BEFORE TBE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )
)
MYRON E. AND DAISY I. MILLER )

For Appellants: J. G. Smith
Certified Public Accountant

For Respondent: Jacqueline W. Martins
Counsel

## O P I N I O N

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 Myron E. and Daisy I. Miller against proposed assessments of additional personal income tax in the amounts of $356.54, $381.50 and $5,879.60 for the years 1973, 1974 and 1975, respectively.

The issues for determination are: (1) Whether appellants have met their burden of proving that certain bad debts were deductible as claimed in 1975; and (2) Whether appellants were entitled to the deductions claimed in 1973, 19'74 and 1975 for losses incurred in their son's business.

Appellants are longtime residents of Placerville, California, where they owned and operated the Phillips 66 distributorship. In 1975 appellants sold the distributorship and claimed a deductionin the amount of $16,993.00 for bad debts relating to the distributorship. As the result of an audit respondent discovered that debts in the amount of only $1,374.00 had been assigned to collection agencies. Appellants had made no apparent effort, other than to mail an occasional statement, to collect on the other debts, some of which had originated as early as 1963. Appellants stated that, since Placerville was a small town, they did not press their debtors when they were having a hard time. Respondent disallowed all the bad debt deductions claimed for 1975 except for the $1,374.00 assigned for collection. Thereafter, appellants submitted schedules itemizing certain debts which, they contend, should have been allowed as deductions for 1973, 1974 and 1975. Appellants, however, have offered no reasons why they believe these debts became worthless in the years scheduled.

In 1968 appellants' son Gary opened a beauty shop in Placerville which he operated as a sole proprietor with five beautician-employees. Appellants stated that Gary operated the beauty shop in a negligent manner, continually failing to pay suppliers for merchandise. As a result of the mismanagement, the shop's creditors complained to appellants. In order to keep the shop operating for her son's benefit, Mrs. Miller assumed the management of the beauty shop in 1969. She paid all the bills and kept all the necessary records. Many of the bills, such as the shop rent, were actually paid with appellants' own funds. However, Gary continued to treat the business as his own, withdrawing funds as wages, ordering supplies and scheduling appointments. Each of the beauticians retained 60 percent of the receipts generated as compensation while Gary retained the balance. For 1973, 1974 and 1975, appellants claimed losses from the operation of the beauty shop in the amounts of $9,869.00, $10,963.00 and $13,205.00, respectively. It is appellants' position that without their contributions to the beauty shop their distributorship would not have prospered as well as it did. Respondent disallowed all the claimed loss deductions.

Respondent made certain other adjustments to appellants' 19'75 return. However, appellants have conceded the

propriety of these adjustments and they are not at issue in this appeal.

The first issue concerns the propriety of appellants' bad debt deduction claimed for 1975.

Section 17207 of the Revenue and Taxation Code provides for the deduction of any debt which becomes worthless during the taxable year. In order to be entitled to a bad debt deduction, the taxpayer has the burden to establish that the debt had some intrinsic or potential value at the beginning of the year and that it became worthless in the taxable year in question. (Redman v. Commissioner, 155 F.2d 319 (1st Cir. 1946); Appeal of Jordan Associates, Inc., Cal. St. Bd. of Equal., April 24, 1967.)

In the present appeal appellants have submitted two schedules listing accounts payable, the date of the last charge and the date of the last payment on the account. No information concerning the debtors' financial condition or ability to pay has been offered. Furthermore, no apparent effort has ever been made to collect these accounts other than mailing an occasional statement to the debtor. Mere nonpayment of a debt does not prove its worthlessness and the taxpayers failure to take reasonable steps to enforce collection of the debt, regardless of the motive for the failure, does not justify a bad debt deduction unless there is proof that those steps would have been futile. (Earl v. Perry, 22 T.C. 968 (1954); A. Finkenberg's Sons, Inc., 17 T.C. 973 (1951).) Under the circumstances we must conclude that appellants have failed to carry their burden of proving the deductibility of the bad debts-disallowed by respondent.

The final issue concerns the deductibility of the losses incurred in the business of appellants' son during 1973, 1974 and 1975.

In the case of an individual, section 17206 of the Revenue and Taxation Code provides for the deduction of a loss not compensated for by insurance that is incurred in carrying on a trade or business, is incurred in a transaction entered into for profit, or results from a casualty. One of the requirements which must be met for the allowance of a loss deduction is that the loss be sustained by the taxpayer. Deductions for losses are confined to the taxpayers sustaining them. They are personal to them and not transferable or usable by others. (Cf. New Colonial Ice Co. v. Helvering, 292 U.S. 435 [78 L. Ed. 1348] (1934); Glasgow Village Development Corp., 36 T.C. 691, 702 (1961).) The taxpayer must own or have an

interest in the property with respect to which he is claiming the deduction of a loss. (William H. Albers, 33 B.T.A. 373 (1935).) A voluntary payment of the obligation of another does not result in a deductible loss. (A. Guirlani & Bro., Inc. v. Commissioner, 119 F.2d 852, 875 (9th Cir. 1941); see also, Alexander & Baldwin, Ltd. v. Kanne, 190 F.2d 153 (9th Cir. 1951).)

Since the losses incurred in the operation of the beauty shop did not result from a casualty, in order to be deductible they must be either losses incurred in the taxpayers' trade or business or in a transaction entered into for profit. However, it is evident from the record that appellants cannot claim the deductions as losses arising from a trade or business or from transactions entered into for profit since they owned no interest in the beauty shop. The only reason appellants paid the bills and helped with the bookkeeping was for the benefit of their son. Although appellants suggest that without their contributions to the operation of the beauty shop their distributorship would not have prospered as well as it did, there is no evidence to support this position. Accordingly, we must conclude that appellants' payments of the beauty shop expenses were voluntarily made, solely for the benefit of their son. Therefore, respondent's action in disallowing the loss deductions claimed by appellants for the years 1973, 1974 and 1975 was correct and must be sustained.

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,

Appeal of Myron E. and Daisy I. Miller

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 Myron E. and Daisy I. Miller against proposed **assessments of** additional personal income tax in the amounts of $356.54, $381.50 and **$5,879.60** for the years 1973, 1974 and 1975, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 28th day of June, 1979, by the State Board of Equalization.

, Chairman

, Member

, Member

, Member

, Member