

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
PARABAM, INC.)

For Appellant: C. J. Malley
Certified Public Accountant

For Respondent: Carl G. Knopke
Counsel

O P I N I O N

This appeal is made pursuant to section 25666 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Parabam, Inc. against a proposed assessment of additional franchise tax and penalty in the total amount of \$3,388.35 for the income year 1977.

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During the course of the income year in issue, appellant, an accrual basis manufacturer of fiberglass products, filled a \$35,855 order from Modern Structures & Systems, Inc. ("MS&S") for fiberglass forms. In 1976, MS&S initiated a campaign in the Middle East designed to sell low cost concrete form housing. Earlier attempts by MS&S to sell their product in this country had met with little success. As a result of its sales efforts in the Middle East, however, MS&S began negotiating a contract for the sale of 2,000 modular structures with Saudi Arabia; these negotiations were to be completed, and the contract entered into, by March 31, 1977.

Appellant made progress billings to MS&S from February through July of 1977. However, when the anticipated Saudi Arabian contract failed to materialize, and appellant did not receive any payment from MS&S, appellant stopped all work for MS&S in July of the appeal year. While the record of this appeal reveals that appellant attempted to collect on the MS&S account subsequent to 1977, it nevertheless wrote off the account as having gone bad in that year and deducted the \$35,855 account receivable as a bad debt on its franchise tax return for the subject income year.

Upon audit, respondent determined that the debt became worthless in 1978 rather than 1977. Accordingly, the proposed assessment was subsequently issued, together with a corresponding credit for appellant's 1978 income year. After consideration of appellant's protest of its action, respondent affirmed the proposed assessment, thereby resulting in this appeal.

The sole issue presented for determination is whether appellant is entitled to a bad debt deduction in the amount of \$35,855 for its 1977 income year. Although the assessment includes a delinquent filing penalty, appellant has not disputed the penalty on appeal.

Revenue and Taxation Code section 24348 allows a deduction for "debts which become worthless within the income year." In order to be entitled to a bad debt deduction, the taxpayer must establish that the debt became totally worthless in the year claimed. (Redman v. Commissioner, 155 F.2d 319 (1st Cir. 1946); Appeal of Valley View Sanitarium and Rest Home, Inca, 1. St. Bd. of Equal., Sept. 27, 1978; Appeal of Grace Bros. Brewing Co., Cal. St. Bd. of Equal., June 28, 1966.) The standard for the determination of worthlessness is an objective test of actual worthlessness. The time for

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actual worthlessness must be fixed by an identifiable event or events which furnish a reasonable basis for abandoning any hope of **future recovery**. (United States v. White Dental Manufacturing Co., 274 U.S. 398 [71 L.Ed. 1120] (1927); Appeal of Morlyn L. Brown, Cal. St. Bd. of Equal., Oct. 27, 1964.) When considering the worth of the debt in question, the fact that MS&S's liabilities exceeded its **assets as of December 31, 1977**, simply does not, of itself, establish that the subject debt was then totally worthless. Mere insolvency, without more, does not establish that fact; it merely indicates that a debt may be only partially recoverable. (Trinco Industries, Inc., 22 T.C. 959 (1954); Robert D. Marshall, ¶ 60,288 P-H Memo. T.C. (1960).)

That MS&S's debt to appellant was probably collectible at least in part during 1977 is evidenced by the former's assets of \$335,894 as of the end of the appeal year. (Appeal of Brattain Contractors, Inc., Cal. St. Bd. of Equal., Oct. 27, 1971.) Consequently, there is no basis for a conclusion that the subject debt became wholly worthless during 1977. While apparently insolvent to the extent that its liabilities exceeded its assets, as of December 31, 1977, MS&S continued to operate as a going business concern subsequent to that date. Appellant has not shown that, as of the end of the appeal year, MS&S's liabilities were so greatly in excess of its assets as to preclude the possibility that at least some portion of the debt would be recovered.

Moreover, while section 24348 also provides, under certain conditions, for deduction of partially worthless bad debts, appellant has neither alleged nor proved the amount of any such partial worthlessness.

For the foregoing reasons, we must sustain respondent's action.

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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 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Parabam, Inc. against a proposed assessment of additional franchise tax and penalty in the total amount of \$3,388.35 for the income year 1977, be and the same is hereby sustained.

Done at Sacramento, California, this 29th day of June , 1981, by the State Board of Equalization, with Board Members Mr. Bennett, Mr. Dronenburg and Mr. Nevins present.

-William M. Bennett _____, Chairman
Ernest J. Dronenburg, Jr. _____, Member
Richard Nevins _____, Member
_____, Member
_____, Member