

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
FRANK AND ENEDINA LEON)

Appearances:

For Appellants: Frank Leon,
in pro. per.

For Respondent: Bruce Langston
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 Board on the protest of Frank and Enedina Leon against a proposed assessment of additional personal income tax in the amount of \$269 for the year 1980.

Appeal of Frank and Enedina Leon

The issue presented is whether appellants were entitled to a claimed bad debt loss for 1980.

Appellants claimed a \$2,500 bad debt deduction on their 1980 personal income tax return. In answer to respondent's request for additional information, appellants explained that the bad debt resulted from an unsecured, noninterest bearing loan made in 1978 to appellant Enedina Leon's niece and her husband. The loan was to be used by the niece and her husband to fix their house for immediate sale and was to be repaid in two months. Appellants were requested to supply substantiation that (1) the debt had value at the beginning of 1980, and (2) that the debt became worthless during 1980. When appellants failed to supply that substantiation, respondent disallowed the deduction and issued the proposed assessment, and later denied appellants' protest. This appeal followed.

Revenue and Taxation Code section 17207 allows a deduction for "any debt which becomes worthless within the taxable year." The taxpayer has the burden of proving that he is entitled to the bad debt deduction. (Appeal of James C. and Monablance A. Walshe, Cal. St. Bd. of Equal., uct. 20, 1975) The taxpayer must first prove that the debt is bona'fide; i.e., that it arose "from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money." (Former Cal. Admin. Code, tit. 18, reg. 17207(a), subd. (3), repealer filed April 16, 1981 (Register 81, No. 16).) The taxpayer must also prove that the debt became worthless during the year in which the deduction is claimed. (Appeal of Fred and Barbara Baumgartner, Cal. St. Bd. of Equal., Oct. 1976) In order to do this, the taxpayer must prove that the debt had some value at the beginning of the year in which the deduction is claimed, and that some event occurred during that year which caused the debt to become worthless. (Appeal of Myron E. and Daisy I. Miller, Cal. St. Bd. of Equal., June 28, 1979; Appeal of Joyce D. Kohlman, Cal. St. Bd. of Equal., June 29, 1982) This board has previously noted that claimed deductions arising from intrafamily transactions must be rigidly scrutinized, and that no deduction 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." (Appeal of Arthur and Kate C. Heimann, Cal. St. Bd. of Equal., Feb. 26, 1963.)

Appeal of Frank and Enedina Leon

At the oral hearing of this appeal, appellant Frank Leon explained that the loan was not evidenced by any written agreement and that they required no lien or other security and charged no interest. Appellant further explained that originally the house was to be sold and the loan repaid within 30 days. But the niece and her husband soon thereafter separated and later divorced, and the niece did not sell the house until 1979, at which time she paid appellants \$500 from the sale. Appellants said that they had not taken any steps to enforce the collection of the outstanding balance for fear that such an attempt would place a strain on family relations. Respondent's position was that appellants had failed to prove (1) that a bona fide debt existed, (2) that the debt became worthless during 1980, and (3) that the debt was **cther** than a nonbusiness debt of appellants (which would limit the deduction to \$1,000 even if appellants could prove the first two requirements above). Since appellant maintained that he could provide documents after the hearing which would support his case, we allowed appellants 30 days to provide whatever they could.

Following the hearing, appellant Frank Leon submitted a credit union statement for 1978 and a check stub. The 1978 credit union statement simply records that on February 21, the credit union refinanced an outstanding \$2,500 personal loan it had made previously to E. Leon. It did not record any new loan. The check stub record simply is a notation that a check numbered 3 (perhaps meaning 23) of 11/15 date was written to "Pat Wood (Michael)" in the amount of \$500.

After examining these documents, we can 'only conclude that they do not demonstrate that appellants were entitled to the claimed bad debt deduction because they do not tend to show that a bona fide debtor-creditor relationship existed or that the debt became worthless during 1980. Indeed, they do not even demonstrate the fact for which they were offered, i.e., that appellants withdrew \$2,500 from a financial institution on February 21, 1978. Accordingly, we have no alternative but to sustain respondent's action.

Appeal of Frank and Enedina Leon

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 Board on the protest of Frank and Enedina Leon against a proposed assessment of additional personal income tax in the amount of \$269 for the year 1980, be and the same is hereby sustained.

Done at Sacramento, California, this 8th day of May, 1984, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Dronenburg, Mr. Collis, Mr. Bennett and Mr. Harvey present.

<u>Richard Nevins</u>	, Chairman
<u>Ernest J. Dronenburg, Jr.</u>	, Member
<u>Conway H. Collis</u>	, Member
<u>William M. Bennett</u>	, Member
<u>Walter Harvey*</u>	, Member

*For Kenneth Cory, per Government Code section 7.9