

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
A.F.B. INVESTMENT COMPANY, INC.)

Appearances:

For Appellant: John J. Sullivan  
President

For Respondent: Kathleen M. Morris  
Counsel

O P I N I O N

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of A.F.B. Investment Company, Inc., against a proposed assessment of additional franchise tax in the amount of **\$7,804.89** for the income year ended September 30, 1970.

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The issue presented is **whether** respondent properly disallowed certain bad debt deductions claimed by appellant for the income year in question.

Appellant is a California corporation **engaged** in the real estate development business. Appellant's representative on appeal, Mr. John J. Sullivan, **became** the sole **shareholder** and president **of** appellant in December 1969.

On February 10, 1969, Redwood Builders Service, Inc. (hereafter Redwood) assigned two notes receivable to appellant in exchange for the cancellation **of** Redwood's indebtedness to appellant in the amount of \$97,137. The indebtedness represented the total of various cash advances which appellant had made to Redwood since 1964. No schedule for repayment of the advances had been established by the parties, and no interest had been charged or paid on the advances. As of the date of cancellation of the indebtedness, Redwood had made only one \$3,000 repayment of the advances.

The two notes receivable acquired by appellant from Redwood had **a** combined face value of \$111,500. The **smaller** of the two notes had a face value of \$52,500 and had been executed in December 1967 by the Blue Chip **Motel Company** (hereafter Blue Chip). The note was initially payable to Mr. Blain, the president of Blue Chip, within five **years** of its execution. However, Mr. Blain assigned the note to Redwood in 1968. The record on appeal is not clear concerning the financial condition of Blue Chip during 1968 through 1970. The primary assets of Blue Chip prior to those years were a bowling alley located in Delano, California and a resort located in **Plumas County**, California. Blue Chip sold the resort in 1968, and **any** interest which Blue Chip had in the Delano bowling **alley** was apparently lost in January 1969 as a result of **foreclosure** proceedings initiated by the holder of a first trust deed on the property. Blue Chip ceased doing business sometime in 1970.

The other note acquired by appellant from Redwood had a **face** value of \$59,000. The note had been executed in December 1967 by a Mr. Eidson to secure the purchase **price** of an interest in the Delano bowling alley mentioned above. The note was initially payable to Mr. Blain, the president of Blue Chip, and provided that Mr. Eidson was not personally liable for the obligation thereby created. The note was secured by a deed of trust on the Delano bowling alley. **Mr.** Blain assigned the note to Redwood in 1968.

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Appellant never received any of the payments due on the Blue Chip and Eidson notes. On its return for the income year ended September 30, 1970, appellant claimed bad debt deductions in the total amount of \$111,500, representing the combined face value of the two notes. Respondent disallowed the bad debt deductions on the ground that appellant failed to prove the debts became worthless in the year claimed.

Section 24348 of the Revenue and Taxation Code permits the deduction of "debts which become worthless within the income year." However, the burden is upon the taxpayer to establish by objective standards that the debt for which a deduction is claimed had value at the beginning of the year of deduction, and that the debt became worthless within the year of deduction. (Appeal of Jordan Associates, Inc., Taxpayer, and Edmund F. Schnieders, Assumer and/or Transferee, Cal. St. Bd. of Equal., April 4, Kuhn Enterprises, Inc., Cal. St. Bd. of Equal., Aug. 3, 1965.) A bad debt deduction may not be allowed for a particular year if the debt became worthless in a prior year. (Appeal of Real Estate Buy Keller, Cal. St. Bd. of Equal., Nov. 13, 1973.)

The record on appeal contains no objective evidence that the debts represented by the Blue Chip and Eidson notes had value at the beginning of the income year in question. To the contrary, the record indicates that the notes were worthless at or near the time they were acquired by appellant. While the record is unclear as to the exact nature of the security underlying the Eidson note, it seems apparent that appellant had no recourse to the security once it had been lost in January 1969 by foreclosure of the first trust deed. With respect to the Blue Chip note, appellant has failed to present any concrete evidence that Blue Chip was financially able to satisfy the obligation evidenced by the note prior to the beginning of the income year in question.

Accordingly, it is our opinion that respondent's action in this matter was proper and 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 A.F.B. Investment Company, Inc., against a proposed assessment of additional franchise tax in the amount of \$7,804.89 for the income year ended September 30, 1970, be and the same is hereby sustained.

Done at Sacramento, California, this 16th day of August , 1977, by the State Board of Equalization.

William L. Bennett Chairman  
John E. [unclear] , Member  
[unclear] , Member  
Geoffrey [unclear] , Member  
[unclear] , Member