67-SBE-014

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
JORDAN ASSOCIATES, INC., TAXPAYER,)
AND EDMUND F. SCHNIEDERS, ASSUMER)
AND/OR TRANSFEREE)

Appearances:

For Appellants: Harry Barnett
Certified Public Accountant

For Respondent: Lawrence C. Counts
Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Jordan Associates, Inc., and Edmund F. Schnieders against a proposed assessment of additional franchise tax in the amount of $1,022.48 for the income year ended June 30, 1961.

The question presented is whether Jordan Associates, Inc. (hereafter alone referred to as "appellant") properly claimed a bad debt deduction of $18,590.51 for that year.

Prior to 1958, Mr. Robert Morris acquired a commercial interior decorating business for $20,500. He operated the business as sole proprietor until July 30, 1958, when appellant was incorporated to continue the business in corporate form. Morris invested the assets of his business in the corporation and a Mr. J. Robert Jordan invested cash. Because Morris was having financial difficulties, all of the corporation's stock was issued to Jordan but the understanding of the two parties was that Morris was actually a one-half owner of the corporation. Morris received a total salary of $12,950 from appellant for the three income years preceding June 30, 1962. In 1962, because of disagreements between the parties, Morris sold his one-half interest to Jordan for $30,000.

At some time prior to June 30, 1960, appellant made a loan of $20,000 to Bel Air, Inc., doing business as Bermuda Restaurant. As security, appellant was assigned all of Bel Air's stock. Appellant claimed and was allowed a $20,000 bad debt deduction for the income year ended June 30, 1960, because of this loan. As a result of the default appellant became absolute owner of Bel Air's stock. Bel Air was suspended on January 2, 1959, for failure to pay its corporate franchise taxes.

Appellant's books indicate a loan or loans to Morris in 1958 or 1959, and a credit thereto during the income year in question, leaving an unpaid amount of $10,290.51 as of June 30, 1961. In June of 1960 an entry was made on appellant's books charging Morris with a $17,000 advance, represented by a note. As of June 30, 1961, the unpaid amount on this note was $8,300. The bad debt deduction at issue equals the total of these two unpaid amounts of $10,290.51 and $8,300.

Respondent Franchise Tax Board disallowed the bad debt deduction of $18,590.51. It contends that appellant failed to establish that a bona fide debt actually became worthless during the income year ended June 30, 1961.

Appellant asserts that after Bel Air defaulted on its obligations and ceased operating it was thought the restaurant business might be saved if appellant operated it through Morris with Morris paying the restaurant bills directly. It is claimed that the advances totalling $18,590.51 were made before it was concluded during the income year at issue that the business was a failure and that no more money should be poured into it.

Section 24348 of the Revenue and Taxation Code provides, in part:

> There shall be allowed as a deduction debts which become worthless within the income year ....

So far as material here, section 24348 contains substantially the same language as section 166 of the Internal Revenue Code of 1954.

The taxpayer has the burden of showing, by objective standards, that the debt actually became worthless during the year for which the deduction is sought. (Redman v. Commissioner, 155 F.2d 319.) Mere nonpayment of a debt does not prove its worthlessness and a deduction is not justified when the creditor fails to take reasonable steps to enforce collection unless there is proof that those steps would be futile. (A. Finkenberg's Sons, Inc., 17 T.C. 973.)

Both the facts in this matter and appellant's exact position are unclear. Appellant's books indicate that the loans in issue were made to Morris and that he repaid a substantial part of the loans during the income year in question, the year ended June 30, 1961. Without offering any further proof, appellant has alleged on one hand that the loans were actually made to Bel Air, Inc., and on the other hand that the amounts were equivalent to investments rather than loans. Regardless, however, of whether the loans were made to Morris or to Bel Air, Inc., or whether the amounts were investments rather than loans, there is no evidence that they became worthless during the income year in question.

Accordingly, we hold that the Franchise Tax Board did not err in disallowing the bad debt deduction for the income year ended June 30, 1961.

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,

Appeal of Jordan Associates, Inc., Taxpayer, and Edmund F. Schnieders, Assumer and/or Transferee

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 Jordan Associates, Inc., and Edmund F. Schnieders against a proposed assessment of additional franchise tax in the amount of $1,022.48 for the income year ended June 30, 1961, be and the same is hereby sustained.

Done at Sacramento, California, this 24th day of April, 1967, by the State Board of Equalization.

Paul R. Leake, Chairman

John W. Lynch, Member

Member

Member

Member

ATTEST: _____, Secretary