



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
BAY VIEW FEDERAL SAVINGS AND LOAN ASSOCIATION)

Appearances:

For Appellant: Leo S. Rosen, Certified Public Accountant

For Respondent: W. M. Walsh, Assistant Franchise Tax Commissioner; J. J. Arditto, Franchise Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes of 1929, as amended) from the action of the Franchise Tax Commissioner in denying the claim of Bay View Federal Savings and Loan Association for refunds of tax in the amounts of \$78.66, \$280.38, \$423.67 and \$499.16 for the taxable years 1936, 1937, 1938 and 1939, respectively.

Appellant's claim for refund is based on the contention that for each of the income years 1935-1938, inclusive, it was entitled to a deduction from its gross income of an addition to a reserve for bad debts pursuant to Section 8(e) of the Bank and Corporation Franchise Tax Act. The Commissioner originally argued in support of his disallowance of the deduction that the reserve account was not limited to bad debts, but might be used to "absorb" losses of any kind and that, in any event, the deduction claimed by Appellant for each year as an addition to the reserve was excessive. He subsequently changed his position somewhat, however, and contended that the Appellant was not entitled to the deduction for the income years 1935, 1936 and 1937 inasmuch as it had deducted its actual bad debts for those years. He conceded, however, that the Appellant was entitled to a refund of \$232.36 for the income year 1938.

In its returns of income for the years 1935, 1936 and 1937, the Appellant claimed and was allowed a deduction from its gross income of the difference between the "book cost" and the selling price of certain real property acquired by it through foreclosure. The "book cost" represented the unpaid balance of the Appellant's loan secured by the real property. Appellant states that the "book cost" of each item of property closely approximated the bid in Price of that property and also represented the approximate fair market value of the property at the date of foreclosure. Appellant did not submit any evidence, however, as to the bid in price of the property or its market value as of that date.

The difference between the unpaid balance of each loan and

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the fair market value at the date of foreclosure of the property securing the loan is, in our opinion, properly to be regarded as a bad debt and deductible as such. Commissioner of Internal Revenue v. Spreckels, 120 F. 2d 517; Rogan v. Commercial Discount Co., 149 F. 2d 585; see also Bondholder's Committee v. Commissioner of Internal Revenue, 315 U. S. 189. It must follow then, we believe, that the difference between Appellant's "book cost" and selling price must be regarded as a bad debt rather than a loss. It is quite true that Appellant would be entitled to deduct as a capital loss the difference between the fair market value of the property at the date of foreclosure and the subsequent selling price of the property. It has not submitted any evidence, however, of that fair market value. In view of the short period of time that elapsed between the date of foreclosure and the date of sale, less than one month to about five months, if any assumption were to be made it appears to us far more logical to assume that the decline in value occurred prior to the date of foreclosure rather than between that date and the time of sale.

The Appellant having been allowed a deduction of its actual bad debts for the year in question, it follows of course that it is not entitled to a further deduction of an amount as an addition to a reserve for bad debts. Section 8(e), Bank and Corporation Franchise Tax Act; Rhode Island Hospital Trust Co. v. Commissioner of Internal Revenue, 29 F. 2d 339; Atlantic Bank and Trust Co. v. Commissioner of Internal Revenue, 59 F. 2d 363; Manistique Lumber and Supply Co., 29 B.T.A. 26. Furthermore it should be observed that the Appellant has offered no evidence as to the reasonableness of the amount which it claims to be deductible from its gross income as an addition to a reserve for bad debts. The action of the Commissioner in denying Appellant's claim for refund, except to the extent of the conceded refund of \$232.36 for the taxable year 1939, must therefore, be sustained.

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 that the action of Chas. J. McColgan, Franchise Tax Commissioner, in denying the claim of Bay View Federal Savings and Loan Association for a refund of tax in the amounts of \$78.66, \$280.38, \$423.67 and \$499.16 for the taxable years 1936, 1937, 1938 and 1939, respectively, pursuant to Chapter 13, Statutes of 1929, as amended, be and the same is hereby modified. The Commissioner is hereby directed to allow a credit to said Association against any taxes due from it in the amount of \$232.36, said amount of \$232.36 being an overpayment of tax for the taxable year 1939; and to refund the balance of said amount to it and otherwise to proceed in conformity with this order; in all other respects the said action of the Commissioner is hereby sustained.

Done at Sacramento, California, this 28th day of March, 1946,

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by the State Board of Equalization.

R. E. Collins Chairman
Wm. G. Bonelli, Member
J. H. Quinn, Member
Geo. R. Reilly, Member

ATTEST: Dixwell L. Pierce, Secretary