



Appeal of Linton and Elizabeth Mollath

Three questions are presented by this appeal: (1) whether appellants have shown that they were entitled to a claimed business expense deduction for an amount allegedly paid to their son as salary; (2) whether appellants have shown that they were entitled to a claimed business bad debt deduction; and (3) whether appellants have shown that respondent incorrectly computed the reportable gain on a sale. "Appellant" herein shall refer to **Linton** Mollath.

Appellant is the president of English Properties, Inc., a corporation engaged in leasing properties, and lists his occupation as property manager. For 1979, appellant ~~claimed deductions~~ of **\$43,481.48** for salary paid to his son, Gary Mollath, and **\$12,000.00** for a business bad debt from an **uncollectable** note. He also reported 40 percent of the capital gains from the sale of Keddie Tree Farm. Respondent audited appellant's 1979 return, disallowing the claimed deductions and recomputing the reportable capital gains at 50 percent rather than 40 percent.

Section 17202 allowed a deduction for all ordinary and **necessary** business expense's paid-during the taxable year, including a reasonable allowance for salaries. The regulations under the corresponding federal statute, which apply also to section **17202** (Appeal of Leonard S. and Erlene G. Cohen, et al., Cal. St. Bd. of Equal., Apr. 5, 1983), state that, to be deductible as compensation payments, the payments must be reasonable and paid purely for services. (Treas. Reg. § 1.162-7(a).)

Appellant has presented no evidence to show that he paid any money to his son, that, if paid, it was an expense related to his business as a corporate officer and property manager, or that, if a business expense, it was reasonable in amount and purely compensation for services. The only evidence presented has been Gary **Mollath's** 1979 tax return, filed at the request of respondent in 1984, wherein he reported receiving a salary of 843,481. This is insufficient to support appellant's claimed deduction.

Section 17207 allowed the deduction of business bad debts which became worthless within a taxable year. The taxpayer claiming a bad debt deduction must show that a bona fide debt existed and that it became worthless in the year for which the deduction was claimed. (Appeal of Stanley R. and Helen C. Shutt, Cal. St. Bd. of Equal., Oct. 10, 1984.) We do not believe that appellant has

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proven that either of these two threshold requirements have been met.

A bona fide debt is a debt which arises from a debtor-creditor relationship based on a valid and enforceable obligation to pay a fixed or determinable sum of money. (Appeal of Stanley R. and Helen C. Shutt, supra.) Appellant has presented conflicting evidence as to the nature of the purported debt, referring to it as part of the purchase price of certain property and also as a personal loan to cover surveying costs. In any case, no note has been submitted, and only unidentified records and unsigned proposals have been provided regarding purported repayment schedules. Appellant submitted a canceled check paid to the purported debtor, but this was drawn on the account of appellant's corporation, rather than his personal account. We find such inconsistent and unreliable statements and records insufficient to prove the existence of a bona fide debt owing to appellant.

To establish the worthlessness of a debt, a taxpayer must prove that the debt had some value at the beginning of the year for which the deduction was claimed and that some event occurred during that year which caused the debt to **become worthless**. (Appeal of Joyce D. Kohlman, Cal. St. Bd. of Equal., June 29, 1982.) Even if we were to assume that a bona fide debt existed, we do not believe that appellant has shown that the purported debt became worthless in **1979**. No evidence at all has been submitted to show that the debt had value at the beginning of the year. Appellant's **unsupported assertion** that the debtor was bankrupt in 1979 is not sufficient proof of the worthlessness of the purported debt. (Lunsford v. Commissioner, 212 **F.2d** 878, 883 (5th Cir. **1954**.) Similarly, appellant's allegation that the statute of limitations on collection of the debt expired in 1979 is insufficient since a debt is not worthless merely because its recovery by suit is barred. (Watson v. Fahs, 120 **F.Supp.** 424, 427 (S.D. Fla. **1954**.) **Having concluded** that appellant was not entitled to a bad debt deduction, we need not consider the **question of** whether the debt was related to appellant's trade or business.

Section 18162.5 provides that 50 percent of the gain on the sale of capital assets held more than five years is reportable. Appellant has not contested this recomputation beyond stating that he would not accept the adjustments relating to Keddie Tree Farm. Respondent properly applied section 18162.5 and its recomputation must be upheld.

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For the reasons stated above, the action of the Franchise Tax Board must be sustained in all respects.

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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 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of **Linton** and Elizabeth Mollath against a proposed assessment of additional personal income tax in the amount of **\$6,388.98** for the year 1979, be and the same is hereby sustained.

Done at Sacramento, California, this 4th day Of February , 1986, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Collis, Mr. Bennett, Mr. Dronenburg and Mr. Harvey present.

Richard Nevins , Chairman  
Conway H. Collis , Member  
William M. Bennett , Member  
Ernest J. Dronenburg, Jr. , Member  
Walter Harvey\* , Member

\*For Kenneth Corper Government Code section 7.9