

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA



In the Matter of the Appeal of)
SAMUEL J. BRISKIN)

Appearances:

For Appellant: Kahan, Seltzer and Eckstein,
Certified Public Accountants

For Respondent: Burl D. Lack, Franchise Tax
Counsel; Mark Scholtz,
Associate Tax 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 Commissioner (now succeeded by the Franchise Tax Board) on the protest of Samuel J. Briskin to a proposed assessment of additional personal income tax in the amount of \$101.68, the tax having been reassessed at \$100.80, for the year 1942.

Cinema Sports Center, Inc., was organized in California during 1940 for the purpose of operating a bowling alley and cocktail lounge business. On or about July 30, 1940, it issued and sold 1,000 shares of its capital stock for cash to the following persons in the amounts indicated, receiving \$10.20 per share and an aggregate sum of \$10,200: Samuel J. Briskin, 245 shares, or 24½% of the issue, for \$2,499; Samuel Bischoff, a like amount; Irving Carlin, 490 shares, or 49% of the issue, for \$4,998; Mendel B. Silverberg, 20 shares, or 2% of the issue, for \$204. The corporation entered into various contracts under which it obligated itself to pay the approximate amount of \$90,000 for the improvement of some leased real property and the installation and equipment of bowling alleys and a bar in conjunction therewith.

Delays in the completion of the improvements and in the obtaining of liquor and other licenses prevented the corporation from obtaining operating revenue for use in the payment of its contract obligations, as had originally be anticipated, and it was consequently forced to the alternative of borrowing money for that purpose. Pursuant to appropriate action of its board of directors, it secured loans' from Briskin, Bischoff and Carlin on the dates and in the amounts following:

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<u>Date</u>	<u>Briskin</u>	<u>Bischoff</u>	<u>Carlin</u>	<u>Total</u>
9/10/40	\$2,500	\$2,500	\$2,500	\$7,500
9/20/40	2,500	2,500	7,500	12,500
11/7/40	2,500	2,500	2,350	7,350
11/8/40			150	150
11/14/40			2,500	2,500
	<u>\$7,500</u>	<u>\$7,500</u>	<u>\$15,000</u>	<u>\$30,000</u>

Each loan was evidenced by a promissory note drawn in favor of the lender and bearing interest at the rate of 6% per annum, and each was recorded by the corporation on its books as a note payable to the particular lender. On December 28, 1940, the corporation borrowed an additional \$10,000 from a bank, the loan being personally endorsed and guaranteed by these stockholders.

In 1941 a reduction in the corporation's operating revenue ensued when its business was placed under "off-limits" restrictions by the Armed Forces, and as a result it once more became necessary to borrow funds in order to meet its obligations. Again it was able to do so from Briskin, Bischoff and Carlin, on the dates and in the amounts following:

<u>Date</u>	<u>Briskin</u>	<u>Bischoff</u>	<u>Carlin</u>	<u>Total</u>
3/25/41	\$ 750	\$ 750	\$1,500	\$3,000
5/26/41	500	500	1,000	2,000
7/15/41			2,000	2,000
7/19/41	1,000	1,000		2,000
7/20/41		2,500		2,500
10/1/41		1,000		1,000
10/10/41	1,000		2,000	3,000
	<u>\$3,250</u>	<u>\$5,750</u>	<u>\$6,500</u>	<u>\$15,500</u>

These loans, too, were authorized by the board of directors, evidenced by interest-bearing promissory notes and recorded as notes payable on the books of the corporation.

On July 25 and August 25, 1941, the corporation repaid Bischoff an aggregate sum of \$2,500, and at the end of 1941 the net outstanding loans from Briskin, Bischoff and Carlin were as follows:

<u>Briskin</u>	<u>Bischoff</u>	<u>Carlin</u>	<u>Total</u>
<u>\$10,750</u>	<u> </u>	<u>\$21,500</u>	<u>\$43,000</u>

On January 7, 1942, the corporation gave Briskin seven promissory notes payable on demand, with interest payable only after demand, in exchange for the seven interest-bearing promissory notes it had previously given him,

In 1942 the corporation's liquor licenses were suspended for a considerable period of time.

