BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) No. 81A-1328-AJ
SEYMOUR AND ARLENE GRUBMAN)

For Appellants: Thomas E. O'Sullivan
Attorney at Law

For Respondent: Terry Collins
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 Seymour and Arlene Grubman against a proposed assessment of additional personal income tax in the amount of $82,750.10 for the year 1976.

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

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The issues presented by this appeal are whether appellants are entitled to a bad debt deduction and a worthless stock deduction.

On their 1976 personal income tax return, appellants claimed a bad debt deduction and a worthless securities loss deduction. The Franchise Tax Board determined that appellants had not adequately substantiated either deduction and issued a proposed assessment disallowing both deductions. After considering appellants' protest, respondent affirmed the proposed assessment, and this appeal followed.

The bad debt deduction involved an $800,000 loan appellants made to NHA, Inc. (NHA), a corporation in which appellants owned stock, and Verpet Development Corporation (Verpet), a subsidiary of NHA. The loan was made in 1972 *and* was evidenced by a canceled check. After repaying approximately $80,000, NHA and Verpet *stopped* making payments. In October 1974, appellants accepted a note from the two corporations for the remaining balance, $713,333, which called for payment of principal and accrued interest by September 30, 1976. On April 12, 1976, NHA was declared bankrupt. When the note became due, appellants requested payment from Verpet and were told that Verpet was not financially able to pay and that, in the opinion of Verpet's president, it was doubtful whether Verpet would ever be able to pay any or all of the note. On the basis of the above, appellants determined that the debt became worthless in 1976. Respondent contends that appellants have not established that the debt became worthless in 1976. For the reasons expressed below, we agree with respondent.

Section 17207 allowed a deduction for debts which became worthless within the taxable 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. The standard for the determination of worthlessness is an objective test of actual worthlessness. The time for actual worthlessness must be fixed by an identifiable event or events which furnish a reasonable basis for abandoning any hope of future recovery. Mere insolvency, without more, does not establish that the debt was totally worthless; it merely indicates that a debt may be only partially recoverable. (See Appeal of Parabam, Inc., Cal. St. Bd. of Equal., June 29, 1982, and cases cited therein.)

Appellants base their claim that the debt owed them by Verpet was worthless solely on the fact that Verpet was insolvent. As stated above, insolvency alone does not establish worthlessness. It appears that Verpet's debt to appellants might have been collectable at least in part during 1976, since Verpet had assets of at least 4 1/2 million dollars as of the end of that year. Furthermore, although Verpet may have been insolvent in that its liabilities exceeded its assets, it remained in business after 1976. We conclude that appellants have not established that Verpet's financial condition precluded the possibility that appellants would recover at least part of the debt owed them. Therefore, appellants have not established their entitlement to the claimed bad debt deduction.

Appellants claim that their worthless stock loss resulted from an investment in NHA, which was declared bankrupt on April 2, 1976. Respondent contends that this deduction was properly denied, since appellants did not establish that they had made an investment in NHA. We agree with respondent.

Section 17206 allowed a deduction for any loss exceeding $100 sustained during the taxable year and not compensated for by insurance or otherwise. Securities which become worthless during the taxable year were treated as losses pursuant to section 17206, subdivision (g). As with all deductions, the burden is upon the taxpayer to prove that he is entitled to the claimed deduction. (New Colonial Ice Co. v. Helvering, 292 U.S. 435 [78 L.Ed. 13481 (1934).)

As substantiation of their investment in NHA, appellants submitted a check for $500,000 made out to Land Consultants of California, Inc. (Land Consultants}. Appellants contend that Land Consultants was the predecessor of NHA and either bought out or merged with NHA. Despite respondent's request for evidence that Land Consultants was NHA's predecessor, appellants have not produced any documentation of this fact. In addition, a search of records at the office of the California Secretary of State revealed no connection between Land Consultants and NRA; rather it showed that Land Consultants merged with Verpet on May 31, 1972. Since appellants have not shown that they invested in NHA, the deduction for worthless stock loss was properly denied.

Although not raised as an issue originally, appellants now contend that part of their loss resulted

from the sale of NHA stock in 1976. In support of this, appellants submitted evidence that they sold 30,000 shares of NHA stock in 1976. This does not suffice to establish their entitlement to any deduction, since they still have not shown how they obtained the stock.

For the reasons expressed above, respondent's action must be sustained.

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0 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 Seymour and Arlene Grubman against a proposed assessment of additional personal income tax in the amount of $82,750.10 for the year 1976, be and the same is hereby sustained.

Done at Sacramento, California, this 20th day Of August , 1936, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Collis, Mr. Bennett and Mr. Harvey present.

Richard Nevins, Chairman

Conway H. Collis, Member

William M. Bennett, Member

Walter Harvey*, Member

, Member

*For Kenneth Cory, per Government Code section 7.9