

Appeal of Electric Supply Sales
Company of the Desert, Inc.

The sole issue presented in this appeal is whether appellant is entitled to an additional \$18,043 in bad debt deductions for the income year ended March 31, 1980.

Appellant is a California corporation engaged in business as an electronic equipment wholesaler. It is an accrual basis taxpayer which employs the direct charge-off method of accounting for bad debts.

On its tax return for the income year ended March 31, 1980, appellant claimed \$59,722 in bad debt deductions. Respondent initially issued a proposed assessment disallowing \$55,022 of the bad debt deductions claimed by appellant. Based on information provided by appellant, respondent revised its previous assessment and disallowed only \$18,043 of the \$59,722 bad debt deductions initially claimed by appellant.

Appellant contends that the reduction of the claimed bad debt deductions is improper because a portion of the bad debts claimed was recovered in subsequent years and included in income.

Respondent found that appellant had failed to substantiate \$18,043 of the bad debt deductions claimed. Respondent further found that appellant had failed to show that subsequent recoveries on the debts had been reported as income.

Revenue and Taxation Code section 24348, subdivision (a), provides in part that "There shall be allowed as a deduction debts which become worthless within the income year" As appellant employs the specific charge-off method for accounting for its bad debts it must first show that the debts did exist. Appellant must also show that the alleged debts became worthless during the income year ended March 31, 1980. In other words, the burden is on appellant 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. (Cittadini v. Commissioner, 139 F.2d 29 (4th Cir. 1943); Appeal of Knollwood West Convalescent Hospitals, Inc., Cal. St. Bd. of Equal., March 3, 1982.) The standard for the determination of worthlessness is an objective test of actual worthlessness. (Appeal of Parabam, Inc., Cal. St. Bd. of Equal., June 29, 1982.) The time for worthlessness must be fixed by an identifiable event or events in the year in which the deduction

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is claimed which furnish a reasonable basis for abandoning any hope of future recovery. (United States v. White Dental Mfg. Co., 274 U.S. 338 [71 L.Ed. 1120] (1927); Appeal of B & C Welding, Inc., Cal. St. Bd. of Equal., Oct. 26, 1983.)

Appellant has submitted a copy of an assignment for collection regarding the \$1,443 which Centennial Electric owed appellant. The document shows September 20, 1980, as the date of last payment. The document, itself, is dated October 15, 1981. While this is evidence that the debt existed, it does not indicate an identifiable event or show that the debt became worthless during the income year ended March 31, 1980. Rather the document indicates a payment by Centennial Electric as late as **September of 1980**. Clearly, this is evidence that the account could not have become worthless until after the period in issue.

Appellant has also submitted copies of the payment records of Wilson Electric and Philips Underground. On March 29, 1980, Philips Underground owed appellant **\$1,471.39**. The records, however, indicate a payment by Philips Underground on April 11, 1980, of **\$234.25** and on June 12, 1980, a payment of **\$1,237.14** was received. Similar records were submitted for Wilson Electric which reported an outstanding balance of **\$1,928.48** as of March 26, 1980. The entire balance was paid by Wilson Electric, however, by March 28, 1980. This evidence does not support a finding that these debts were bad debts. Both balances were in fact either paid in full or nearly paid in full by the fall of 1980. **The mere fact that an amount is owed at the end of appellant's fiscal year does, not in itself make the debt a bad debt.** We must conclude that appellant has not shown that the accounts discussed above became worthless within the income year ended March 31, 1980.

As to the remaining amount of \$13,201, appellant has submitted no evidence that these accounts became worthless during the period at issue. Furthermore, there is no evidence that appellant took steps to enforce the collection of any of these accounts during the period at issue.

Accordingly, we must sustain respondent's action.

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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 Electric Supply Sales Company of the Desert, Inc., against a proposed assessment of additional franchise tax in the amount of \$1,651 for the income year ended March 31, 1980, be and the same is hereby sustained.

Done at Sacramento, California, this 13th day of December, 1984, by the State Board of **Equalization**, with Board Members Mr. Nevins, Mr. Dronenburg, Mr. Collis, Mr. Bennett and Mr. Harvey present.

<u>Richard Nevins</u>	, Chairman
<u>Ernest J. Dronenburg, Jr.</u>	, Member
<u>Conway H. Collis</u>	, Member
<u>William M. Bennett</u>	, Member
<u>Walter Harvey*</u>	, Member

*For Kenneth Cory, per Government Code section 7.9