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On October 31, 1942, the corporation's balance sheet showed a net worth of \$17,166.09, its current liabilities, however, exceeding its current assets by \$12,397.79. According to Appellant, in the event of a liquidation of the corporation at that date, it could not have realized enough to pay all its current liabilities. It is also alleged by Appellant, without challenge by the Commissioner, that the corporation's business was offered for sale in 1942, but that no purchaser was found willing to buy at a figure sufficient to liquidate the corporation's obligations, even excluding the advances made by the stockholders. In the same year the corporation's banker refused to make any more loans to the corporation, except upon personal endorsements and guarantees by Appellant and Bischoff. Furthermore, demands were made on the corporation in that year by various of its creditors for the immediate payment of the obligations due them.

Prior to October 31, 1942, Appellant and Bischoff requested that the corporation repay their loans, but the request was not met because of the corporation's poor financial condition. Discussions on the subject were had with Carlin, who also was general manager of the corporation, and Carlin proposed that they compromise their claims and thereby leave the way open for him to rehabilitate the corporation. The proposal resulted in the execution of an agreement on November 10, 1942, under which Carlin was to lend the corporation the sum of \$5,200; the corporation was to pay Briskin and Bischoff each the sum of \$2,600 in full settlement of their loans to the corporation; the corporation was to pay a remaining balance of \$4,400 on the bank loan, together with interest accrued thereon, and thus release Briskin and Bischoff from their personal guarantee; Carlin was to pay the bank the sum of \$3,100, together with accrued interest thereon, which had been borrowed personally by him on Briskin's and Bischoff's endorsements; and Briskin and Bischoff were to transfer all their stock in the corporation to Carlin for \$2.00 and surrender the notes given them by the corporation. In compliance with the agreement, Briskin received the sum of \$2,600 from the corporation, received from the bank the cancelled guarantee, received \$1.00 from Carlin in consideration for his (Briskin's) stock in the corporation, surrendered to the corporation the notes given him by it, and delivered his stock in the corporation to Carlin.

On December 31, 1942, Briskin charged off on his books as a bad debt the sum of \$8,150, which was the difference between the \$10,750 the corporation owed him prior to the completion of the agreement with Carlin and the \$2,600 paid pursuant thereto. The corporation on its part closed out its liability accounts standing in the names of Briskin and Bischoff and made an appropriate credit entry in its surplus account, at the same time increasing the credit balance of the notes payable account in Carlin's name to \$27,000.

In their personal income tax returns for 1942, Briskin and his wife each claimed a bad debt deduction in the amount of one-half of the \$8,150 mentioned, in reliance upon Section 8(f) (1) of the Personal Income Tax Act (now Section 17310 of the Revenue and

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Taxation Code) that section then authorizing the deduction of "Debts ascertained to be worthless within the taxable year and charged off . . ." Believing, however, that Appellant's advances to the corporation were in the nature of additional contributions to capital rather than loans and that the execution of the agreement of November 10, 1942, was tantamount to the sale or exchange of a capital asset, the Commissioner decided that no deduction was allowable under Section 8(f)(1), but that instead the Briskins were entitled under former Section 9.4 of the Act (now Sections 17711 and following of the Revenue and Taxation Code) to a capital loss deduction equivalent approximately to only 60% of the amount which they had claimed as a bad debt. He now also maintains that even if the advances were loans, they were not worthless in 1942.

As regards his contention that the advances were capital contributions, the Commissioner states that they were made by the several stockholders in amounts directly proportionate to their stockholding interests. This was not exactly the case, since a stockholder owning 2% of the stock made no advances to the corporation. Nevertheless, even if all the stockholders had made advances proportionate to their shareholdings, it would not follow from that alone that the advances were capital contributions and not loans. The authorities concur in the view that whether advances by a stockholder to the corporation whose shares he holds are in the one category or the other depends on his intent in making them, as manifested by the evidence, and that a mere payment by him to the corporation is not per se a capital contribution. Daniel Gimbel, 36 B.T.A. 539; Edward Katzinger Co., 44 B.T.A. 533, affirmed 129 Fed. 2d 74; Berman Gsba, T.C. Memo., Docket 6171, September 12, 1945; Lucia Chase Ewing, T.C. Memo., Docket 7077, October 4, 1946; Ethel S. White, R. L. White, T.C. Memo., Dockets 12570, 12571, September 25, 1947.

