



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
JOHN S. AND HELEN C. FERGUSON)

For Appellants:, John S. Ferguson,
in pro. per.

For Respondent: John A. Stilwell, Jr.
Counsel

O P I N I O N

This appeal is made pursuant to section 18593 of the Revenue and Taxation Code from the action of 'the' Franchise Tax Board on the protest of John S. and Helen C. Ferguson against a proposed assessment of additional personal income tax in the amount of \$5,467.48 for the year 1975.

Appeal of John S. and Helen C. Ferguson

The question presented is whether appellants have substantiated a claimed deduction for cattle maintenance fees. "Appellant" herein shall refer to John S. Ferguson.

Appellants filed their joint personal income tax return for 1975 using the cash accounting method. On that return, they claimed a **\$50,000.00** deduction for cattle maintenance fees allegedly paid to F & I Maintenance Company, Inc. (F & I), an Arkansas corporation which appellant had apparently formed in 1973, and in which he owned 33 percent of the stock. When respondent requested substantiation of the deduction, appellant produced receipts for payment of cattle maintenance fees, but all were dated in 1974. Because these did not show payments made in 1975, respondent issued a proposed assessment reflecting disallowance of the deduction.

In his subsequent protest, appellant contended that his cattle maintenance fees for 1975 and part of 1976 had been satisfied by his assumption of a \$65,000 note of F & I. He provided a copy of his "Cattle Maintenance Agreement" with F & I, dated January 3, 1975, in which no amount was stated for the maintenance fees, but reference was made to an "attached agreement." The "attached agreement" was apparently a handwritten note below the signature line of the contract which read:

I hereby agree to assume the responsibility for the attached note in the amount of **\$65,000.00** made to F & I Maint. Co. and guaranteed by myself. In return **\$50,000.00** will be applied as maintenance fees for my cattle for the year 1975 and \$15,000 for the year 1976. I also agree to pay the remainder of the maintenance fees when due in 1976. I shall also assume the interest payments on this **attached note.**

[signed] John S. Ferguson

The note referred to was dated November 29, 1974, and signed by appellant for himself and for F & I and by Bruce Anderson. Appellant also provided copies of agreements which first extended the payment date of the note from January '28, 1975, to May 1, 1975, and then made it payable on demand. Payment records show only interest paid on the note from March 10, 1975, through July 21, 1978.

Appeal of John S. and Helen C. Ferguson

At the protest hearing, appellant produced cancelled checks payable to F & I-in the total amount of \$56,372.64, but again, all were dated in 1974. Appellant contended that these checks represented loans to F & I, which were offset by crediting him with \$50,000.00 for his cattle maintenance fees. Only one \$3,000.00 check was marked as a loan to F & I. Appellant also supplied a receipt, dated November 1, 1975, signed by Dr. Samuel Maehara as secretary of F & I, stating that \$50,000.00 had been received from appellant as full payment of his cattle maintenance fees.

Respondent determined that no adequate substantiation had been provided for the claimed deduction, and affirmed the proposed assessment, resulting in this appeal.

The burden is on the taxpayer to show he, is entitled to a claimed deduction. (New Colonial Ice Co. v. Helvering, 292 U.S. 435 [78 L.Ed. 13481 (1934).] A cash basis taxpayer may generally take a deduction only in the year in which an allowable expense is paid. (Cal. Admin. Code, tit, 18, reg. 17591, subd. (a)(1).) Therefore, appellant's receipts for payments made in 1974 do not support his claimed deduction for 1975.

On appeal, appellant relies solely on the November 1, 1975, receipt signed by F & I's secretary. Although such a receipt might, under some circumstances, be acceptable substantiation of a payment, the circumstances in this case raise questions as to whether the "payment" for which the receipt was given may be considered a payment for income tax purposes. Admittedly, no cash or check was given to pay the cattle maintenance fees in 1975. Rather, appellant has contended at different times that the payment was made either by an assumption of liability on a corporate note or by offset against loans made to the corporation. Although the corporation may have considered payment to have been made, these transactions must be examined to see if either qualifies as a payment for tax purposes.

In the handwritten note at the end of his cattle maintenance agreement, appellant agreed "to assume the responsibility" for a \$65,000.00 note. Appellant was already primarily liable on the note, having been one of the original makers, and any additional liability he may have assumed by his ex parte declaration is questionable. At most, this "assumption" was appellant's promise to pay, given to satisfy his

Appeal of John S. and Helen C. Ferguson

obligation for cattle maintenance fees. Although appellant and F & I may have considered this sufficient to constitute a payment, for income tax purposes the giving of one obligation to satisfy another does not constitute a payment by a cash basis taxpayer. (See Cleaver v. Commissioner, 158 F.2d 342 (7th Cir, 1346); Thomas Watson, 8 T.C. 569 (1947); 4 Bittker, Federal Taxation of Income, Estates and Gifts, ¶ 105.2.4 (1981).)

Appellant's contention that the receipt evidenced an offset against monies loaned to F & I during 1974 also does not stand scrutiny. Although payment may be made by offsetting claims owed to the taxpayer (2 Mertens, Law of Federal Income Taxation, § 12.54 (1974 Revision)), there must first be some debt to the taxpayer. A debt obligation is ordinarily evidenced by a note or some writing with provisions for repayment, interest, or security provisions; (Appeal of Cecil W. Harris, Cal. St. Bd. of Equal., Jan. 6, 1977.) Such indicia are totally lacking here, and appellant has not shown by any other means that his expenditures were in fact loans to F & I. They could just as easily have been cattle maintenance fee payments or even contributions to capital. Since there is no proof that the checks constituted loans, appellant's contention fails without even considering whether or not there was an offset.

We find that appellant has not substantiated his claimed **deduction** and, therefore, sustain respondent's action.

