

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
ISADORE TEACHER)

Appearances:

For Appellant: Theodore A. Teacher, Attorney at Law

For Respondent: Burl D. Lack, Chief Counsel;
A. Ben Jacobson, Associate 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 Isadore Teacher to a proposed assessment of additional personal income tax in the amount of \$664.98 for the year 1950.

The question presented here is whether or not the Appellant may claim a bad debt deduction of \$11,082.95 for the year 1950.

During 1946 W. C. Jarrett approached Appellant for a business loan. At that time, Mr. Jarrett owned and operated three night clubs in Long Beach, California, and was Appellant's tenant. Appellant arranged for Mr. A. Tenenbaum, a close friend, to make the loan to Mr. Jarrett.

On September 12, 1946, W. C. and Dorothy Jarrett executed a note in the amount of \$14,735.00 in favor of Mr. A. Tenenbaum. The note provided for 6% interest and was payable in monthly, \$1,000.00 installments. Any default was to cause the entire principal and interest to become immediately due and payable.

The Jarretts defaulted on their note the following month without making any payment. On March 12, 1947, no payment having yet been made, Mr. Tenenbaum entered into an agreement with the Jarretts which provided that in consideration for \$3,000.00 being paid on the loan the note payments would be reduced to \$500.00 per month for a period of one year at the end of which time the entire balance would become due.

Mr. Tenenbaum then made a written assignment of the note to the Appellant on March 17, 1947. The assignment stated that it was made "for a valuable consideration."

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The only payments ever made on the note or supplemental agreement were as follows:

April 12, 1947	\$ 323.28
June 3, 1947	3,000.00
July 12, 1947	778.48
November 28, 1947	539.00

The balance due and owing after the last payment was \$11,082.95.

In the latter part of 1947 the Appellant consulted an attorney concerning the Jarrett note. However, because Appellant believed that Mr. Jarrett's financial straits were only temporary he did not instruct the attorney to collect the note in full until late 1948. The attorney's investigation revealed that Mr. Jarrett had no assets in his own name worth attaching. In 1949, not only were no attachable assets uncovered, despite the attorney's diligent efforts, but also it was learned that Mr. Jarrett owed a considerable amount of back taxes to the Federal Government. During the first part of 1950, the attorney advised Appellant that it was useless to spend any more time or money attempting to collect the debt, that obtaining a judgment would be only a further waste, and to consider the Jarrett note as wholly worthless,

In his personal income tax return for 1950, Appellant claimed a bad debt deduction of \$11,082.95. The Franchise Tax Board disallowed this deduction on the grounds (1) that Appellant had failed to show that the debt for which he claimed a deduction had any cost to him for which he might properly claim a loss and (2) that Appellant had failed to prove that the debt became worthless during 1950.

With respect to the first point, Appellant contends that he gave the money for the Jarrett loan to Mr. Tenenbaum, that Mr. Tenenbaum at all times acted as his agent and that he, Teacher, acted as an undisclosed principal. Assuming that this contention is true, Appellant has nevertheless failed to establish that the debt became worthless in 1950.

Section 17310 (now Section 17207) of the Revenue and Taxation Code permitted a deduction for debts "which become worthless within the taxable year." This language is identical to that of Section 23(k) of the 1939 Internal Revenue Code (now Section 166 of the 1954 Code) as amended by Section 124(a) of the 1942 Revenue Act and Section 113(a) of the 1943 Revenue Act.

Before 1942, Section 23(k) allowed a deduction for "debts ascertained to be worthless." This same language appeared in former Section 8(f) of the California Personal Income Tax Act.

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Under this test the taxpayer was entitled to deduct a bad debt in the year he determined the obligation to be worthless.

The 1942 amendment to Section 23(k) substituted an objective test of actual worthlessness for the subjective, ascertainment of worthlessness test. A similar amendment to the California statute was made in 1943. Now, the taxpayer has the burden of showing that the debt actually became worthless during the year for which the deduction is sought. (Redman v. Commissioner, 155 F. 2d 319; Cittadini v. Commissions, 139 F. 2d 29.)

Since actual worthlessness is the test, the dates of ascertainment or eventual giving up by the taxpayer on the possibility of recovery are immaterial. (H. W. Findley, 25 T.C. 311, aff'd, 236 F. 2d 959.) No bad debt deduction may be allowed for a particular year if the debt became worthless prior or subsequent to that year. (Redman v. Commissioner, supra.) In order to sustain his contention that the debt became worthless in 1950, the Appellant must show that the note had value at the end of 1949 and that there was some substantial change in Mr. Jarrett's financial condition during 1950 that marked the worthlessness of the debt. (Bella Feinstein, 24 T.C. 656; H. W. Findley, supra.)

The evidence shows that early in 1950 an attorney advised the Appellant to consider the debt worthless. This is the only evidence relating to 1950. Nothing indicates that the situation was then different in any respect from the situation prior to that year. The attorney did not purport to say that the debt became worthless in 1950 and even if he had, the opinion would not be conclusive in the absence of facts to support it. (Matthew Edwards, Sr., T.C. Memo., Dkt. No. 61950, July 21, 1959; cf. William B. Stout, T.C. Memo., Dkt. No. 15548, November 2, 1949; where the debtor's place of business burned down in the year that the attorney gave his opinion.) The date of the attorney's advice at most establishes the time of ascertainment of worthlessness, not the time of actual worthlessness. We hold that the Franchise Tax Board did not err in disallowing the bad debt deduction for the year 1950.

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 Isadore Teacher to a proposed assessment of additional personal income tax in the amount of \$664.98 for the year 1350 be, and the same is hereby sustained.

Done at Sacramento, California, this 4th day of April, 1961, by the State Board of Equalization.

John W. Lynch, Chairman

Paul R. Leake, Member

Richard Nevins, Member

Geo. R. Reilly, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary