

Appeal of Roderick E. and Mary M. Ristow

Appellants filed a joint California personal income tax return for 1967, On this return they deducted as a bad debt the amount of \$5,687.10 allegedly owed by one W. H. Seiler. They claimed a second bad debt deduction in the amount of \$2,162.48 allegedly owed by Kilpatrick & Co. Respondent disallowed both deductions and issued a proposed assessment of additional tax in the amount of \$620.30. (Part of the assessment was attributable to respondent's disallowance of interest, travel and entertainment expenses which had been claimed by the appellants.) Appellants protested that portion of the proposed assessment relating to the disallowed bad debt deduction. Respondent's denial of the protest gave rise to this appeal.

. THE W. H. SEILER BAD DEBT DEDUCTION.:

In 1960 Roderick Ristow (hereafter referred to as appellant) entered into an oral partnership agreement with one W. H. Seiler. The terms of the agreement required Seiler to devote full time to the work of the partnership while appellant furnished necessary capital. The partnership could be dissolved at any time Seiler judged that the object thereof could not be successfully attained. Any profits realized were to go first to repay-appellant for his contributions, then to be divided equally. In the event the partnership was dissolved, Seiler agreed to personally repay in full the contributions made by appellant.

In 1963, after appellant had made contributions totaling \$5,687.10, Seiler decided that the partnership could not succeed. Following its dissolution Seiler allegedly gave appellant a written promise to repay "the funds advanced to the company." Appellant has submitted no evidence that the alleged note was secured, that interest was to be paid, or that repayment was due on a date certain.

From 1963 to 1967, Seiler repeatedly told appellant that he was financially unable to pay him.

Appeal of Roderick E. and Mary M. Ristow

On two occasions appellant asked an attorney to try to collect what Seiler owed him. In late 1967, the attorney advised appellant that he could discover no assets belonging to Seiler and that the statutory period for collection of the debt would expire on November 30, 1967. No legal action against Seiler was ever taken.

Section 17207, subdivision (a)(1), of the California Revenue and Taxation Code provides that "there shall be allowed as a deduction any debt which becomes worthless within the taxable year;..." Assuming that a bona fide debt was created between Seiler and appellant, we believe appellant has failed to establish that such debt became worthless in 1967.

The actual financial condition of the debtor is the primary test of worthlessness. (See W. A. Dallmeyer, 14 T.C. 1282.) The taxpayer-creditor must establish, by objective standards, that a substantial change in the debtor's financial condition occurred in the year of deduction. (H. W. Findley, 25 T.C. 311, aff'd per curiam, 236 F.2d 959.) An attorney's appraisal of the collectibility of a debt does not establish worthlessness unless supported by objective facts, (Matthew Edwards, Sr., T.C. Memo. , July 21, 1959.)

There is no evidence to show what Seiler's financial position was when the partnership was dissolved in 1963. Since Seiler made no payments but instead gave appellant a written promise to pay, it could be inferred that he had no resources from which the debt could be satisfied. Appellant admits that from 1963 to 1967 he frequently saw Seiler, and that Seiler repeatedly told him he had no money.. Appellant's attorney, from 1965 to 1967, was unable to locate any assets of Seiler which could have been used to satisfy a judgment.

In view of the above we must conclude that the assumed debt was not less valuable in 1967 than at any prior time, and in fact was probably valueless at inception. Accordingly, respondent did not err in denying the protest to the proposed assessment of additional tax related to the Seiler debt.

Appeal of Roderick E. and Mary M. Ristow

THE KILPATRICK & CO. BAD DEBT DEDUCTION:

From 1961 to 1965 appellant was one of two equal partners in the Risto-Brugger Company, a contracting business. In 1964 Risto-Brugger and Kilpatrick & Co. undertook a joint venture to enlarge the freezing plant facilities of a poultry processing firm in Texas. In 1965 appellant bought Brugger's interest in Risto-Brugger and continued the business under the name of Risto-Los Angeles.

The joint venture agreement between Risto-Brugger and Kilpatrick & Co. provided that profits up to 20 percent of contract costs would be shared equally, and all profit over 20 percent of cost would go to Risto-Brugger. Losses were to be shared equally. Risto-Brugger was to act as liaison between Kilpatrick and the Texas company, and to furnish all information needed by Kilpatrick to process the contract. Risto-Brugger was also to furnish certain equipment to Kilpatrick.

When the joint venture was initiated, Kilpatrick advanced to Risto-Brugger the sum of \$11,500.00 against anticipated profits. In due course Kilpatrick issued purchase orders to Risto-Brugger for equipment which was delivered and invoiced for a total of \$21,495.38. The amount of those invoices was paid except for \$2,162.48. Kilpatrick carried that balance on its books as an account payable and Risto-Brugger recorded it as a receivable.

In April 1965, Kilpatrick determined that certain differences between it and the Texas company could not be resolved. As manager of the joint venture Kilpatrick therefore closed its books on the joint venture contract on April 30, 1965. On that date Kilpatrick wrote off a total loss on the venture of \$97,133.05. Rather than ask Risto-Brugger to share that loss or to return any of the advance against profit, Kilpatrick closed out the \$2,162.48 balance carried on its books as an account payable to Risto-Brugger. When

Appeal of Roderick E. and Mary M. Ristow

appellant demanded payment of that amount, Kilpatrick refused. In a letter dated January 23, 1967, Kilpatrick stated that it had already paid more than the total amount of the invoices for equipment purchased from Risto-Brugger. Appellant and his wife claimed a bad debt deduction of \$2,162.48 in their 1967 joint return on the ground that the receivable became worthless in 1967 when Kilpatrick refused to pay it.

The same statutes and authorities which determined the deductibility of the Seiler bad debt are controlling here. Appellant admits that Kilpatrick was at all times solvent and able to pay. Under such circumstances, mere refusal by the debtor to pay will not make a debt worthless under any objective standard. (Earl V. Perry, 22 T.C. 968, 974.) It is possible as indicated by appellant's attorney that legal action to enforce payment would have been fruitless in view of the potential offsets available to Kilpatrick. This does not change the fact, that appellant could have sought a judgment for the \$2,162.48 had he been willing to accept any resulting consequences.

We conclude that the Kilpatrick debt never became worthless and that respondent therefore did not err in denying its deduction as a bad debt in 1967.

ORDER _ _

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

Appeal of Roderick E. and Mary M. Ristow

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 Roderick E. and Mary M. Ristow against a proposed assessment of additional personal income tax in the amount of \$620.30 for the year 1967, be and the same is hereby sustained.

Done at Sacramento, California, this 31st day of July, 1973, by the State Board of Equalization.

William B. ..., Chairman
..., Member
John W. ..., Member
..., Member
..., Member

ATTEST: *W. W. ...*, Secretary