



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of }
MORLYN L. AND VELMA K. BROWN }

For Appellants: Morlyn L. Brown, in pro. per.
For Respondent: Burl D. Lack, Chief Counsel;
Peter S. Pierson, Associate
Tax Counsel

O P I N I O N

These appeals are made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Morlyn L. and Velma K. Brown against a proposed assessment of additional personal income tax in the amount of \$1,023.73 for the taxable year ended November 30, 1957, and pursuant to section 19059 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of Morlyn L. and Velma K. Brown for refund of personal income tax in the amount of \$50.09 for the short period taxable year begun December 1, 1957, and ended December 31, 1957.

Appellant Morlyn L. Brown (hereafter referred to as "appellant") became a resident of California in 1954, and from that time until 1958 he filed his California income tax returns on the basis of a fiscal year ended November 30. In June 1957 he married his present wife, Velma. Prior to the marriage, Velma had been a resident of the State of Massachusetts.

On February 21, 1958, appellant filed with respondent a request for a change of his accounting period from a fiscal year ended November 30 to a calendar year, so that he and his wife could file joint returns for 1958 and subsequent taxable years. Respondent granted appellant's request on March 7, 1958. Appellant then filed a separate return for the fiscal year ended November 30, 1957, and a separate short period return for the period from December 1, 1957, through December 31, 1957.

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Appellant's wife filed no California income tax return for 1957. Her only income for that year appears to have been \$1,111.17 in dividends received after the date of their marriage, Appellant and his wife filed joint returns on a calendar year basis for the years 1958, 1959, 1960 and 1961.

In February 1962 appellant was advised by respondent that his 1957 fiscal year return had been audited and that certain adjustments to income were to be proposed. On February 27, 1962, prior to receipt of any deficiency notice for the fiscal year ended November 30, 1957, appellant and his wife filed amended joint returns for the fiscal year ended November 30, 1957, and for the short period December 1 through December 31, 1957, in which they incorporated the income changes recommended by respondent. Respondent's deficiency notice was issued on March 5, 1962.

The amended joint returns filed by appellant and his wife reflected a net savings of tax over the deficiency proposed for the fiscal year ended November 30, 1957, and a net savings of tax over that already paid for the short period of December 1 through December 31, 1957. Respondent's affirmance of the proposed additional assessment and its denial of appellant's claim for refund were based on its determination that appellant and his wife were not entitled to file joint returns for 1957. Since a decision as to the propriety of that determination by respondent will affect both appeals, the two are consolidated for purposes of this opinion,

Although Mrs. Brown filed her federal income tax returns on a calendar year basis for the year 1957 and subsequent years, appellant contends that she was entitled to and did adopt a fiscal year for her first taxable year as a California taxpayer. Under the regulations, however, the adoption must be made in a timely return. (Cal. Admin. Code, tit. 18, reg. 17551(a), subd. (1)(c). See also Atlas Oil & Refining Corp., 17 T.C. 733.) Mrs. Brown did not file a return for the fiscal year ended November 30, 1957, until 1962. The first California return that she filed was on a calendar year basis,

In order to adopt a fiscal year for filing returns, moreover, a taxpayer must establish that he keeps books and regularly computes his income on the basis of that fiscal year in keeping the books, (Rev. & Tax, Code, § 17551, subd. (c) and (g.)) The required books may consist of unbound records but must clearly reflect income for the accounting period that is employed, (Cal. Admin. Code, tit. 18, reg. 17551(a), subd. (7).) Since the "checkbooks and other books and records" which appellant alleges were kept by his wife are not before us and have not been described in detail, we cannot find that they

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clearly reflected income or that they were kept on the basis of any particular accounting period, (Cf. Louis M. Brooks, 6 T.C. 504; Atlas Oil & Refining Corp., 17 T.C. 733.) Without deciding that the method of filing federal returns is conclusive for state purposes, the fact that those returns were filed on a calendar basis indicates that Mrs. Brown did not regularly compute her income on the basis of a fiscal year.

Section 18402, subdivision (b) of the Revenue and Taxation Code provides in part that a joint return shall not be made if husband and wife have different taxable years. Appellant was clearly a fiscal year taxpayer in 1957. Since we agree with respondent that Mrs. Brown has failed to establish her right to file on the basis of a fiscal year, the difference in their taxable years precludes them from filing joint returns for 1957.

One of the income adjustments proposed by respondent for the taxable year ended November 30, 1957, was the disallowance of an \$8,000 bad debt deduction. The debt arose from an advance of \$8,000 made by appellant to Kesling Modern Structures, Inc. In consideration of the loan, appellant received a \$12,000 note secured by a fourth deed of trust on one piece of property and what was believed to be a third deed of trust on another piece of property. On September 4, 1957, Parcel 1 was sold by the trustee under default of the first deed of trust. Appellant purchased the property for \$55,000, an amount insufficient to pay off the third trust deed. On November 18, 1958, Parcel 2 was sold by the trustee. It was then learned that the title insurance company had failed to discover a prior third deed of trust on Parcel 2, and that as a result appellants actually held a fourth deed of trust on that piece of property.

Appellant took an \$8,000 bad debt deduction for the taxable year ended November 30, 1957, on the theory that because the property was so heavily encumbered the note was worthless after the trustee's sale of the first parcel. Respondent disallowed the deduction in that taxable year, but allowed it in 1958 on the ground that the loss was not sustained until the sale of the second parcel in 1958. In filing their amended joint returns for 1957 appellant and his wife complied with this adjustment. They now take exception to the disallowance, however, contending, that the above facts support the bad debt deduction in 1957.

Section 17207, subdivision (a)(1) of the Revenue and Taxation Code provides for the deduction of any debt which becomes worthless within the taxable year. As under similar federal legislation, the burden is on the taxpayer to prove not only that the debt was worthless but also that it became worthless during the taxable year in question. (Denver &

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Rio Grande Western Railroad Co., 32 T.C. 43, 56, aff'd, 279 F.2d 368; Appeal of William S. and Betty V. Jack, Cal, St. Bd. of Equal., May 17, 1962.)

In *construing* comparable federal statutes, the courts have insisted that worthlessness must be established by some identifiable event in order to justify the deduction of losses resulting from bad debts, (United States v. White Dental Mfg. Co., 274 U.S. 398 [71 L. Ed. 1129]; Watkins v. Glenn, 88 F. Supp. 70.) A secured debt does not become totally worthless until the collateral security itself becomes worthless, (See Loewi v. Ryan, 229 F.2d 627; A.W. Blackie, 2 B.T.A. 747.) Appellant has alleged but has failed to prove that the mortgage which he held on the second parcel of land became totally worthless in 1957. The identifiable event which established the total worthlessness of his note was the sale of that second parcel in 1958, and respondent's action in disallowing the deduction for 1957 must, therefore, be upheld,

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 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Morlyn L. and Velma K. Brown against a proposed assessment of additional personal income tax in the amount of \$1,023.73 for the taxable year ended November 30, 1957, be and the same is hereby sustained, and, pursuant to section 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board denying the claim of Morlyn L. and Velma K. Brown for refund of personal income tax in the amount of \$50.09 for the short period taxable year begun December 1, 1957, and ended December 31, 1957, be and the same is hereby sustained,

Done at Sacramento, California, this 27th day of October, 1964, by the State Board of Equalization.

<u>Paul R. Leake</u>	Chairman
<u>John W. Lynch</u>	Member
<u>Hubert Allen</u>	Member
_____	Member
_____	Member

Attest: [Signature] Secretary