

# BEFORE THE STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )
B. J. ALLEN, INC.

For Appellant:

Barbara J. Allen

President

For Respondent:

Charlotte A. Meisel

Counsel

## <u>O P I N</u> 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 B. J. Allen, Inc., against a proposed assessment of additional franchise tax in the amount of \$918 for the income year 1978.

# &peal of B. J. Allen, Inc.

The issue presented is whether appellant is entitled to claim a bad debt deduction of \$34,744 for the year under appeal.

Appellant is a California corporation, incorporated in January of 1975. A cash basis taxpayer, it' was formed and operated by Barbara J. Allen (hereinafter "Barbara"). In January of 1975, Barbara, together with her husband Wallace H. Allen (hereinafter "Wallace"), also formed Glenwood Industries Corporation (hereinafter "Glenwood"). Wallace served as president of-Glenwood and conducted its business, which consisted of the manufacture of furniture.

On its 1978 franchise tax return, appellant deducted \$34,744 as a bad debt loss. Upon audit, respondent learned that appellant based this deduction upon \$12,744 for unpaid rent and \$28,877 for an unpaid loan, both by Glenwood. When asked for substantiation of the loss, it was further learned that Dorothy Mooney, Barbara's mother, had in fact advanced some \$29,000. to Glenwood. Glenwood executed a promissory note to appellant, though, because appellant was allegedly acting as quarantor of the loan.

Respondent determined that appellant, a cash basis taxpayer, was not entitled to deduct'the unpaid rent since it had not previously reported that amount as income. Moreover, respondent determined that appellant was not entitled to deduct the unpaid loan since the loan was not made by appellant. Appellant apparently did not contest the determination concerning the unpaid rent but did protest the additional assessment involving the unpaid loan. Respondent's denial of that protest led to this appeal.

Section 24348 allows a deduction for debts which become worthless within the income year. The record before us establishes that the subject \$29,000 was not advanced by appellant to Glenwood but by Barbara's mother.

1/ Appellant has failed to reconcile these amounts with the deduction claimed (\$34,744). Respondent initially made a total adjustment of \$41,619 (unpaid rent of \$12,744 plus unpaid loan of \$28,875) but has agreed to modify its assessment to reflect the amount actually deducted in the return.

### Appeal of B. J. Allen, Inc.

Accordingly, there would appear to be no requisite debtorcreditor relationship between appellant and Glenwood. (Appeal of Valley View Sanitarium and Rest Home, Inc., Cal. St. Bd. of Equal., Sept. 27, 1978.) Since the loan was not made by appellant, ordinarily any bad debt loss resulting from the loan would not be deductible by appellant. However, appellant contends that it was the quarantor of that loan and, therefore, should be entitled to deduct the sum in the year at issue. Appellant has introduced no evidence indicating that it made any payments to Barbara's mother pursuant to its quaranty, thereby incurring a loss. The rule is well established that a quarantor may not claim a bad debt deduction when he has not paid any amount to the principal creditor. Badenhausen, 7 B.T.A. 910 (1927); see also, Donald M. Perry, 49 T.C. 508 (1968).) Therefore, we must find that appellant has not established that it is entitled to a bad debt deduction for the year at issue.

For the foregoing reasons, we must sustain responent's action.

#### ORDER

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 B. J. Allen, Inc., against a proposed assessment of additional franchise tax in the amount of \$918 for the income year 1978, be and the same is hereby modified in accordance with respondent's concession. In all other respects, the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 5th day of April , 1984, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Dronenburg, Mr. Bennett and Mr. Harvey present.

Richard Nevins	_,	Chairman
Ernest J. Droncnburg, Jr.	_ ,	Member
William Il. Bennett	,	Member
Walter Harvey*	•	Member
		Member

<sup>\*</sup>For Kenneth Cory, per Government Code section 7.9