

Appeal 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**.^{1/} 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 guarantor 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.

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Accordingly, there would appear to be no requisite debtor-creditor 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 guarantor 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 guaranty, thereby incurring a loss. The rule is well established that a guarantor may not claim a bad debt deduction when he has not paid any amount to the principal creditor. (J. P. 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 respondent's action.

