



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
GORDON AND JUNE **K.** FRASER) No. **81A-1132-MW**

For Appellants: Ruben **Kitay**
Certified Public Accountant

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 Gordon and June **K.** Fraser against a proposed assessment of additional personal income tax plus penalty in the total amount of **\$12,684.83** for the year 1978.

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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Two questions are presented by this appeal: (1) whether appellants have proven that they were entitled to a loss deduction for worthless stock, and (2) whether appellants have proven that they were entitled to a bad debt deduction. "Appellant" herein shall refer to appellant Gordon Fraser.

Over a period of years, while an executive of a record company, appellant obtained 18 master recordings. In 1975, appellant exchanged these master recordings for 10 shares of Record Artists of America, Inc. (Artists). In 1978, Artists was apparently discharged in bankruptcy. Appellants determined that their shares in Artists were worthless and claimed a \$25,000 capital loss deduction on their 1978 return. The Franchise Tax Board (FTB) determined that appellants had not substantiated their basis in the master recordings and, thus, in the stock. Therefore, it assigned a zero basis to the stock and disallowed the deduction.

Appellants also claimed a bad debt deduction of **\$5,600** on their 1978 return. Appellants contend that they loaned \$5,000 in 1974 and \$600 in 1976 to an **individual, Mr. Huson**, and have submitted canceled checks issued to Mr. Huson in those amounts. The FTB disallowed this deduction because appellants did not prove that a **bona fide debt existed** or that the alleged debt became worthless in **the** year the deduction was claimed.

In addition to the proposed assessment resulting from the disallowance of the worthless stock and bad debt deductions, the FTB also imposed a 25 percent penalty for failure to furnish information. After this appeal was filed, the FTB determined that the **\$2,536.96** penalty should be abated.

Section 17206 allowed a deduction where stock became worthless during the taxable year and the loss was not compensated for by insurance or otherwise. **(See I.R.C. § 165 for corresponding federal provision.)** The amount of the loss is determined using the adjusted basis of the property. (Rev. & Tax. Code, § 17206, subd. **(b).**) **The FTB's** determination of basis is presumptively correct and the appellant bears the burden of showing that such determination is erroneous. (Appeal of James B. and Martha W. Mears, Cal. St. Bd. of **Equal., Dec. 5, 1978.**) Where taxpayers do not prove their basis in stock, the **FTB** may properly determine that the basis was zero. (Appeal of Charlotte Lewis, Cal. St. Bd. of Equal., Sept. 12, 1984.)

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In this appeal, appellants have presented no evidence establishing the basis of the master recordings which were exchanged for the stock. They argue that they must have paid something for them and that "a reasonable **valuation**" should be assigned to them. (App. Bf. at 1.) However, we are given no basis for determining a value and "[e]stimates and crude approximations of losses are not sufficient." (Golden State Towel and Linen Service, Ltd. v. United States, 373 F.2d 938, 942 (Ct.Cl. 1967).) Proof of basis is presumably within the taxpayers' control and it is their failure to provide such proof which compels us to sustain the **FTB's** determination of a zero basis. Having decided the question of basis adversely to appellants, we need not consider whether the stock became worthless in 1978.

Section 17207 allowed a deduction for debts which **became** worthless in the taxable year. (See I.R.C. § 166 for the corresponding federal provision.) The taxpayers bear the burden of proving that they are entitled to a bad debt deduction. They must show both 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**, and that the debt became worthless during the year for which the deduction is claimed. (Appeal of Frank and Enedina Leon, Cal. St. Bd. of Equal., May 8, 1984.)

Appellants have only presented copies of canceled checks made out to the alleged debtor which contain notations that they are loans. By themselves, these canceled checks do not show that a bona fide debtor-creditor relationship existed and there is no evidence at all to show that the alleged debt became worthless in 1978. Lacking such evidence, we must sustain the **FTB's** determination that appellants were not entitled to a bad debt deduction.

