BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
ALLEN L. AND)
JACQUELINE M. SEAMAN)

Appearances:

For Appellants: Wareham Seaman
Attorney at Law

For Respondent: Paul J. Petrozzi
Counsel

OPINION

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Jacqueline M. Seaman against proposed assessments of additional personal income tax in the amounts of $77.50 and $2,127.00 for the years 1966 and 1967, respectively; and from the action of the Franchise Tax Board on the protest of Allen L. and Jacqueline M. Seaman against a proposed assessment of additional personal income tax and a penalty in the amounts of

$493.32 and $98.66, respectively, for the year 1968. Respondent concedes that it inadvertently included all, rather than only one-half, of a long-term capital gain in Mrs. Seaman's gross income for 1.967, so that the additional tax in issue for 1967 should be $1,414.01 rather than $2,127.00.

The first question presented concerns certain bad debt deductions claimed on the 1967 and 1968 fiduciary income tax returns that were filed on behalf of a revocable trust of which Jacqueline Seaman was both grantor and sole beneficiary. On her separate returns for 1966 and 1967, and on the joint return she filed with her husband for 1968, Mrs. Seaman apparently included in her income only the amounts of trust income actually distributed to her. Respondent determined, however, that as the grantor of a revocable trust she was taxable on all of the trust's income, whether or not distributed. (Rev. & Tax. Code, §§ 17781, 17789.) Accordingly, when respondent increased the trust's income by disallowing the bad debt deductions described below, it attributed the additional income to Mrs. Seaman and asserted deficiency. assessments against her. On appeal the appellants do not contest the attribution of trust income to Mrs. Seaman, but they do dispute the disallowance of the trust's bad debt deductions.

The 1967 return filed for **the trust claimed a bad debt deduction of** $10,000.' **That aniount had been paid by checks** to one William Mondloch, as follows: two checks on May 10, 1965, in the amounts of $1,500 and $4,000, and one check'on June 2, 1965, in the amount of $4,500. In connection with the first two checks, the trust received two interest bearing notes co-signed by Mondloch and one David Jones. One note for $4,000 was dated May 3, 1965, and the other, in the amount of $1,500, was dated May 10, 1965. Both notes were payable August 31, 1965, but the trust never received payment under either one. On September 7, **1966,** Mondloch filed for bankruptcy, and he was discharged as bankrupt on May 29, 1967. The record does not reveal the financial position of David Jones at any time.

For 1968 the bad debt deduction taken by the'trust was **$9,206.24,** which was allowed by respondent to the extent of $3,500. The remaining **$5,706.24** was allegedly loaned in 1965 to Kountry Boys Auto Sales, Inc., a used car dealership owned and controlled

by William Mondloch. Appellants have submitted trust checks to Kountry Boys totaling only $4,990.50, however, and have not produced any notes or other evidences of indebtedness relating to those checks. Kountry Boys was suspended by the Secretary of State on July 3, 1967, for failure to pay its franchise taxes, and it apparently was never revived.

Section 17207 of the Revenue and Taxation Code allows a deduction for "any debt which becomes worthless within the taxable year." Respondent's regulations provide that only a bona fide debt--one which arises from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money--qualifies for purposes of section 17207. (Cal. Admin. Code, tit. 18, reg. 17207(a), subd. (3).) Initially, therefore, the appellants must establish that the alleged loans to Mondloch and Kountry Boys constituted bona fide debts. (Appeal of Estate of John M. Hiss, Sr., Deceased, and Ella N. Hiss, Cal. St. Bd. of Equal., Sept. 23, 1974.) With respect to the $4,500 check to Mondloch on June 2, 1965, and the advances to Kountry Boys, the evidence offered by appellants is wholly inadequate to prove the existence of bona fide debts. No notes relating to those transactions were produced, and the record lacks any other concrete evidence tending to prove that the putative debtors' obligation to pay was certain and actually in existence, as required for a valid debt within the meaning of the statute. (Bercaw v. Commissioner, 165 F. 2d 521, 525.)

The two May 10, 1965, advances to Mondloch in the amounts of $1,500 and $4,000 stand on somewhat different footing since the trust received promissory notes in corresponding amounts. But even assuming that these advances constituted valid debts, which respondent vigorously disputes, the appellants have the burden of establishing that the debts became worthless in the year for which they were claimed as a deduction. (Redman v. Commissioner, 155 F. 2d 319; Appeal of Cal-Russ Construction Corp., Cal. St. Bd. of Equal., Nov. 14, 1972.) The standard for the determination of worthlessness is an objective test of actual worthlessness. The time of actual worthlessness must be fixed by identifiable events which form a reasonable basis for abandoning any hopes for future recovery. The actual financial condition of the debtor, as evidenced

by some event or substantial change which adversely affects his ability to make payment, furnishes the primary test of worthlessness. (Appeal of Cal-Russ Construction Corp., supra.) In the present case, there is ample evidence concerning Mondloch's financial situation but none which shows that David Jones, who cosigned the two notes, was unable to make payment on his obligations to the trust. Consequently, appellants have failed to establish that the alleged debts of $1,500 and $4,000 became worthless in 1967 or in any other year.

