BEFORETHE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)

HARRY B. AND **MAIZIE E. BREITMAN**)

Appearances:

For Appellants: Mike Mayo, Attorney at Law

For Respondent: Burl D. Lack, Chief Counsel

O P I N I O N

This appeal is made pursuant to section 19059 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of Harry **B. and** Maizie E. Breitman for refund of personal income tax in the amount of $499.21 for the year 1957,

The question presented here is whether or not appellants may claim a bad debt deduction of **$8,775.00** for the year **1957.**

On January 8, 1952, Harry Breitman (hereafter "appellant") paid **$13,000.00** to Michael Levine, who was the 'father of appellant's son-in-law and the president and principal stockholder of the 331-335 South Broadway.Corporation. This payment represented the purchase price of a 25 percent stock **interest** in that corporation **and a** loan to it in the amount of **$8,775.00.** This loan was to be repaid on January 8, 1957. In addition, Mr. Levine was given a five year option under, **which** he could repurchase appellant's shares at their book value or cost, whichever was greater, plus payment of all loans **due from** the corporation.

The corporation's sole asset, with the minor exception of a **few** fixtures, **was** a lease-on a Los Angeles office building..

The lease, which expires on February 28, 1965, calls. for certain fixed minimum rental payments each month and provides that the lessor may terminate the lease, on ten days' notice, if the lessee corporation defaults on its rent. It also provides that if the corporation is adjudicated insolvent or bankrupt and, such disability continues for sixty days, the lessor may terminate the lease and all rights of the corporation thereunder.

The corporation'soperation was simply the subletting of the office building, Its profit or loss depended on whether the rentals it took in were more or less than the cost of operating the building plus the lease payments. The corporation reported a loss for the fiscal year in which appellant made his investment and continued to report losses until the year ended November 30, 1961. In each year the corporation took deductions for amortization of the cost of the leasehold and leasehold improvements and for depreciation on a small amount of fixtures. As a result of the continual losses, the corporation showed an increasing deficit. The corporation was able to continue operating because the losses were made up by additional loans to the corporation from Mr. Levine. The following schedule indicates the amount of the gain or loss reported, the year-end: deficit, the amount deducted for amortization and depreciation and the adjusted gain or loss derived by adding back the amortization and depreciation deduction.

Year Ended Nov. 30	Reported Gain (Loss) (a)	Year End Deficit	Amortization and Depreciation (b)	Adjusted Gain (Loss) (a & b)
1953	($4,996.97)	$ 4,778.96	$3,839.84	($ 1,157.13)
1954	(9,716.05)	14,545.11	3,844.51	(5,871.54)
1955	(6,957.44)	21,552.45	4,204.94	(2,752.50)
1956	(2,307.47)	23,859.92	4,204.94	1,897.47
1957	(4,646.05)	28,505.97	4,204.94	(441.11)*
1958	(9,628.90)	38,159.87	4,204.94	(5,423.96)
1959	(8,325.11)	46,509.98	4,204.94	(4,120.17)
1960	(2,084.87)	48,694.85	4,204.94	2,120.07
1961	6,015.78	42,779.07	4,204.94	10,220.72
Totals,	($42,647.08)		$37,118.93	($ 5,528.15)

*Total adjusted loss as of 11/30/57 - $8,324.81

During 1957 appellant made a formal demand upon the corporation for-repayment of the loan. In answer, appellant'

received a letter from Michael Levine stating that the corporation did not have enough money to repay the loan nor any prospective means of acquiring the needed funds. Appellant was familiar with the corporation's financial condition and was aware that it had been operating at a loss. Levine also informed appellant, apparently in a conversation, that he would not exercise his option to buy out appellant's interest. Attempts by the debtor to sell its business have been unsuccessful. Based upon his investigation of the corporation, appellant determined that an action by him to collect the debt would force the debtor into bankruptcy and any judgment secured by him would be worthless. Upon the advice of his accountant and his attorney, appellant concluded that the debt became totally worthless in 1957, He made no further efforts to collect the obligation.

