75-SBE-036

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the -Matter of the Appeal of)
)
HARRY P. AND)
FLORENCE 0. WARNER)

For Appellants: Harry P. Warner, in pro. per.

For Respondent: Crawford H. Thomas
Chief Counsel

Noel J. Robinson
Counsel

OPINION

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Harry P. and Florence 0. Warner against a proposed assessment of additional personal income tax in the amount of $103.00 for the year 1968.

The sole issue for determination here is whether a monetary advance made by appellants in 1967 constituted a bona fide loan.

Appellants are residents of Los Angeles where Mr. Warner engages in the private practice of law. In 1967, Mrs. Warner's brother, Robert M. Oran, became financially distressed. He had been recently divorced and was having difficulty making child support payments out of his earnings. In October 1967, his checking account was $300.00 overdrawn, and he had written four checks totaling $1,213.00 which were still outstanding.

During October 1967, Mrs. Warner deposited two checks, totaling $1,625.00, in her brother's checking account. On November 1, 1967, she wrote Mr. Oran confirming those deposits. Her letter also alluded to an agreement whereby Mr. Oran was obligated to make repayments of at least $25.00 per month beginning in January 1968, and continuing until the advance was repaid in full. That letter was not signed by Mr. Oran, and there is no evidence of any other written instrument which was signed by him. The alleged agreement apparently made no provision for the payment of interest and no collateral was taken by appellants as security for the advance.

Appellants state that Mr. Oran left the Los Angeles area before making any repayment on the advance. He apparently remained away for the balance of 1968 and even after returning to Los Angeles he made no effort to repay appellants.

Appellants filed a timely California personal income tax return for 1968 wherein they deducted the amount advanced to Mr. Oran as a bad debt loss. They reported the total loss to be $2,547.05, but limited their deduction to a capital loss of $1,000.00. Appellants have presented no evidence to explain the discrepancy between the $2,547.05 reported as a loss and the $1,625.00 advance referred to in the letter from Mrs. Warner to Mr. Oran.

In June 1972, respondent requested additional data from appellants concerning their 1968 bad debt deduction. Appellants responded in July 1972, and included with their response a copy of the letter dated November 1, 1967, from Mrs. Warner to Mr. Oran.

In October 1972, respondent disallowed the 1968 bad debt deduction and asserted the deficiency assessment here in issue. Thereafter, on November 13, 1972, Mrs. Warner wrote her brother demanding repayment of the alleged loan. Mr. Oran responded on November 20, 1972, stating in part, "... As you know my financial position at that time was weak and hasn't improved....I didn't have the resources for repayment then, nor now and don't forsee [sic] repayment in the forseeable [sic] future. ..." On December 5, 1972, appellants filed a protest against the proposed deficiency assessment, and respondent's denial of that protest gave rise to this appeal.

Section 17207 of the Revenue and Taxation Code allows as a deduction any debt which -becomes worthless within the taxable year. Respondent's regulations provide:

> Only a bona fide debt qualifies for purposes of Section 17207. A bona fide debt is a debt which arises from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money. (Cal. Admin. Code, tit. 18, reg. 17207(a), subd. (3).)

In the Appeal of Arthur and Kate C. Heimann, decided by this board on February 26, 1963, we made the following observation with respect to advances to family members:

> The benefits of the federal counterpart of this section are applied very sparingly to intra-family transactions, which are subject to especially rigid scrutiny, No deduction for a bad debt based upon such a transaction is allowed unless there is an affirmative showing that there existed at the time of the advance a real expectation of repayment and an intent to enforce collection. (E. T. Ellisberg, 9 T. C. 463; Evans Clark, 18 T. C. 780; Leonard Henly Rernheim, T. C. Memo., Dkt. No. 20117, Nov. 10, 1950.)

Applying the, same close scrutiny to the present case, we must conclude that the advance made by appellants to Mr. Oran in 1967. did not constitute a bona fide loan. While it is true, that the November "1967 letter from Mrs. Warner to her brother did contain some evidence of an agreement, it also appears that no such agreement was ever signed by Mr. Oran and it contained no provision for either interest or security. Even the amount allegedly advanced is uncertain. In addition, Mr. Oran's financial position was precarious at best. Not only was he having difficulty making his child support payments, but his checking account was overdrawn with a number of checks still outstanding against it. Mr. Oran himself stated in the November 1972 letter to Mrs. Warner that appellants knew his financial position was weak at the time of the advance. We must conclude that appellants could have had no reasonable expectation of repayment.

Neither do we believe that appellants intended to enforce collection of the alleged. loan. Appellants argue that they instituted no legal action against Mr. Oran in 1968 because he was absent from Los Angeles throughout 1968, and therefore unavailable for service of process, and because he would have been unable to satisfy a judgment against him anyway. We find these arguments to be unconvincing where there is no evidence other than the self-serving statements of appellants, that any demands for repayment were ever made. Furthermore, the letter from Mrs. Warner to Mr. Oran in November 1972, and his reply, can be given little weight as evidence, for both were written five years after the alleged loan and were obviously in response to respondent's disallowance of the bad debt deduction.

For the reasons stated above we must sustain respondent's action in this matter.

ORDER

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

Appeal of Harry P. and Florence 0. Warner

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Harry P. and Florence 0. Warner against a proposed assessment of additional personal income tax in the amount of $103.00 for the year 1968, be and the same is hereby sustained.

Done at Sacramento, California, this 22nd day of April, 1975, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: _____, Executive Secretary