The second issue raised by appellants is whether their tax liability for 1966 and 1967 may now be computed on the basis of joint returns, even though they originally filed separate returns for those years. Subject to certain limitations, spouses who have filed separate returns for a particular taxable year may later file a joint return for that year and have their liability determined on that basis. (Rev. & Tax. Code, § 18410 et seq.) They may not file such a joint return, however, for any year with respect to which either of the spouses has protested a notice of deficiency. (Rev. & Tax. Code, § 18410.2, subd. (b).) Therefore, since Mrs. Seaman protested the deficiencies against her for 1966 and 1967, respondent has refused to permit the appellants to file joint returns for those years. Appellants contend, however, for the reasons enumerated below, that respondent is estopped from denying them the right to file jointly.

According to appellants' representative, respondent began aninquiry in October 1968 into attributing all of the trust income to Mrs. Seaman. Thereafter, the representative orally advised one of respondent's auditors that if respondent took that action, the appellants would then file joint returns in order to prevent any increased tax liability, The auditor agreed that joint returns would have that effect, but he did not indicate that respondent's future actions would be in any way affected by this consideration. Nonetheless, appellants' representative apparently concluded that respondent would drop the matter. Thus, when respondent later questioned the trust's bad debt deductions without mentioning the attribution of income issue, appellants' representative seemingly believed that any resulting increase in the trust's income would not be taxed to Mrs. Seaman. It appears that this belief

persisted until respondent issued the deficiency assessments now in dispute, and that no attempt was made to file joint returns until after the deficiencies were protested. Based on the events related above, the appellants argue that they cannot now be denied the right to substitute joint returns for the separate returns they filed for 1.966 and 1967.

As a general rule, an estoppel will be applied against the government in a tax case only where the facts clearly establish that grave injustice would otherwise result. (Appeal of Willard S. Schwabe, Cal. St. Bd. of Equal., Feb. 19, 1974; California Cigarette Concessions, Inc. v. City of Los Angeles, 53 Cal. 2d 865, 869 [3 Cal. Rptr. 675, 350 P. 2d 715].) Four conditions must be satisfied before the estoppel doctrine can be applicable: the party to be estopped must be apprised of the facts; the other party must be ignorant of the true state of the facts; the party to be estopped must have intended that its conduct be acted upon, or so act that the other party had a right to believe that it was so intended; and the other party must rely on the conduct to his injury. (California Cigarette Concessions, Inc. v. City of Los Angeles, supra; City of Long Beach v. Mansell, 3 Cal 3d 462, 489 [91 Cal. Rptr. 23, 476 P. 2d 423].) In virtually every respect, the facts relied upon by the appellants fail to meet this test. There is no showing of a state of facts known to respondent but unknown to appellants; there is no evidence that respondent intended by any of its actions to induce appellants not to file joint returns, or that appellants had a right to believe that, such was respondent's intent; and appellants were not injured by any conduct on the part of respondent, since appellants' right to file jointly was terminated solely by Mrs. Seaman's own action in protesting the deficiencies against her. Even after the issuance of those deficiencies, appellants could have obtained the result they seek by promptly filing joint returns and paying the deficiencies without protest. (Rev. & Tax. Code, §§ 18410-18410.2.) Under these circumstances we fail to perceive any basis for applying the doctrine of equitable estoppel against respondent.

The last issue presented concerns the propriety of the late filing penalty imposed on appellants for 1968. There is no dispute that appellants' 1968 joint return was filed more than three months late; the only question is whether the penalty for such late filing is excused because, in the words of the statute, it was "due

to reasonable cause and not due to willful neglect. " (Rev. & Tax. Code, § 18681.) Appellants contend that there was "reasonable cause" for their delinquency because Allen Seaman was hospitalized with an illness and was unable to sign a timely return. Although illness may constitute "reasonable cause" if it can be shown that the taxpayer was prevented from filing a timely return because of it (John Michael Hayes, T. C. Memo.', April 17, 1967), appellants have offered no evidence to show that the circumstances of Mr. Seaman's illness were such as to prevent either the preparation or signing of a timely return. Moreover, appellants could have filed a timely joint return even if Allen Seaman had been unable to sign it. (See Joyce Primrose Lane, 26 T. C. 405; Hamilton D. -Hill, T. C. Memo. , June 1, 1971.) Accordingly, we must conclude that appellants have not shown the "reasonable cause" that is required to excuse the late filing penalty imposed by section 18681.

ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

Appeal of Allen L. and Jacqueline M. Seaman

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Jacqueline M. Seaman against 'proposed assessments of additional personal income tax in the amounts of $77.50 and $2,127.00 for the years 1966 and 1967, respectively, and on the protest of Allen L. and Jacqueline M. Seaman against a proposed assessment of additional personal income tax and a penalty in the amounts of $493.32 and $98.66, respectively, for the year 1968, be and the same is hereby modified in accordance with respondent's concession regarding the additional tax for 1967. In all other respects the action of the Franchise Tax Board is hereby sustained.

Done at Sacramento, California, this 16th day of December, 1975, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____ Member

ATTEST: _____, Executive Secretary