



BEFORE THE STATE BOARD, OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
ANDREW J. AND FRANCES RANDS)

Appearances:

For Appellants: Andrew J. Rands, in pro. per.
For Respondent: Gary Paul Kane
Tax Counsel

O P I N I O N

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Andrew J. and Frances Rands against a proposed assessment of additional personal income tax in the amount of \$257.96 for the year 1961.

The question raised by this appeal is whether appellants were entitled to a bad debt deduction in 1961,

In 1961 Andrew J. Rands (hereafter referred to as "appellant") was one of two equal stockholders of Rigid Metal Products Company (hereafter "Rigid Metal"). He had supplied most of the initial capital to Rigid Metal, while the other stockholder furnished the technical knowledge necessary to operate the business.

During 1961 Rigid Metal suffered financial difficulties and at one point it did not have sufficient cash on hand to pay its payroll expenses and federal tax liabilities. In addition, metal suppliers had refused to supply any additional materials unless they received payment. In that critical situation appellant was persuaded to give Rigid Metal his personal check for \$12,000. The transaction was referred to in the company records as a loan, although no note or other evidence of indebtedness was ever executed. Almost simultaneously with the receipt of appellant's check for \$12,030, Rigid Metal repaid \$10,039.16 to him,,

At the close of 1961 Rigid Metal's books showed that its assets exceeded its liabilities although there were some accounts receivable which were due but which had not been paid. In 1962 appellant entered into an agreement with the other stockholder, whereby appellant cancelled all his claims against Rigid Metal, including his investment in the corporation, for \$20,000. Rigid Metal was eventually sold to International Aluminum Corporation in 1963.

In his California personal income tax return for 1961 appellant reported \$25,400 as income received from Rigid Metal. That amount did not include the \$10,039.16 which Rigid Metal repaid to appellant shortly after receiving his personal check for \$12,000. According to an officer of International Aluminum Corporation, which now has the books and records of Rigid Metal, the \$25,400 was composed of appellant's salary of \$200 per week for 52 weeks (\$10,400) plus a \$15,000 bonus paid to him on March 15, 1961.

In his 1961 return appellant claimed a bad debt deduction in the amount of \$10,039.16. Respondent disallowed that deduction on the ground that if a bad debt had been created by the transaction between appellant and Rigid Metal, it had not become worthless during 1961,

Section 17207 of the Revenue and Taxation Code provides for the deduction of debts which become worthless in the taxable year. Only a bona fide debt qualifies for purposes of that section. (Cal. Admin. Code, tit. 18, reg. 17207(a), subd. (3).) Whether advances to a closely held corporation by a stockholder are loans or contributions to capital is a question of fact. The taxpayer has the burden of proving that a bona fide debt existed and that it became worthless in the taxable year in which he claims the deduction, (Matthiessen v. Commissioner, 194 F.2d 659; Redman v. Commissioner, 155 F.2d 319.)

In the instant case! appellant gave Rigid Metal his check for \$12,000 in 1961. He contends that this transaction constituted a loan to the company, although no formal indicia of debt were executed. There is no evidence of any due date for repayment having been established, nor was any provision made for the payment of interest. Appellant had furnished the capital needed to get the business started, and the financial assistance given by appellant in 1961 was necessary if the company was to continue operating. In view of Rigid Metal's poor financial condition in 1961, it seems unlikely that appellant really anticipated repayment of the entire \$12,000. Full repayment would have depended upon the success of the business, and an advance made under those circumstances

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is generally considered to be a contribution to capital rather than a loan. (Gilbert v. Commissioner, 248 F.2d 399; Appeal of George E. Newton, Cal., St. Bd. of Equal., May 12, 1964.)

In our opinion appellant has failed to establish that a bona fide debt was created by this 1961 transaction. Instead, the facts and circumstances lead us to conclude that appellant made a contribution to capital.

Even if we had determined, however, that a valid debt existed between appellant and Rigid Metal as a result of the \$12,000 advance by appellant in 1961, the debt would not have been as large as the deduction claimed by appellant in his return, Rigid Metal repaid \$10,039.16 to appellant at the time appellant gave Rigid Metal his check. Thus, the maximum amount of any debt which could have existed at the end of 1961 was \$1,960.84, the difference between the \$12,000 advance by appellant and the \$10,039.16 repayment by Rigid Metal.

Finally, even if we assumed that a bona fide debt existed in the amount of \$1,960.84, appellant has failed to prove that such a debt became worthless during 1961. Although Rigid Metal had some financial problems in 1961, its books indicate that its assets exceeded its liabilities as of December 31, 1961. Rigid Metal continued to operate as a corporation until it was sold in 1963. These facts contradict, rather than support, a finding of worthlessness in 1961.

For the above reasons we must sustain respondent's action in this matter.

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,

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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 Andrew J. and Frances Rands against a proposed assessment of additional personal income tax in the amount of \$257.96 for the year 1961, be and the same is hereby sustained.

Done at Sacramento, California, this 6th day of November, 1967, by the State Board of Equalization,

Paul R. Leake, Chairman
Robert H. Coe, Member
John W. Lusk, Member
Richard G. ..., Member
_____, Member

ATTEST: [Signature], Secretary