47-SBE-006

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
CHARLES S. HOWARD)

Appearances:

For Appellant: Orville S. Vaughn, Attorney at Law

For Respondent: James J. Arditto, Franchise Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 18593 of the Revenue and Taxation Code (formerly Section 19 of the Personal Income Tax Act) frdm the action of the Franchise Tax Commissioner in overruling the protest of Charles S. Howard to a proposed assessment of additional tax in the amount of $10,918.27 for the taxable year ended December 31, 1937.

There is presented for our consideration herein the question of the correctness of the action of the Franchise Tax Commissioner in disallowing the following items claimed by Appellant as deductions on his 1937 personal income tax return:

A. Bad Debts

1.	Olinghouse Mining Company	$16,571.15
2.	Gerhardt A. Steffen	3,080.87
3.	The Tamalpais School	7,000.00
4.	A, S. Jacobs	500.00
5.	I. H. McCreery	100.00

B. Worthless Stock

1.	'631 shares Compania Mexicana del Aqua Caliente, S. A.	$24,025.00
2.	20 shares National Press Building Company, preferred	1,000.00
3.	40 shares California National Livestock Show	2,000.00

Section 8(f) of the Personal Income Tax Act, as in effect in 1937, allowed deductions for debts "ascertained to be worthles and charged off within the taxable year." The burden is, of course, upon the Appellant to establish that he ascertained the debt to be worthless and charged it off in 1937. Continental Pipe Mfg. Co. v. Poe, 59 Fed. 2d 694; Person Construction Co. v. Commissioner, 116 Fed. 2d 94.

Section 8(d) of the Personal Income Tax Act, as it read in

1937, authorized a deduction for "Losses sustained during the taxable year and not compensated for by insurance or otherwise . . . . " Under this Section a deduction for worthless stock may be taken only in the year in which the worthlessness occurs, Gowen v. Commissioner, 65 Fed. 2d 923. Again the burden is upon the Appellant to establish that the stock became worthless in the taxable vear 19'37 and not in a prior or subsequent year. Mahler v. Commissioner, 119 Fed. 2d 869.

The Commissioner contends, as respects the asserted bad debts, that the obligations were not ascertained to be worthless, and in fact did not become worthless, during the taxable year. In the case of the stocks, he argues that they, too, did not become worthless during that year, We are, accordingly, called upon to consider whether the Appellant has sustained the burden of proof in justifying the deductions as against the determination of the Commissioner that they are not allowable for 1937.

The bad debt deductions:

1. Olinghouse Mining Company.

The debt arose from advances made in 1934 and 1935 to the Company, a corporation in which Appellant owned two-thirds of the stock. The advances were made to enable the Company to extend its mine shafts but, although this work was accomplished in 1935, no paying ore was found. In 1936, the property was leased and development was continued by the lessee until 1937 when the lease was abandoned. Appellant contends that he then ascertained the debt to be worthless and charged it off. The Commissioner, however, found that at the end of 1937 the corporation retained assets including a mill, certain mining claims not fully developed and a bank account, that the corporation showed a profit from its 1937 operations and in fact for some years thereafter continued to receive income from other leased properties, and that the corporation remained in business and continued work on other claims. Appellant has disputed the value of these assets and stated that the Company's balance sheet showed a surplus deficit of $12,061.66 at December 31, 1937. No evidence was introduced to support these contentions, and Appellant has not shown any change in these facts from prior years. Appellant's only basis for the deduction is the abandonment of the lease in 1937. Furthermore, Appellant has not presented any evidence to overcome the presumption of correctness attaching to the Commissioner's determination that if the debt was worthless in 1937, then it was also worthless in 1935 when the Company, with Appellant's knowledge, abandoned its development work as unproductive. It must be concluded, therefore, that Appellant has not established that the debt was reasonably ascertained to be worthless in 1937, and the deduction claimed must, accordingly, be disallowed, Kahn v. Commissioner, 108 Fed. 2d 748; Avery v. Commissioner, 22 Fed. 2d 6.

