

Appeal of Crystal Ice and Cold Storage Company

The issue presented is whether amounts paid by appellant to its parent corporation, designated as "management fees", were deductible as reasonable allowances for compensation for services **actually** rendered.

Appellant is a California corporation formed in 1925. Its business activities include the production of ice and the cold storage of frozen foods. In September of 1970 all of appellant's stock was acquired by Tsakis, Inc. (**Tsakis**), created in August of 1970. After the issuance of the 300 shares of Tsakis' stock, **Mr. William** Cummings owned 112 shares and Mr. Angelo Tsakopoulos, 83 shares thereof -and, consequently, together they controlled appellant's parent corporation.

After the formation of **Tsakis**, Mr. Tsakopoulos, Ernest G. Cheonis and Mr. Cummings were elected **directors**, and president, vice president and **secretary-treasurer**, respectively, of appellant. Appellant's new directors pledged the assets of appellant to the **Crocker** Citizens National Bank for a loan to Tsakis of \$284,000, which was used to partially pay the liability of Tsakis to appellant's previous shareholders for the purchase of their stock. Moreover, these directors authorized an interest-free loan from appellant to Tsakis of \$150,000, which was also used to pay appellant's former stockholders.

At a special board of directors meeting of appellant in October of 1970, these directors agreed that appellant would enter into a new three-year employment contract with Bart Eddy, appellant's existing general manager. Moreover, at a subsequent special meeting of the board in 1970, Mr. Eddy was elected president, **succeeding** Mr. Tsakopoulos. At the October meeting, a discussion was also held concerning the financial condition of appellant. Mr. Tsakopoulos and Mr. Cummings also **indicated** at that meeting that they would go to **Crocker** Citizens National Bank to make arrangements for a line of credit.

In the minutes of a special meeting of appellant's board of **directors** on December 21, 1970, it is stated that "discussion was then held relative to the extensive management advice and skills provided for and on behalf of Crystal Ice and Cold Storage Co. by the officers and staff of Tsakis, Inc." The minutes disclose that the board then "resolved that Crystal Ice and Cold Storage Co. pay to Tsakis., Inc.-for and as a management consultant fee for services rendered the **sum** of **\$25,000.00.**"

For the income years 1970 and 1972 appellant deducted from gross income \$25,000 and \$23,000, respectively, which it designated as "management fees" paid to Tsakis.

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Other than the minutes for 1970, respondent's auditor found no documentation indicating that such services were actually performed by Tsakis. No written contract had been entered into between Tsakis and appellant. Moreover, there was no evidence of any fee agreed upon, of the services being requested by any officer or staff of appellant, or of any method established to determine the value of any such services. No billing for services was made.

During the years under consideration, Tsakis did not have any paid employees or make any payments to its officers or directors. Nor was there evidence of it having any substantial funds with which to operate. Respondent determined that such management services, if any, were actually performed by the officers and directors of appellant in their capacity as agents of appellant.

Respondent concluded that management services had not actually been rendered by Tsakis for appellant, and that the payments were actually distributions of corporate earnings to Tsakis, the sole shareholder, in lieu of any formal dividends. ^{1/} Consequently, respondent disallowed the deductions.

Section 24343 of the Revenue and Taxation Code provides, in pertinent part:

(a) There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the income year in carrying on any trade or business, including--

(1) A reasonable allowance for salaries or other compensation for personal services actually rendered

It is well established that the taxpayer who claims a deduction has the burden of proving that it is entitled thereto; a determination by respondent that a deduction should be disallowed is supported by a presumption that it is correct. (New Colonial Ice Co. v. Helvering, 292 U.S. 435 [78 L. Ed. 1348] (1934); Appeal of Peter F. and Betty H. Eastman, Cal. St. Bd. of Equal., May 4, 1978.)

1/ Tsakis used the amounts received to pay interest on the loan from Crocker Citizens National Bank.

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Furthermore, where a deduction is claimed for compensation for services rendered and the payment is made to a sole shareholder, the proof must establish the rendering of the services, the reasonableness of the compensation, and that the payments were not disguised distributions of profits.

(See East St. Louis Finance Co., Inc., 34 B.T.A. 1085 (1936).)

In support of the deductions, Mr. Cummings, a member of appellant's board of directors and secretary-treasurer of both appellant and Tsakis, claims that there was a verbal agreement between Tsakis and appellant for the management services. He asserts that before Tsakis acquired appellant, the latter corporation was poorly managed. To improve appellant's management, he claims that together with another director of Tsakis, he met bi-weekly with Mr. Eddy to discuss day-to-day operations. However, the allegation of poor management must be weighed in light of the fact that after Tsakis' acquisition of appellant's stock, Mr. Eddy was employed under a new **three-year** contract and was then elevated to the presidency.

Appellant received a property tax reduction in 1970. A limited new line of credit with the Bank of America was also established for appellant-in 1971, but only for a brief period of time. Mr. Cummings also maintains that these two benefits were-acquired by actions of Tsakis' board of directors.

Other than the statement in the December **special** meeting minutes, relating only to the year 1970, appellant relies exclusively on the uncorroborated self-serving assertions of its secretary-treasurer. No independent evidence **has been offered. Clearly, such absence of persuasive evidence** is insufficient to meet the burden of proof. (See Heil Beauty Supplies v. Commissioner, 199 F.2d 193 (8th Cir. 1952); see also West Mayfair Co., Cal. St. Bd. of Equal., Nov. 27, 1956.)

Consequently, we must sustain respondent's action.

