of income. Such an argument, would appear to be foreclosed by public policy,^{4/} even if his trade or business or other income-producing activity had been under the taxing jurisdiction of California. Where the claimed loss is allocable to out-of-state activities or employment which predates the taxpayer's establishment of California residency, as in the case of Watergate defendant H. R. Haldeman, section 17285 disallows

^{4/} See Standard Oil Co. v. Commissioner, 129 F.2d 363 (7th Cir. 1942), where the court stated, in reference to a claimed deduction for damage payment, pursuant to a consent decree, for Teapot Dome oil illegally obtained by bribery: "[W]e think it tolerably safe to say that torts which are committed against the government and which are also violative of the criminal statutes may not furnish the basis of deduction." (129 F.2d at 371.)

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any deduction under sections 17202 and 17252^{5/}. (See Haldeman v. Franchise Tax Board, supra, 141 Cal.App.3d at 377.)

The judgment amount is not deductible, then, under the statutory provisions for deductions. However, appellant argues that the Franchise Tax Board should "do what is fair" and follow the federal claim of right doctrine allowing a taxpayer to deduct from taxable income the refund of any amounts which in previous years had been declared and taxed as income. (See I.R.C. § 1341.) In 1973, pursuant to a nolo contendere plea to charges of felony tax evasion, appellant paid taxes, penalties, and interest to the federal government and the State of Maryland assessed on certain unreported payments made to him by public works contractors. The claim of right rationale for allowance of a deduction in the year of repayment of an amount previously reported as income is the concept of equity to the taxpayer. (Dubroff, The Claim of Right Doctrine, 40 Tax L. Rev. 729, 748-751 (1985).) That same concept of equity, however, has led the courts and Congress to limit the allowable federal deduction to prevent the occurrence of unwarranted tax benefits to either the government or the taxpayer. (See I.R.C. § 1341. See also Buras v. Commissioner, ¶ 77,325 T.C.M. (P-H) (1977); U.S. v. Skelly Oil Co. 394 U.S. 678, 681 [22 L.Ed.2d 642] (1969).) Without citation to any state authority, appellant seeks to draw on the equitable principles underlying the federal claim of right doctrine to justify deduction of his

5/ In pertinent part section 17285 provides:

No deduction shall be allowed for--(a) Any amount otherwise allowable as a deduction which is allocable to one or more classes of income other than interest (whether or not any amount of income of that class or classes is received or accrued) wholly exempt from the taxes imposed by this part, or any amount otherwise allowable under section 17252 (relating to expenses for production of income) which is allocable to interest (whether or not any amount of such interest is received or accrued) wholly exempt from the taxes imposed by this part.

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payment of the 1982 civil judgment.⁶¹ The claim of right doctrine has in fact been applied in California personal income tax law but only when the repaid funds had previously been included in California taxable income. (Appeal of Arthur G. and Eugenia Lovering, Cal. St. Bd. of Equal., Apr. 21, 1966; Appeal of Bernard and Lorraine Kirsch, Cal. St. Bd. of Equal., Oct. 3, 1967; Appeal of John A. and Barbara J. Vertullo, Cal. St. Bd. of Equal., July 26, 1976.) Appellant may be entitled to deduct the judgment on his federal return (see Rutkin v. U.S., 343 U.S. 130 [96 L.Ed 8331, reh. den., 343 U.S. 952 [96 L.Ed. 1353] (1952)), and on a return for Maryland, if he had income taxable in Maryland in 1982. However, it would hardly be "equitable" for the taxpayers of California essentially to foot the bill for part of appellant's liability to the taxpayers of Maryland for bribes received while he was a resident and elected official of that state.

Finally, there is no evidence on the record before this board that the funds for which the 1982 judgment ordered appellant to pay restitution to the State of Maryland are the very same contractor payments on which appellant was forced to pay tax to the State of Maryland. As the gravamen of appellant's argument appears to be the specter of double taxation, establishing the identity of the funds would appear to be basic to that claim.?

For the above reasons, we find that appellant is not entitled to deduct from his 1982 California taxable income the amount he paid in that year in satisfaction of a civil judgment ordering him to pay restitution to the State of Maryland for accepting payments from public works contractors while holding public office. Respondent's action in denying appellant's claim for refund will, therefore, be sustained.

6/ Appellant concedes, "There is no on point applicable California State authority; however, even the federal authorities recognize a 'Claim of Right Doctrine' to avoid hardships to taxpayers."

7/ We note that appellant cites to the trial judge's comment that appellant should be entitled to "a credit . . . to the extent that there have been monies paid to the State of Maryland for taxes on the one hundred forty-seven thousand five hundred dollars (\$147,500) received by Mr. Agnew." However, appellant fails to mention the point noted by the counsel for the State of Maryland, namely, that during the civil trial, appellant's counsel "produced no evidence tying these [the 1974 Maryland] tax adjustments to anything at issue in this case." Therefore, the trial court declined "to make any finding with regard to any set off for taxes paid"

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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 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of Spiro T. and Elinor I. Agnew-for refund of personal income tax in the amount of \$24,197.18 for the year 1982, be and the same is hereby sustained.

Done at Sacramento, California, this 6th day of April, 1989, by the State Board of Equalization,

Paul Carpenter , Chairman
Conway H. Collis , Member
William M. Bennett , Member
Ernest J. Dronenburg, Jr. , Member
John Davies* , Member

*For Gray Davis, per Government Code Section 7.9.