The Franchise Tax Board disallowed the bad debt deduction claimed by appellant on his 1957 return on the ground that he failed to show that the debt became worthless in that year.

Section 17207 of the Revenue and Taxation Code permits a deduction for debts "which become worthless within the taxable year." Similar language is found in section 166 of the 1954 Internal Revenue Code.

Since the question has not been raised or argued, we assume, without deciding, that appellant's advance of $8,775.00 created a bona fide debt. Thus, the sole question, before us is whether that debt actually became worthless during 1957.

The problem of whether or not a debt is worthless is a question of fact. (Redman v. Commissioner, 155 F.2d 319.) Appellant has the burden of showing that some identifiable event occurred during 1957 which formed a reasonable basis for abandoning any hope that the debt would be paid sometime in the future. (Redman v. Commissioner., supra; Watkins v. Glenn, 88 F. Supp. 70.) It has been said that the debt must appear to be worthless to a reasonable business man. (Loewi & Co. v. Commissioner, 232 F.2d 621.) A deficit or the insolvency of a corporation does not, of itself, establish the worthlessness of a debt. (W. D. Roussel, 37 T.C. 235; Robert D. Marshall, T.C. Memo., Dkt. No. 78898, Dec. 30, 1960.)

Nothing occurred during the year 1957 which can be said to have fixed appellant's loss. The corporation continued

in much the same manner that it had in previous years. The fact that appellant's formal demand for repayment was refused in no way altered the debtor's financial condition. We conclude that appellant has failed to show that any identifiable even-t' occurred which indicates that a loss was sustained in 1957.

We are not unmindful of the fact that at the end of 1957 the corporation's balance sheet showed a deficit of some $28,505. About $20,000 of this amount, however, represented the deductions taken for amortization and depreciation. These deductions were book adjustments rather than actual out-of-pocket losses and did not affect the debtor's ability to repay appellant's loan. While the corporation's actual losses (totaling $8,324.81 by 195[illegible]) were substantial, it appears that Mr. Levine' considered the corporation's prospects sufficiently encouraging to induce him to continue making financial transfusions which kept the business going. We cannot assume that he acted unreasonably,

We think the fact that Mr. Levine continued to make these advances while appellant retained his claim is the crucial factor which distinguishes the instant appeal from the Appeal of Samuel J. Briskin, Cal, St. Bd. of Equal,, March 2, 1950, 1 CCH Cal. Tax Cas. Par. 200-084, P-H State & Local Tax Serv. Cal. Par. 58053, cited by appellant. In that appeal this board held that a debt owed to a stockholder-creditor was worthless where the debtor corporation's current, liabilities exceeded its current assets and it was unable to sell its business for enough to meet its obligations, In an effort to rehabilitate the corporation one of its stockholders offered to supply additional funds if the other two stockholders would surrender their stock. and accept a partial payment as settlement in full for certain loans they had made to the corporation. Thus the additional funds were made available only after the remaining stockholders 'agreed to extinguish any future claims they might have. Here, Mr., Levine made additional advances to keep the business going without requiring that appellant give up his claim. As long as. the corporation remained alive, there was a very real possibility that appellant's claim would eventually be satisfied. The rapid improvement in the debtor's financial condition in 1960 and 1961 illustrates this.

In other cases, the fact that advances were made to the debtor subsequent to the time when the debt allegedly became worthless, and.the fact that the debtor remained a going-concern, have been found to be inconsistent with a claim

of worthlessness. (Janet McBride, 23 T.C. 926; Miriam Coward Pierson, 27 T.C. 330, aff'd, 253 F.2d 928; John F. Douglas, T.C. Memo,, Dkt. No. 64661, Feb. 28, 1958; Robert T. Ely, T.C. Memo,, Dkt. No. 60483, May 13, 1958.) We find that the debt owed to appellant by the corporation did not become worthless during 1957.

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, &JUDGED 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 Harry B. and Maizie E. Breitman for refund of personal income tax in the amount of $499.21 for the -year 1957, be and the same is hereby sustained.

Done at Sacramento, California, this 18th day of February, 1964, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: _____, Sedretary