In the instant case, the evidence regarding the circumstances under which the advances in question were made by Appellant to Cinema Sports Center, Inc., the authorizing and recording of the advances as loans on the books of the corporation and the issuance of the promissory notes by the corporation indicate that the advances were loans and were considered such by all concerned. We see nothing else in the evidence which can reasonably support a contrary conclusion, and are of the opinion, accordingly, that the Commissioner erroneously treated Appellant's advances as capital contributions.

As respects the nondeductibility in 1942 of the unpaid balance of the advances as a bad debt, the Commissioner maintains that Cinema Sports Center, Inc., was not insolvent in that year and, further, that not only did Appellant receive a cash consideration in the amount of \$2,600 in settlement of his advances, but that he received additional valuable consideration in the amount of \$7,500 in being released by the execution of the agreement of November 10, 1942, from his potential obligation as endorser and guarantor of the bank loans negotiated by the corporation and Carlin.

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With respect to insolvency the Commissioner states that the corporation's balance sheet of October 31, 1942, showed current liabilities of \$14,000, contract obligations of \$12,000 and physical assets of \$90,000, from which he draws the conclusion that ~~the corporation~~ could have realized "sufficient funds through refinancing to pay off the \$12,000 . . ." He further says that the balance sheet merely showed a "temporarily weak financial position," and "more important, there is no evidence of any act on the part of the corporation or any of its creditors to establish the fact of insolvency." An examination of the balance sheet reveals that in exact figures the current liabilities totalled \$14,413.12, the contract obligations, \$12,367.54 and the physical assets \$92,484.83 (without allowance for depreciation in the amount of \$17,098.68). In addition, the financial statement showed current assets in the amount of \$2,015.33, notes in the sum of \$43,300 payable to the stockholders and a total net worth of \$17,166.09.

Despite this balance sheet showing of net worth, the evidence establishes that the financial position of Cinema Sports Center, Inc., immediately before the agreement of November 10, 1942, was such that it was unable to pay its operating expenses or natured obligations and that it could not obtain bank loans for that purpose solely on the strength of its own credit. Although the business was offered for sale, no prospective purchaser was willing to offer enough to pay off even the corporation's current and contract obligations, let alone the notes payable to its stockholders. In addition, there is evidence that the corporation could not have realized enough on a liquidation sale to pay all its current liabilities. This follows from the fact that a major portion of the cost of the corporation's equipment was the labor expense incurred in installing it. The assets being the subjects of conditional sales contracts, there was little net equity in the corporation in the event of liquidation. Similarly, the leasehold improvements were valueless to it in that situation. These factors, in our opinion, justify the assertion in the agreement of November 10, 1942, that "Bischoff and Briskin recognize that if they sought to enforce collection of the entire indebtedness of Corporation to them, the amount which they would probably succeed in collecting would not exceed Two' Thousand, Six Hundred Dollars (\$2,600.00) each, if as much," and also demonstrate the uncollectibility of the \$8,150 for which a deduction was claimed by Appellant and his wife as a bad debt.

The Commissioner places great reliance upon First National Bank and Trust Company in Macon v. United States, 115 Fed. 2d 194, in urging that Appellant was not entitled to a bad debt deduction. While that decision involves a factual situation somewhat similar to that presented here, the two differ in one extremely important respect. In the cited case the Court points out that there was no showing that the debt held by the stockholder against the corporation was worthless and that, on the contrary, the stockholder-creditor wished to retain his claim as of some value, parting with it along with his stock in order to get a release from liability under his endorsement of the corporation's note. Such was not the case here, however, for as we have above con-

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cluded the Appellant was warranted in regarding as uncollectible the remaining portion of the corporation's indebtedness to him, and any liability to which he might have been subjected on his endorsement would simply have constituted an additional loss incurred by him,

O R D E R

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 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Commissioner (now succeeded by the Franchise Tax Board)' on the protest of Samuel J. Briskin to a proposed assessment of additional personal income tax in the amount of \$101.68, the tax having been reassessed at \$100.80, for the year 1942 be and the same is hereby reversed and the Franchise Tax Board is hereby directed to abate said proposed assessment of additional tax.

Done at Sacramento, California, this 2 day of March, 1950, by the State Board of Equalization.

George R. Reilly, Chairman
J. H. Quinn, Member
J. L. Seawell, Member
Wm. G. Bonelli, Member

ATTEST: Dixwell L. Pierce, Secretary