86-SBE-064

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) No. 84A-101-MA
ABNER AND LILLIE M. WHEELER)

Appearances:

For Appellants: Abner Wheeler, in pro. per.

For Respondent: Grace Lawson Counsel

O P I N I O N

This appeal is made pursuant to section 18593[1/] of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Abner and Lillie M. Wheeler against a proposed assessment of additional personal income tax in the amount of $5,074 for the year 1981.

1/ Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the year in issue.

Appeai of Abner and Liiie M.Wheeler

The issues to be decided in this appeal are: (1) whether appellants have shown that they are entitled to a claimed bad debt deduction in the year at issue, and (2) whether appellants are entitled to deduct gambling losses from other income.

During the year at issue appellant-husband, Mr. Wheeler, was retired. Mrs. Wheeler was employed as a teacher's aide.

On their 1981 California Individual Income Tax Return, appellants listed total income of $138,449. This total consisted of $9,439 in wages, interest income of $3,010, and $127,000, which appellants received as a prize awarded by the Reader's Digest Sweepstakes. Appellants claimed a $1,000 capital loss deduction as a result of a loan of $5,000 to Freddie L. Reed and Bobbye Darwin. Appellants also claimed an itemized deduction of $40,000 for gambling losses incurred as a result of betting at, Hollywood Park race track.

Respondent denied both the bad debt capital loss and gambling loss deductions. Appellants protested this action and, after due consideration, respondent affirmed its proposed assessments. This timely appeal followed.

The loan to Reed and Darwin was made in March 1981. At that time, appellants received from Reed and Darwin a promissory note for the principal amount with interest at 8 percent to be repaid in April 1981. The purpose of this loan was to allow the borrowers to replace inventory in their liquor store.

On December 9, 1981, Bobbye Darwin filed a petition in bankruptcy which was granted by court order filed April 2, 1982. On June 15, 1982, Freddie L. Reed filed a petition in bankruptcy which was granted by court order filed October 13, 1982. On November 24, 1981, a judgment in the amount of $5,000 plus attorney's fees and costs was entered in favor of appellants against Freddie L. Reed in the Los Angeles County Municipal Court.

Section 17207, subdivision (a)(1) provides, in pertinent part: "There shall be allowed as a deduction any debt which becomes worthless within the taxable year; ..." This section is the counterpart of section 166 of the Internal Revenue Code of 1954. Two tests must be satisfied in order for the taxpayer to take a bad debt deduction. First, a bona fide debt must exist. Second,

the debt must have become worthless in the taxable year for which the deduction is claimed. (Appeal of Fred and Barbara Baumgartner, Cal. St. Bd. of Equal., Oct. 6, 1976; Redman v. Commissioner, 155 F.2d 319 (1st Cir. 1946); Appeal of Grace Bros. Brewing Co., Cal. St. Bd. of Equal., June 28, 1966; Appeal of Isadore Teacher, Cal. St, Bd. of Equal., Apr. 4, 1961,) The taxpayer has the burden of proving that both of these tests have been satisfied. (Appeal of Andrew J. and Frances Rands, Cal. St. Bd. of Equal., Nov. 6, 1967.)

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. While it is clear that in the instant case a valid debt existed, there is a question as to whether the note became worthless as a result of an identifiable event.

'As we noted in Baumgartner, whether a debt has become worthless in a given year is to be determined by objective standards. (Redman v. Commissioner, supra; Appeal of Cree L. and June A. Wilder, Cal. St. Bd. of Equal., Sept. 15, 1958.) No deduction may be allowed for a particular year if the debt became worthless before or after that year. (Redman v. Commissioner, supra.) To satisfy their burden, therefore, appellants must show that the alleged debts had value at the beginning of the taxable year (Dallmeyer v. Commissioner, 14 T.C. 1282, 1291 (1950)), and that someidentifiable event occurred during 1981 which formed a reasonable basis for abandoning any hope that the debts would be paid sometime in the future. (Green v. Commissioner, ¶ 76,127 T.C.M. (P-H) (1976); Appeal of Samuel and Ruth Reisman, Cal. St. Bd. of Equal., Mar. 22, 1971; Appeal of George H. and G. G. Williamson, Cal. St. Bd. of Equal., Apr. 24, 1967.)

In the present case, appellants have failed to provide objective evidence that the note became worthless upon the occurrence of some identifiable event in 1981, the year in which the debt is claimed to be worthless. Bobbye Darwin, one of the debtors, filed a petition in bankruptcy in December 1981 but was not adjudicated bankrupt until April 1982. The filing of a petition in bankruptcy, without more, is not necessarily indicative of an inability to recover the money owed. (Edgar . Commissioner, ¶ 79,524 T.C.M. (P-H) (1979).) As to the other debtor, Freddie L. Reed, his petition in bankruptcy was not filed or granted until 1982; therefore, we have no indication that he was not solvent in 1981. Finally,

the record discloses that in a letter dated May 12, 1981, appellants notified the escrow company which handled the Reed's liquor business sale that they claimed $5,800 of the proceeds of the sale. (Resp. Supp. Br., Ex. C.) As respondent points out, this letter evidences appellants' belief that funds were reachable to satisfy the debt owed to them. Appellants presented no evidence as to the ultimate disposition of the escrow funds. Accordingly, we conclude that appellants have failed to meet their burden of proving that the debt in question became worthless in the year claimed and the deduction was properly disallowed.

Appellants argue that the prize money received from the Reader's Digest Sweepstakes should be considered wagering gains and that they should be able to offset against this amount the $40,000 in losses they incurred betting at the Hollywood Park race track. We disagree. The Reader's Digest sweepstakes money was clearly a prize and not a wagering gain since there is no transfer of money or other consideration involved in entering the Reader's Digest sweepstakes and appellants were not required to hazard anything of value in order to win the prize. (Cal. Gas. Retailers v. Regal Petroleum Corp., 50 Cal.2d 844 [330 P.2d 778] (1958).) As such, it cannot be considered a wagering transaction. Additionally, appellants have submitted no proof that they, in fact, incurred any gambling losses.

For the reasons stated above, we conclude that respondent's action in this matter must be sustained.

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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 Abner and Lillie M. Wheeler against a proposed assessment of additional personal income tax in the amount of $5,074 for the year 1981, be and the same is hereby sustained..

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

Richard Nevins , Chairman

Conway H. Collis , Member

Ernest J. Dronenburg, Jr. , Member

Waler Harvey* , Member

, Member

*For Kenneth Cory, per Government Code section 7.9