

Appeal of V.I.E. Industries, Inc.

The sole issue presented by this appeal is whether respondent properly determined that appellant was not entitled to a worthless stock loss deduction in the amount of \$35,985 for the income year ended January 31, 1976.

On its franchise tax return for the income year in issue, appellant reported that 67,070 shares of U.S. Franchise Corporation ("USF") stock it had previously acquired for \$36,035 had been sold during the appeal year for \$50, thereby resulting in a loss of \$35,985. Appellant's return for the income year ended January 31, 1970, disclosed that, for services rendered, it had acquired 5,000 shares of USF stock issued at \$1.00 a share. That return also revealed that appellant had made franchise, equipment, and lease deposit payments to USF in the total amount of \$28,355 pursuant to an agreement to purchase a restaurant franchise from the latter corporation. In a Statement attached to its return, however, appellant disclosed that the franchise agreement with USF had been rescinded, and that its deposits with USF had been converted to an account receivable for which it agreed to accept additional USF stock on the same basis agreed to by other creditors of USF. Information subsequently obtained from appellant indicated that its account receivable with USF had been converted to an additional 62,070 shares of USF stock purportedly worth \$31,035.

Upon receipt of appellant's return for the income year in issue, respondent conducted an audit which revealed, among other things, that the corporate powers, rights, and privileges of USF had been suspended on June 1, 1971, pursuant to Revenue and Taxation Code section 23301.5,^{1/} and that USF had not reported any activity

1/ Section 23301.5 provides as follows:

Except for the purpose of amending the articles of incorporation to set forth a new name, under regulations prescribed by the Franchise Tax Board, the corporate powers, rights and privileges of a domestic corporation may be suspended, and the exercise of, the corporate powers, rights and privileges of a foreign taxpayer in this state may be forfeited if a taxpayer fails to file a return.

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subsequent to that date. Based upon this and other information revealing that USF was in serious financial difficulties when it issued its stock to appellant, respondent determined that appellant was not entitled to the subject worthless stock loss deduction because the stock had become worthless prior to the 1976 income year. In accordance with that determination, respondent concluded that the sale of that stock for \$50 during the appeal year was insufficient to establish that it had value at the beginning of, or during, the appeal year. The subject proposed assessment reflecting respondent's determination was subsequently issued.

A loss from a security which becomes worthless during the income year is deductible, if not compensated for by insurance or otherwise, pursuant to Revenue and Taxation Code section 24347, subdivision (d). A deduction is allowed only for the income year in which the loss is sustained, as evidenced by closed and completed transactions and fixed by identifiable events occurring in that income year. (Cal. Admin. Code, tit. 18, reg. 24347, subd. (a) (2).) The worthless stock provisions of section 24347 are essentially the same as those of Internal Revenue Code section 165; thus, federal case law in this area is highly persuasive in interpreting the California statute. (Rihn v. Franchise Tax Board, 131 Cal.App.2d 356, 360 [280 P.2d 893] (1955).)

The parties appear to agree that appellant's USF stock became worthless, but they disagree as to the year in which this occurred. It is well settled that the taxpayer bears the burden of showing that the stock became worthless in the year for which the deduction is claimed. (Boehm v. Commissioner, 326 U.S. 287, 294 [90 L.Ed. 78] (1945); Appeal of Medical Arts Prescription Pharmacy, Inc., Cal. St. Bd. of Equal., June 13, 1974.) To meet this burden, appellant herein must show both that the stock had value at the beginning of its income year ended January 31, 1976, and that some identifiable event occurred in that year which rendered it worthless by the end of that year. (Appeal of Medical Arts Prescription-Pharmacy, Inc., supra.)

In an effort to establish that its USF stock had value at the beginning of, and during, the income year in question, appellant points to the sale of that stock for \$50 in 1975. While the 1975 sale was undoubtedly a factor to be considered by respondent, there is no rule which gives it conclusiveness. (Brown v. Commissioner, 94 F.2d 101 (6th Cir. 1938).) The fact

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that appellant found a party willing to take a "flyer" on the stock at a nominal price does not mean that the loss had not actually occurred prior to the appeal year. (Gilbert H. Pearsall, 10 B.T.A. 467 (1928).)

After careful review of the record on appeal, we believe that the evidence supports respondent's determination that USF's stock was worthless before the commencement of appellant's 1976 income year. USF was in dire financial straits at the time it issued appellant the stock under discussion. In fact, apparently the only manner in which USF could "satisfy" any of its liabilities to its creditors was to issue additional stock. There is no evidence to establish that USF conducted any business, filed any returns, or issued any financial reports in, or after, 1971. Finally, as previously indicated, the corporate rights, powers, and privileges of USF had been suspended by respondent on June 1, 1971, for failure to file a franchise tax return. No one of these factors alone may be conclusive, but together they are a strong indication that USF's stock was, for all practical purposes, worthless as early as 1971, at least four years before the beginning of the appeal year.

We find that appellant has not borne its burden of establishing that the USF stock had value at the beginning of the 1976 income year or that an identifiable event occurred during that year which resulted in the stock's worthlessness. We therefore sustain respondent's action.

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ORDER

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 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of V.I.E. Industries, Inc. against a proposed assessment of additional franchise tax in the amount of \$3,239.00 for the income year ended January 31, 1976, be and the same is hereby sustained.

Done at Sacramento, California, this 29th day of June , 1982, by the State Board of Equalization, with Board Members Mr. Bennett, Mr. Dronenburg and Mr. Nevins present.

-William M. Bennett _____, Chairman

Ernest J. Dronenburg, Jr. _____, Member

Richard Nevins _____, Member

_____, Member

_____, Member