



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
JAMESTOWN ENTERPRISES)

Appearances:

For Appellant: R. H. Henry, Certified Public
Accountant

For Respondent: Crawford H. Thomas, Associate Tax
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 Jamestown Enterprises against proposed assessments of additional franchise tax in the amounts of \$2,023.24 and \$8,568.55 for the income years 1954 and 1955, respectively.

Appellant is a California corporation engaged in the business of selling automobiles at retail. It reports its income on the basis of a calendar year and uses the accrual method of accounting.

Most of Appellant's sales of automobiles are made under conditional sales contracts calling for payments over periods ranging from 18 to 36 months. Appellant assigns the contracts to a bank at a discounted price and agrees to repurchase them for the unpaid balance if the automobile buyer defaults in his payments. When such a default occurs, the bank repossesses the automobile and, when Appellant repurchases the contract, transfers the automobile to Appellant.

For tax and bookkeeping purposes, Appellant established a "reserve for losses" on the contracts. Additions to the reserve were made according to the percentage of outstanding contracts which, based on prior experience, Appellant believed would be uncollectible. Actual losses were charged against the reserve as they occurred.

On its franchise tax returns for the income years in question Appellant deducted the net additions to its reserve, \$34,857.94 for 1954 and \$186,828 for 1955. These deductions were disallowed by the Franchise Tax Board on the ground that no statute permits a deduction for additions to such a reserve.

Appeal of Jamestown Enterprises

Appellant has conceded two issues originally presented in this appeal, namely, whether it may deduct a reserve for estimated expenses on product guarantees and whether proceeds from sales of lubrication service books should be included in income in the year in which the books are sold. The only remaining question is whether Appellant may deduct the net additions to its reserve for losses on the conditional sales contracts.

It is argued by Appellant that the reserve for losses is equivalent to a reserve for bad debts and that the deductions are permissible under section 24348 (formerly **24121f**) of the Revenue and Taxation Code.

Section 24348, which allows a deduction for a reasonable addition to a reserve for bad **debts**, is, so far as material here, substantially identical with section 166 of the United States Internal Revenue Code.

Since this appeal was submitted for decision, a case directly in point has been decided by the U. S. Court of Appeals for the Ninth Circuit. In Wilkins Pontiac v. Commissioner, **298 F.2d 893**, the court held that additions to a reserve for losses maintained by an automobile dealer with respect to conditional sales contracts assigned to a financing agency were deductible by the dealer under section 166 of the Internal Revenue Code in view of his guarantee of payment on the contracts. The court stated:

Nowhere in the code or the regulations do we find any requirement that a Sec. 166(c) reserve must relate to debts presently owing to the taxpayer. Rather, it would seem that it must relate to an existing debt as to which the taxpayer in the ordinary course of business may ultimately sustain a bad debt loss.

* * *

Section 166(c) deals with a situation where a bona fide debt has not yet become worthless **but where there is an existing risk of such a loss. The risk is every bit as real to this taxpayer under its contracts of guaranty as it would be were the debt now owed directly to it.**

In the Wilkins case no issue was raised as to whether the **additions** were, as **required by statute, reasonable** in amount, Similarly, **no such issue has been raised in the case before us.**

Upon the authority of the **above decision**, we conclude that the **action** of the Franchise Tax Board in disallowing the additions to the **reserve** in question **should be reversed.**

