



Appeal of SBK Corporation, Taxpayer, and  
Baldwin Jewelers, Assumer and/or Transferee

The issue presented on appeal is whether respondent properly denied appellant's addition to its bad debt reserve for the year in question.

Appellant is a California corporation that accounts for bad debts by the reserve method. In the year at issue, appellant made an addition to its reserve of \$12,941. Subsequently, respondent recomputed appellant's bad debt reserve using the six-year moving average formula developed in Black Motor Co. v. Commissioner, 41 B.T.A. 300 (1940), affd. on other grounds, 125 F.2d 977 (6th Cir. 1942). As a result of its recomputation, respondent determined that only \$1,563 should be added to the reserve account for the year at issue. Accordingly, respondent disallowed \$11,378 of the addition which appellant had made to its reserve for bad debts. (Resp. Pr., Ex. A.)

Following respondent's ruling, appellant filed a protest in which it claimed that respondent's determination was arbitrary and had no basis in fact. In its protest, however, appellant did not present any facts in rebuttal. Accordingly, respondent affirmed its assessment and this appeal followed.

Section 24348 provides, in part: "There shall be allowed as a deduction debts which become worthless within the income year; or, in the discretion of the Franchise Tax Board, a reasonable addition to a reserve for bad debts."

Respondent's use of the six-year moving average formula of Black Motor Co. to determine if an addition to a bad debt reserve is reasonable has been approved by this board. (See, e.g., Appeal of Brighton Sand and Gravel Company, Cal. St. Bd. of Equal., Aug. 19, 1981.) Also, as we have noted in previous opinions, respondent's determination with respect to additions to a reserve for bad debts carries great weight because of the express discretion granted it by statute. Under the circumstances, the taxpayer must not only demonstrate that additions to the reserve were reasonable, but also must establish that respondent's actions in disallowing those additions were arbitrary and amounted to an abuse of discretion. (Appeal of H-B Investment, Inc., Cal. St. Bd. of Equal., June 29, 1982; Appeal of Brighton Sand and Gravel Company, supra.)

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On appeal, appellant appears to agree with the original disallowance by respondent, but merely challenges the calculation of that disallowance. (App. Ltr., June 25, 1985.) Indeed, appellant's representative offered to discuss "by phone or in person" the "proper" method of computing the reserve allowance. In spite of this offer, the record itself does not clarify or document such "proper" method. After a brief, reply brief, oral hearing, and three post-hearing memoranda by appellant, such clarification should be abundantly manifested. Unfortunately, it is not.

On the record before us, we must conclude that appellant has failed to carry its burden of proving that the addition to its bad debt reserve for the year in question was reasonable. Further, we conclude that appellant has failed to prove that respondent's assessment was arbitrary and an abuse of discretion. Accordingly, respondent's action in this matter 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 SBK Corporation, Taxpayer, and Baldwin Jewelers, Assumer and/or Transferee, against a proposed assessment of additional franchise tax in the amount of \$1,024 for the income year ended June 30, 1977, be and the same is hereby sustained.

Done at Sacramento, California, this 9th day of October, 1985, by the State Board of Equalization, with Board Members Mr. Dronenburg, Mr. Collis, Mr. Bennett, Mr. Nevins and Mr. Harvey present.

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

\*For Kenneth Cory, per Government Code section 7.9