2. Gerhardt A. Steffen.

How this debt arose has not been explained, As security Appellant held insurance policies having a face value of $27,000

on the life of the debtor. The cash surrender value of the policies in 1937 is not disclosed but Appellant has continued payment of the premiums amounting to $760.00 a year. The Commissioner contends that a deduction of this indebtedness is improper inasmuch as the taxpayer made no effort to realize the cash surrender value of these policies, and Appellant has, failed to show that collection could not be made through resort to this cash surrender value. A creditor may write off a debt secured by insurance on the life of the debtor upon a showing that there was no cash surrender value. Northern National Bank 16 B.T.A. 608. It is also possible'that the taxpayer could have taken a partial deduction if the cash surrender value were less than the debt, See Ross v. Commissioner, 72 Fed. 2d 122. Where, however, the creditor holds such a policy on the life of the debtor the debt is a secured one and cannot be deducted as worthless without accounting for the security. In addition, the' Commissioner determined that the debtor was employed and that his financial position in 1937 was no different than in prior years. Appellant introduced no evidence to dispute this or to explain how and why he ascertained the debt to be worthless in the year in question. Clearly, the Appellant has failed to establish that the debt was reasonably ascertained to be worthless in 1937.

3. The Tnmalpais School.

Again there was no showing of how this debt arose. The Commissioner found that the debtor was hopelessly insolvent and had not operated for several years prior to 1937, which facts were known to Appellant who had previously written off as worthlessstock in a corporation to which the school was indebted. The Appellant has not presented any evidence to controvert this finding. He has produced merely two letters written two years later in which the authors, who may be assumed to have known the debtor's financial condition, expressed the opinion that the school was insolvent in 1937, which is entirely consistent with the Commissioner's position,, Here, too, it must be concluded that the Appellant has failed to meet the burden of proof resting upon him.

4 and 5. A. S. Jacobs; I. H. McCreery.

In regard to the claimed deductions for the debts of A. S. Jacobs and I. H. McCreery, no evidence was introduced to. explain the nature of the obligations or to show that the debts were ascertained to be worthless and charged off by taxpayer in 1937.

The deductions for worthless stocks:

1. Compania Mexicana del Aqua Caliente, S. A.

On December 18, 1937, the President of Mexico issued a decree instructing the Mexican Treasury Department to expropriate the properties of the company, with a proviso directing the Department of Finance to reimburse the corporation to the extent of the value of the properties seized, such reimbursement to be made within ten years,, It was stated at the hearing that the value of this property was set at nothing by the Mexican

Secretary of the Treasury, but it is not clear when this was determined. If such a determination was made subsequent to the taxable year it would not indicate the stock was worthless at the time of the decree of expropriation *in* view of the provision for compensation. The stock was not listed, but it was contended by Appellant,, on the basis of a letter from a brokerage firm, that the bid price on this stock in December, 1937, was 25 cents a share. The letter also stated that the stock was being offered at 75 cents a share. Appellant states, but has not offered evidence to estalbish, that this was less than the expenses incident to a sale. The Appellant has thus failed to establish that the stock was wholly worthless in the taxable year for which the deduction was claimed.

2. National Press Building Company.

By a letter written subsequent to the oral hearing before the Board on this appeal, Appellant has conceded that the 20 shares of National Press Building Company did not become worthless in 1937. The disallowance of this claimed deduction must, therefore, be sustained.

3. California National Livestock Show.

The only evidence with regard to the worthlessness of the 40 shares of California National Livestock Show was a letter from the former President of the corporation, written in 1940, to the effect that the company had on hand on January 1, 1937, the sum of $143.40 which was subsequently paid to an attorney for legal services. It is not stated, however, when the liability for the legal services was incurred and no event has been pointed to by Appellant as justifying a determination of worthlessness in 1937. The writer of the letter also expressed the opinion that the stock became worthless in 1937, but such an expression of opinion does not prove the date of worthlessness. See Royal Packing Co. v. Lucas, 38 Fed. 2d 180, 182.

Appellant having failed to sustain the burden of proof in support of the various deductions involved, it follows that the action of the Commissioner in disallowing these deductions must be sustained.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in these proceedings, 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 Chas. J. McColgan, Franchise Tax Commissioner, in overruling the protest of Charles S. Howard to a proposed assessment of additional tax in the amount of $10,918.27, for the taxable year ended December 31, 1937, be and the same is hereby sustained.

Appeal of Charles S. Howard

Done at Sacramento, California, this 24th day of July, 1947, by the State Board of Equalization.

Wm. G. Bonelli, Chairman
Geo. R. Reilly, Member
J. H. Quinn, Member
Jerrold L. Seawell, Member

ATTEST: Dixwell L. Pierce, Secretary