



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
SUPERIOR MOTOR SALES, INC.)

Appearances:

For Appellant: Mr. Sidney J. Matzner, Certified
Public Accountant

For Respondent: Burl D. Lack, Chief Counsel;
Crawford H. Thomas, Associate Counsel

O P I N I O N

This appeal is made pursuant to Section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Superior Motor Sales, Inc. to proposed assessments of additional franchise tax in the amounts of \$347.12, \$347.12 and \$161.94 for the taxable years ended June 30, 1948, 1949 and 1950, respectively.

The Appellant is a California corporation organized on May 7, 1948. It is engaged in the business of selling automobiles. Many of Appellant's sales are made on an installment basis, with Appellant executing a conditional sales contract and receiving the purchaser's note for the purchase price less the down payment. As they were received during the years in question, the conditional sales contracts and notes were sold "without recourse" to Commercial Credit Corporation.

The sales of contracts and notes to Commercial were made pursuant to a written agreement which required Appellant to repurchase any automobiles repossessed by Commercial and to reimburse Commercial for certain other specified losses it might suffer. To secure the payment by Appellant of obligations arising under the agreement, Commercial was authorized to set up for Appellant a "loss reserve account" and to retain in that account a portion of the purchase price of each contract and note. Upon request, Appellant was entitled to receive any amount of the reserve fund in excess of 10% of the balance outstanding on contracts and notes purchased from Appellant, During the years in question there was no such excess.

Appellant did not include in its gross income the amounts retained in the loss reserve account. These amounts aggregated

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\$9,884.45 during the income year ended June 30, 1948, and \$3,910.30 during the income year ended June 30, 1949. The Franchise Tax Board has included these amounts in Appellant's gross income for the respective years. Because Appellant keeps its books and files its returns on the accrual basis, the action of the Respondent presents the question whether the amounts withheld in the loss reserve by Commercial were accruable as income of Appellant for those years.

In the case of an accrual basis taxpayer when the right to receive an amount becomes fixed, the right accrues." Spring City Foundry Co. v. Commissioner of Internal Revenue, 292 U.S. 182, 78 L. Ed. 1200. For the purpose of properly reflecting the taxpayer's income, a consistent treatment of all items of income, under the accrual method of accounting, requires that every item of income shall be accrued when earned rather than when received. John I. Chipley, 35 P.T.A. 1103. Hence, the issue is whether the amounts credited to the loss reserve by Commercial became earned by Appellant upon the sale of the notes and contracts to Commercial.

There are two divergent lines of decisions which have considered this question. In Keasbey & Mattison Co. v United States, 141 F. 2d 163, the court concluded that amounts placed in a reserve fund by a finance company to liquidate losses from uncollectible notes were not accruable as an asset of the seller of the paper for the reason that his right to receive anything from the reserve was contingent and unascertainable during the taxable year. See also Ernest G. Beaudry, B.T.A.M. Dec., Docket 99343, entered Feb. 14, 1941. On the other hand, Shoemaker-Nash, Inc. v. Commissioner of Internal Revenue, 41 B.T.A. 417, heads a group of cases which hold that amounts credited to automobile dealers in loss reserve accounts are absolute credits at the time of the sale of the notes to which the credits are attributable. In accord with this view are Colorado Motor Car Co., B.T.A.M. Dec., Docket 96860, entered March 25, 1940; Royal Motors, Inc., T.C.M. Dec., Docket 5380, entered July 12, 1945; and Town Motors, Inc., T.C.M. Dec., 2697, entered July 24, 1946.

In each of the cases the agreement involved contained a provision for payment to the taxpayer of such amount in the loss reserve as should be in excess of a specified percentage of the balance outstanding on notes purchased by the finance company from the taxpayer. Other provisions of the contracts relating to obligations or liabilities of the parties vary from case to case. An attempt to reconcile the two lines of the authorities on the basis of the presence or absence of some specific provision contained in the document creating the reserve will not eliminate all of the conflict in the decisions.

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Nevertheless, it appears that the Keasbey & Mattison case, relied upon by Appellant, turns on the contractual provision authorizing the finance company in that case to charge the loss reserve with delinquent or unpaid notes, Such a provision was not contained in the Shoemaker-Nash agreement. On the basis of such a distinction in the facts the Keasbey & Mattison rule is not available to Appellant, because its agreement with Commercial did not provide that the reserve could be charged with the amount of a note in default. Furthermore, even the presence of such a provision did not deter the Tax Court from following the Shoemaker-Nash rule in recent decisions. Ray Woods Used Cars, Inc., T.C.M. Dec., Docket 32062, entered September 30, 1952, and Blaine Johnson, 25 T.C. No. 20, entered October 27, 1955.

The agreement before us for consideration is substantially similar to that in the Shoemaker-Nash case. As in the facts considered in that decision, it appears that there is no contention herein that the amounts in the reserve are not credited to the Appellant or that they do not represent profit on the sale of the notes, There is no contention that the amounts in the reserve are uncollectible. Ultimately Appellant will receive the funds withheld or they will be credited against indebtedness owing Appellant to Commercial. We conclude that the reserve credits were accruable as income in the years in which the notes to which they were attributable were assigned to Commercial.

Since Appellant was on the reserve basis for bad debts for the years in question, it takes the alternative position that it should be permitted to increase its reserve for bad debts by the amounts retained in the dealer's reserve. No showing has been made that, if the amounts credited to the dealer's loss reserve were to be treated as additions to Appellant's bad debt reserve, they would be within the requirement that additions to the bad debt reserve be in a reasonable amount as provided in Section 24121f of the Revenue and Taxation Code. Furthermore, no evidence has been presented by Appellant to show what, if any, additions were made to the bad debt reserve during the taxable years. For that reason, we need only refer to the rule that a taxpayer may not increase his reserve for bad debts after the close of the taxable year. Rogan v. Commercial Discount Co., 149 F. 2d 585 (cert. den. 326 U.S. 764, 90 L. Ed. 460); Farmville Oil & Fertilizer Co. v. Commissioner of Internal Revenue, 78 F. 2d 83.

One further issue is presented by Respondent's disallowance of fifty percent of the amounts of travel and entertainment expense claimed by Appellant. Appellant has no records of the claimed expenditures other than checks drawn to "cash" and

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cashd by Appellant's president and principal stockholder. His affidavit containing a statement which merely sets forth generally how the amounts were spent is insufficient to substantiate the deductions and we must, therefore, accept the estimate by the Franchise Tax Board. See Neils Schultz v. Commissioner of Internal Revenue, 44 B.T.A. 146, wherein it was stated:

"The Commissioner disallowed . . . these amounts because they were 'not substantiated.' In other words, he allowed about one-fourth of the amounts deducted as general expenses . . . He has recognized that 'something was spent', and has made presumably 'as close an approximation' as he could, There is nothing upon which the Board can base a different or greater approximation,"

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, pursuant to Section **25667** of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of Superior Motor Sales, Inc. to proposed assessments of additional franchise tax in the amounts of **\$347.12, \$347.12 and \$161.94** for the taxable years ended June **30, 1948, 1949** and 1950, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 1st day of February, 1956, by the State Board of Equalization.

Paul R. Leake, Chairman
Robert E. McDavid, Member
J. H. Quinn, Member
Geo. R. Reilly, Member
Robert C. Kirkwood, Member

ATTEST: Dixwell L. Pierce, Secretary