BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
CREE L. and JUNE A. WILDER)

Appearances:

For Appellant: Cree L. Wilder, in pro. per,

For Respondent: Burl W. Lack, Chief Counsel; Jack Rubin, Junior Counsel

O P I N I O N

This appeal was made pursuant to Section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Cree L. and June A. Wilder to proposed assessments of additional personal income tax against each Appellant in the amount of $195.55 for the year 1951. They have since paid the amounts in dispute and under Section 19061.1 of the Revenue and Taxation Code the appeal is to be treated as an appeal from the denial of a claim for refund.

The question presented is whether Appellants were entitled to a bad debt deduction in 1951. The liability of June Wilder depends upon that of Cree Wilder and for the purpose of convenience Cree Wilder will hereafter be referred to as if he were the only Appellant.

In 1943 Orville B. Jones, Sr,, and Cree L. Wilder formed a partnership for the purpose of conducting a plumbing and sheet metal business. Appellant and Jones were equal partners and shared equally in the profits of the business. On July 31, 1951, Appellant sold his interest in the partnership business to Mr. Jones and several other individuals for $60,000. As a part of this transaction Appellant accepted a promissory note from Jones in the amount of $10,000. The note bore interest at the rate of 6 percent per annum and was due on November 1, 1951. Since the sale of his interest in the partnership Appellant has had *no* interest in the business.

The partnership assets and business were transferred by Jones and his associates on August 1, 1951, to Wilder and Jones, Inc., which has continued to conduct the business since that date. Mr. Jones has since that date continually owned more than 50 percent of the stock of the corporation.

Mr. Jones' individual share of the partnership income for the period ended July 31, 1951, was $36,482.91. In addition, he received a substantial but undisclosed salary from Wilder and Jones, Inc., for the remainder of 1951 and for each year thereafter. He also owned an interest in an auto court from which he received 50% of the profits and a home which was encumbered by a bank loan in an unknown amount.

Orville Jones failed to pay the $10,000 note when it became due on November 1, 1951. Shortly thereafter Appellant consulted the attorney who had previously handled the legal work of the partnership of Wilder and Jones and was then representing the successor corporation in several matters, including its application to the Commissioner of Corporations for permission to issue stock. This attorney advised against taking action to enforce collection of the note at that time. His reasons were that: (1) with respect to the auto court, the only interest of Mr. Jones that could be reached was his share of the profits, which, during the off season, were very small; (2) shortly before dissolution of the partnership Mr. Jones had constructed an expensive new home which the attorney was sure was heavily encumbered by a bank loan and which may have been homesteaded; and (3) the only other principal asset of Jones was his interest in the corporation which was then very much in debt since Jones had raised a substantial amount of cash to pay for Appellant's intereet. The attorney believed that any action to collect the note in 1951 would have forced the sale of the business or would have led to bankruptcy, in either event requiring payment by Appellant of a bank loan of $15,000 which was assumed by the corporation but upon which Appellant remained liable.

The Appellant claimed a bad debt loss in the full amount of the $10,000 note in his return for 1951. Mr. Jones paid interest on the note in each of the years 1952 through 1954. He paid $2,000 on the principal in 1953 and the balance of $8,000 in 1955. The position of the Franchise Tax Board is that the note did not become worthless in 1951.

Former Section 17310 of the Revenue and Taxation Code (now Section 17207) provided that "In computing net income there shall be allowed as a deduction debts which become worthless within the taxable year ..." So far as material here, this section was substantially the same as Section 23(k) of the United States Internal Revenue Code of 1939 as amended in 1942.

It is necessary for the taxpayer to prove that, as determined by objective standards, the debt was actually worthless within the taxable year (Earl V. Perry, 22 T.C. 968), or at least that it would be considered worthless by a reasonable man (Loewi & Co. v. Commissioner, 232 Fed. 2d 621). Mere nonpayment of a debt does not prove its worthlessness and a deduction is not justified when the creditor fails to take reasonable steps to enforce collection unless there is proof that those steps would be futile (Earl V. Perry, supra; A. Finkenberg's Sons, Inc., 17 T.C. 973. Cf. Smyth v. Barneson, 181 Fed. 2d 143, and comment thereon in Mertens, §30.39).

The record fails to disclose that Appellant did anything more to collect the debt than to seek the advice of an attorney when the debt was not paid within a short time after the due date. The attorney's advice was against taking legal action to collect the note at that time. It appears that the corporation in which Jones had a majority interest was operating successfully, even though it was in debt. It is alleged by the Franchise Tax Board and not denied by Appellant that the corporation had a substantial net income in 1951 and 1952. The income from the auto court in which Jones had an interest may have been small during the off season as the attorney stated, but there is nothing to show that its income was small during the peak season, Also, while Mr. Jones's house may have been heavily encumbered at that time, and it may have been homesteaded and therefore exempt from execution, there is nothing to show how heavily it was encumbered or that it was actually homesteaded. The Franchise Tax Board has alleged its belief that Mr. Jones's equity in the house exceeded his obligation thereon,

The evidence tends to indicate at most that the debtor did not have cash or other assets which could be quickly converted into cash to discharge the debt, but even evidence of insolvency does not necessarily establish the worthlessness of a debt, particularly where there is potential ability to pay (Miriam Coward Pierson , 27 T.C. 330; Trinco Industries, Inc., 22 T.C. 959). In our opinion Appellant has not established that the debt was worthless in 1951. It follows, therefore, that the action of the Franchise Tax Board must be sustained.

Appeal of Cree L. and June A. Wilder

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 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of Cree L, and June A. Wilder for refund of personal income tax in the amount of $195.55 for each Appellant for the year 1951 be and the same is hereby sustained.

Done at Sacramento, California, this 15th day of September, 1958, by the State Board of Equalization.

Geo. R. Reilly, Chairman

Paul R. Leake, Member

Robert E. McDavid, Member

J. H. Quinn, Member

Robert C. Kirkwood, Member

ATTEST: Ronald B. Welch, Acting Secretary