



BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
JOSEPH B. AND CORA MORRIS )

Appearances:

For Appellants: Michael Fowler  
Certified Public Accountant

For Respondent: A. Ben Jacobson  
Counsel

O P I N I O N

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the protest of Joseph B. and Cora Morris against a proposed assessment of additional personal income tax plus a penalty in the total amount of \$6,240.11 for the year 1963. Since Cora Morris died subsequent to the filing of this appeal, Joseph B. Morris will hereafter be referred to as appellant.

Appellant is a financier. He and an associate each owned fifty percent of the voting stock of Republic National Financial Corporation (Republic), a Texas corporation which was organized on June 12, 1963. Republic owned eighty percent of the stock of Valley National Mortgage Co. (Valley), a Texas corporation organized on September 12, 1963, and appellant and his associate each owned ten percent of Valley's stock. Both Republic and Valley filed federal income tax returns on the basis of a fiscal year ending September 30. For the fiscal years ended September 30, 1963, and September 30, 1964, the corporations filed consolidated federal returns. The 1963 return showed a net loss consisting of a loss by Republic and no gain or loss by Valley. The 1964 return,

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which reported a net loss consisting of a loss of \$251,481.22 by Republic and a profit of \$176,947.49 by Valley, was rejected by the Internal Revenue Service as untimely. Thereafter, Valley was assessed federal tax and penalties on the income it had reported in the rejected consolidated return. As of the date of the hearing in this appeal, Valley had not yet paid the federal tax and penalties,

After auditing appellants' federal return for 1963, an Internal Revenue Agent issued an audit report which, among other adjustments, increased appellants' income in the amount of \$79,026.02 for unreported dividends received from Valley. On the basis of this federal audit report, which appellants did not contest, respondent Franchise Tax Board issued a notice of proposed assessment making corresponding changes in appellants' California taxable income for 1963. Respondent also followed federal action in adding a negligence penalty to the entire assessment. The only aspect of respondent's action that appellant disputes is the increase of \$79,026.02 for dividends from Valley.

It is axiomatic that a deficiency assessment based on a federal audit report is presumptively correct and that the burden lies on the taxpayer to establish that respondent's determination is erroneous. (Todd v. McColgan, 89 Cal. App. 2d. 509 [201 P.2d 414]; Appeal of Nicholas H. Obritsch, Cal. St. Bd. of Equal., Feb. 17, 1959.) Appellant's primary contention is that Valley had insufficient earnings and profits to support dividends to him in the amount determined by respondent. This contention is based upon appellant's unsubstantiated allegations that his business associate also received \$79,026.02 in dividends from Valley and that Valley was assessed some \$100,000 in federal income tax and penalties for its fiscal year 1964, the fiscal period during which Valley made the distributions in question. If proved, these allegations might establish that Valley's current and accumulated earnings and profits available for dividends in fiscal year 1964 (\$176,947.49 less federal income taxes of \$100,000 and less the dividends of \$79,026.02 to his associate.) could not support the dividends attributed to appellant. However, since appellant has failed to introduce the corporate records or other probative evidence to show the correct amount of Valley's earnings and profits, we cannot find that he has met his burden of **proving the** insufficiency of those earnings or profits to support the

