*38-SBE-006

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
NEWPORT HARBOR PUBLISHING COMPANY)

Appearances:

For Appellant: S. A. Meyer, its Manager; J. O. Heinley, its Accountant

For Respondent: Chas. J. McColgan, Franchise Tax Commission
Frank M. Keesling, Franchise Tax Counsel;
Clyde Bondeson, Senior Franchise Tax Auditor

O P I N I O N

This appeal is made pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes of 1929, as amended) from the action of the Franchise Tax Commissioner in overruling the protest of the Newport Harbor Publishing Company to his proposed assessment of an additional tax in the amount of $58.15 for the fiscal year ended February 28, 1936, based upon the income of the company for the fiscal year ended February 28, 1935.

In its return of income for the fiscal year ended February 28, 1935, the Appellant deducted from its gross income the amount of $132.25 either as a contribution or a businessexpense the amount representing a contribution to a local church, and the amount of $1,726.91 as bad debts. The Commissioner disallowed these deductions, the former upon the grounds that the deduction of charitable contributions was not authorized by the Act and the contribution did not represent an ordinary and necessary business and the latter upon the ground that sufficient information was not furnished to establish that the debts became worthless and were charged off during the year, This appeal presents for our consideration the validity of this action of the Commissioner.

The Appellant contends that the amount of its contribution to a local church which was conducting a building campaign was deductible as a business expense inasmuch as it was believed that the contribution would tend to increase its business with the church and the members thereof. While the Bank and Corporation Franchise Tax Act does not authorize the deduction of charitable donations or contributions by corporations, being in this respect similar to the Federal Revenue Act prior to its amendment in 1935, such donations or contributions may be deducted as ordinary and necessary business expenses when they represent a consideration for a benefit flowing directly to the corporation as an incident of its business. Fairmont Creamery Corporation

v. Helvering, 89 F. (2d) 810. The test to be applied in the determination of the deductibility of a donation or contribution is whether it may reasonably be expected to result in a direct benefit to the business commensurate with the expenditure, in which case it may be deducted, or whether it may result merely in some indirect or remote benefit such as that resulting from the maintenance of good will. Old Mission Portland Cement Co. v. Helvering 293 U.S. 289; Merchants National Bank of Mobile v. Commissioner of Internal Revenue, 90 F. (2d) 223; Morgan Construction Co. v. United States, 18 F. Supp. 892.

The benefit, if any, reasonably to be expected from the contribution here in question is, in our opinion, one resulting from the maintenance of good will and too remote and indirect to furnish a basis for the deduction of the contribution as an ordinary and necessary business expense. This conclusion is amply supported by Helvering v. Evening Star Newspaper Co., 78 F. (2d) 604, cert. den. 296 U.S. 628, and the Brush-Moore Newspapers, Inc. v. Commissioner of Internal Revenue, 33 B.T.A. 362, which upheld the action of the Commissioner of Internal Revenue in disallowing the deduction as business expenses of contributions made by newspaper publishers to local charitable agencies even though the expenditures aided in the maintenance of the publisher's good will and may have had advertising value.

One of the larger accounts included by Appellant in the deduction for bad debts disallowed by the Commissioner is that of the Norrins Realty Company in the amount of $799.85. While there is some conflict in the facts as set forth by the Appellan in its petition and as presented by it at the hearing, it appear that the indebtedness arose about 1928 and 1929 as that of the Orange County Bond and Realty Company, that a partial settlement was made a few years thereafter through the acceptance by Appellant of certain shares of stock in that company or the Norrins Realty Company, that the firm of Norrins and Dewey, a partnership, while not assuming the indebtedness, agreed to and did in fact make some payments on the indebtedness, the last payment being made in 1932, and that during the fiscal year ended February 28, 1935, the Appellant was compelled to pay an assessment with respect to the shares of stock which it had previously accepted in partial settlement of the account and, accordingly, ascertained the account to be worthless and charged it off during the year. We are unable to conclude from the evidence presented to us that the Commissioner acted improperly in determining that the account could not reasonably be ascertained to have become worthless during the fiscal year ended February 28, 1935, and in disallowing the deduction of the account as a bad debt for that year.

We are, however, of the opinion that the account of the Crandall Boat Company in the amount of $642.52 was reasonably ascertained to have become worthless and was charged off during the year in question and that the Commissioner acted improperly in disallowing its deduction as a bad debt for the year. This account arose about 1929, sales being made to the firm as late as 1932. The Los Angeles wholesalers Board of Trade obtained control of the assets of the firm shortly thereafter

and&tempted to realize some proceeds therefrom for the benefit of the creditors, the Appellant being advised by the Board of Trade in 1933 that the matter was not settled and that the process of collection was being continued. No payments being made or further information respecting payments being furnished to Appellant during the fiscal year ended February 28, 1935, the account was ascertained to be worthless and charged off during that year.

The remaining portion of the bad debt deduction disallowed by the Commissioner represents eleven accounts in amounts varyin from $6.50 to $70.08, the sum of which is $284.54. These account appear to have been ascertained to be worthless and to have been charged off during the year in question in accordance with ordinary and reasonable business practice in such matters and, accordingly, to be deductible as bad debts for that year. The Commissioner, therefore, in our opinion, acted improperly in disallowing the deduction of these accounts as bad debts in the Appellant's return of income for the fiscal year ended February 28, 1935.

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 that the action of Chas. J. McColgan Franchise Tax Commissioner, in overruling the protest of the Newport Harbor Publishing Company to his proposed assessment of an additional tax in the amount of $58.15 for the fiscal year ended February 28, 1936, based upon the income of the company for the fiscal year ended February 28, 1935, be and the same is hereby modified. Said action is hereby reversed insofar as the Commissioner denied to said company a deduction for bad debts in the amount of $927.06, the deduction to include the following items:

Crandall Boat Co.	$642.52
H. Glenn	30.25
Hancock Service	10.31
Hixon Roofing	9.00
Pioneer Service	21.40
Cornish J. Roehm	14.80
Shafer's Twin Palm Inn	39.85
A. E. Bodagh	6.50
Nelson Stafford	6.75
Assets Liquidation Corp.	70.08
K. I. Fulton	46.00
Forest A. Gayden	29.60

In all other respects said action is sustained, The correct amount of the tax to be assessed to the Newport Harbor Publishing Company is hereby determined as the amount produced by means of a computation which will include the allowance of a deduction from gross income of the said amount of $927.06 in the calculation thereof. The Commissioner is hereby directed to proceed in

conformity with this order and to send to the Newport Harbor Publishing Company a notice of assessment revised in accordance therewith.

Done at Sacramento, California, this 7th day of April, 1938, by the State Board of Equalization.

R. E. Collins, Chairman
Fred E. Stewart, Member
John C, Corbett, Member
William G. Bonelli, Member

ATTEST: Dixwell L. Pierce, Secretary