



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
H. & F. COMPANY, INC.)

Appearances:

For Appellant: John Y. Maeno, Attorney

For Respondent: Chas. J. McColgan, Franchise Tax Commissioner

O P I N I O N

This is an appeal pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Ch. 13, Stats. 1929, as amended) from the action of the Franchise Tax Commissioner in overruling the protest of the H. & F. Company, Inc. to a proposed additional assessment in the amount of \$99.58, based upon its return for the period September 1, 1933 to December 31, 1933. The only issue involved in this appeal is whether the Commissioner acted properly in disallowing as a deduction from gross income an item of \$10,929.10 which was charged off on the books of the Appellant in December 1933 as a bad debt ascertained to be worthless.

According to the information furnished to this Board by Appellant, it appears that about twenty-five years ago, the H. & F. Company, partnership was created for the purpose of engaging in the produce commission merchant business. About five years later, a party by the name of M. Takahashi became a partner in the company, Mr. Takahashi continued as a partner until December 1932 when he withdrew from the partnership. Shortly thereafter, he became a partner in H. F. & R. Company, another produce merchant concern. In May 1933, he took over the H. F. & R. Company and started the Takahashi Company.

On or about August 24, 1933, the H. & F. Company partnership apparently decided to incorporate and formed the H. & F. Company, Inc., the Appellant herein. On September 1, 1933, the corporation, according to the brief of Appellant, took over the business of the partnership, for and in consideration of the sum of \$25,000. Among the assets of the partnership at this time was a claim against M. Takahashi for \$10,929.10. This claim apparently represented the balance due from M. Takahashi on account of advances made to him by the H. & F. Company partnership and on account of loans made by such partnership to the H. F. & R. Company partnership, of which, as above noted, M. Takahashi was a partner for a short while prior to the time it became the Takahashi Company.

At the time the corporation took over the partnership, M. Takahashi was doing a good business, and, Appellant alleges,

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there was every reason to believe that the good business would continue and that he would be able to pay off his indebtedness to the company. It seems, however, that shortly thereafter, his business took a decided turn for the worse, and in December 1933, it became necessary for him to close his business. At that time, his financial condition was so bad and his prospects of making a "comeback" were so slight that Appellant was convinced he would never be able to discharge his various obligations. Accordingly, Appellant's claim against him for \$10,929.10 was charged off on its books as a debt ascertained to be worthless. In its return for the period ended December 31, 1933, Appellant took a deduction from gross income on account of the debt so charged off. The Commissioner disallowed the deduction and proposed the additional assessment in question. From his action in overruling Appellant's protest to such assessment, this appeal was filed.

We are of the opinion that the Commissioner acted properly in disallowing the deduction in question. There is no evidence before us that Appellant actually and in good faith paid the sum of \$25,000 or any other sum for the business of the H. & F. Company partnership. For all that appears from the record, the alleged payment of this sum may simply have been a bookkeeping transaction.

Furthermore, even though there was an actual sale and purchase of the business of the partnership for the sum of \$25,000, it does not appear what portion, if any, of this sum was paid for the debt of M. Takahashi.

In the absence of proof to the contrary, perhaps we should assume that the Appellant paid the partnership an amount equivalent to the fair market value of the debt at the time it was acquired by the Appellant. But even if we should make such an assumption, we still would not be justified in reversing the Commissioner. In our opinion, it is very questionable whether the debt had any very substantial value at the time the Appellant took over the business of the partnership. The debt was wholly unsecured. Appellant had to rely for payment of its claim entirely upon the chance that M. Takahashi would make a success of his new venture into the produce commission merchant business. Although his business may have been good and his prospects excellent at the time Appellant acquired its claim, a prudent person could scarcely have been expected to have paid for the claim an amount either equal to or approximating the face value thereof. The folly of so doing clearly appears from the fact that less than four months later his business was a complete failure and the claim was admittedly worthless.

For the above reasons we must **sustain** the Commissioner in overruling Appellant's protest to the proposed additional assessment,

O R D E R

Pursuant So the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

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IT IS HEREBY ORDERED, ADJUDGED AND DECREED, that the action of Charles J. **McColgan**, Franchise Tax Commissioner, in overruling the protest of H. & F. Company, **Inc.**, a corporation, against a proposed assessment of an additional tax in the amount of \$99.58, based upon the return of said corporation for the period September 1, 1933 to December 31, 1933, pursuant to Chapter 13, Statutes of 1929, as amended, be and the same is hereby **sustained**.

Done at Sacramento, California, this 25th day of October, 1935, by the State Board of **Equalization**.

R. E. Collins, Chairman
John C. Corbett; Member
Fred E. **Stewart**, Member
Orfa Jean Shontz, Member
Ray L. Riley, Member

ATTEST: Dixwell L. Pierce, Secretary