



BEFORE THE: STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
KNOLLWOOD WEST CONVALESCENT HOSPITALS, INC.)

For Appellant: Richard S. Ciceric
Certified Public Accountant

For Respondent: James C. Stewart
Counsel

O P I N I O N

This appeal is made pursuant to section 25666 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Knollwood West Convalescent Hospitals, Inc., against a proposed assessment of additional franchise tax in the amount of \$4,199.02 for the income year 1975.

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The issue presented by this appeal is whether appellant was entitled to a bad debt deduction for the taxable year 1975.

In 1970, appellant, a California corporation, loaned to Knollwood Sanitariums, Inc. ("Sanitariums") \$52,141. This was followed by additional loans to Sanitariums in **1971, 1972, 1973, and 1974** in the amounts of \$6,030, \$1,653, \$1,620, and \$1,253, respectively. In 1970, Sanitariums' landlord, **Samuel Blasker ("Blasker")**, filed an action against Sanitariums and Sanitariums filed a cross-complaint alleging damages of \$250,000. At about the same time, Sanitariums suffered business difficulties which left it with a single asset, the claim against Blasker. The Blasker lawsuit was not brought to trial by 1975. Therefore, the court **dis-**missed the original complaint and the cross-complaint in 1975 pursuant to section 583 of the California Code of Civil Procedure which mandates dismissal of an action if it is not brought to trial within five years after the plaintiff filed the action.

Appellant's position is that, since the cause of action against Blasker was Sanitariums' only asset, appellant's receivable from Sanitariums had value as long as Sanitariums had a possibility of recovering against Blasker. It contends that the receivable became worthless when the court dismissed the lawsuit in 1975. In its tax return for 1975, appellant claimed a bad debt deduction in the amount of \$62,601, the entire amount **owed** to it by Sanitariums. After audit, respondent concluded that appellant had not proven that the debt became worthless during 1975. Therefore, it disallowed the **bad debt** deduction and issued a notice of proposed assessment of additional franchise tax in the amount of **\$4,199.02**. Respondent denied **appellant's** subsequent protest, and this timely appeal was filed.

A deduction is allowed for "debts which become worthless within the income year." (Rev. & Tax. Code, § 24348.) The burden is on the taxpayer to prove that the debt for which the deduction is claimed had some value at the **beginning** of the taxable year in which the deduction is claimed, and that it became worthless during that year. (Appeal of A.F.B. Investment Company, Inc., Cal. St. Rd. of Equal., Aug. 16, 1977.) A bad debt deduction is not allowed if the debt became worthless in a year prior to the year for which the deduction is claimed. (Appeal of Real Estate Buy Keller, Cal. St.

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Bd. of Equal., Nov. 13, 1973.) We conclude that appellant has not met his burden of proof; therefore, respondent correctly disallowed the bad debt deduction.

Appellant attempts to support its position that Sanitariums' debt became worthless during 1975 by contending that Sanitariums' only asset, the cause of action against Blasker, had value at the beginning of 1975 and became worthless later in that year. The only evidence produced by appellant is a letter from Sanitariums' attorney which states that, in the attorney's opinion, appellant should write off its receivable from Sanitariums in the year of 1975. This board has held that the opinion of an attorney is not sufficient to prove worthlessness of a debt unless it is supported by objective, underlying facts. (Appeal of Grace Bros. Brewing Company, Cal. St. Bd. of Equal., June 28, 1966.) The facts revealed by this letter do not support appellant's claim that the debt became worthless during 1975. The letter states that the only chance appellant had of collecting the debt was if Sanitariums prevailed on its claim against Blasker, and that the claim was barred by the dismissal of the Blasker lawsuit. The letter explains that Sanitariums decided not to prosecute its claim against Blasker "because of the many cross-claims, the heavy expense of litigation and the risk of adverse judgment." Although this letter makes it clear that after 1975 Sanitariums had no chance of recovery against Blasker, it does not support the proposition that Sanitariums had such a possibility in the beginning of 1975. On the contrary, the reasons which led Sanitariums to decide not to prosecute its **claim** indicate that the claim may never have had any value. The cross-claims, expense of litigation and the risk of adverse judgment would have been present in the years preceding 1975 as well as during that year. At most, the evidence presented by appellant tends to prove that appellant may have learned in 1975 that the debt was worthless. However, we have previously held that the taxpayer **must** prove when the debt actually became worthless; proof of the date upon which he realized the debt to be worthless is irrelevant. (Appeal of Real Estate Buy Keller, supra.) Since **appellant** has produced no evidence showing that the debt had value at the beginning of 1975, respondent correctly disallowed the claimed bad debt deduction.

On the basis of the foregoing, respondent's action must be sustained.

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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 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Knollwood West Convalescent Hospitals, Inc., against a proposed assessment of additional franchise tax in the amount of \$4,199.02 for the income year 1975, be and the same is hereby sustained.

Done at Sacramento, California, this 3rd day of March , 1982, by the State Board of Equalization, with Board Members Mr. Bennett, Mr. Reilly, Mr. Dronenburg, Mr. Nevins and Mr. Cory present.

William M. Bennett , Chairman
George R. Reilly , Member
Ernest J. Dronenburg, Jr. , Member
Richard Nevins , Member
Kenneth Cory , Member