BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) No. 84A-1224-SW
CONSTANCE Y. CHUNG)

Appearances:

For Appellant: Manny Flekman
Certified Public Accountant

For Respondent: Israel Rogers
Supervising Counsel

O P I N I O N

This appeal is made pursuant to section 18593 1/ of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Constance Y. Chung against a proposed assessment of additional personal income tax in the amount of $5,587 for the year 1980.

1/ Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the year in issue.

The issue presented in this appeal is whether appellant has shown that she is entitled to a bad debt deduction.

Appellant's sister established a business which was incorporated in 1978 under the name of Mimi Barron, Inc. When this corporation borrowed $45,000 from the Bank of America, a condition of the loan required a guarantor. Appellant, who is a television newscaster, cosigned and guaranteed the loan. The business failed and appellant, as guarantor, was required to pay $50,788 in principal and interest in satisfaction of her liability. Appellant's sister filed in bankruptcy on May 11, 1981, but appellant's claim was not paid.

On her California income tax return for 1980, appellant claimed a business bad debt deduction for $50,788. Respondent denied the deduction, taking the position that appellant had not met her burden of proof in showing entitlement to the deduction.

Appellant contends that when the guarantee was executed, her sister assigned to her certain shares of IBM stock in consideration. for her signing as guarantor. The IBM stock was to be purchased under appellant's brother-in-law's profit sharing plan over the subsequent year. Appellant did not, however, receive the promised IBM shares.

Initially, we note that irrespective of whether the debt is characterized as a business debt or a non-business debt, no deduction can be granted unless the debt is a bona fide debt. Section 17207 provides that a deduction will be allowed for any debt which becomes worthless within the taxable year. The provisions of section 17207 are substantially the same as section.166 of the Internal Revenue Code. It is well settled in California that when state statutes are patterned after federal legislation on the same subject, the interpretation and effect given the federal provisions by the federal courts and administrative bodies are relevant in determining the proper construction of the California statutes. (Andrews v. Franchise Tax Board, 275 Cal.App.2d 653, 658 [80 Cal.Rptr. 403] (1969).)

Section 166 of the Internal Revenue Code is further clarified in Treasury Regulation § 1.166-9(e)(1), which provides:

> (e) Special Rules--(1) Reasonable consideration required. Treatment as a worthless debt of a payment made by a taxpayer in discharge of part or all of the taxpayer's agreement to act as a guarantor, endorser, or indemnitor of an obligation is allowed only if the taxpayer demonstrates that reasonable consideration was received for entering into the agreement. For purposes of this paragraph (e)(1), reasonable consideration is not limited to direct consideration in the form of cash or property. Thus, where a taxpayer can demonstrate that the agreement was given without direct consideration in the form of cash or property but in accordance with normal business practice or for a good faith business purpose, worthless debt treatment is allowed with respect to a payment in discharge of part or all of the agreement if the conditions of this section are met. However, consideration received from a taxpayer's spouse or any individual listed in section 152(a) must be direct consideration in the form of cash or property.

Internal Revenue Code section 152(a)(3) defines a "sister" as a person **includible** under this section.

In this situation, appellant guaranteed a loan for her sister so that she could start a new business. There is no evidence, however, that appellant received any reasonable consideration for this obligation. While appellant has stated that her sister assigned her certain shares of **IBM** stock, there is no support for this contention. The stock, which was to be purchased in the near future, apparently was sold by appellant's sister and brother-in-law sometime between 1978 and 1981 without appellant's consent. This action in itself is evidence that no assignment was ever con&mated. Appellant did produce a letter from her sister indicating that an assignment should be made, but only if the sister were to die and appellant had to pay as guarantor. We must conclude that even if an assignment was made, it was made not as consideration for appellant serving as guarantor but to reimburse appellant if she was forced to pay as the guarantor of the debt. For tax purposes, therefore, the amounts advanced must be **classified** as a "gift" which does not qualify as a debt'under section 17207.

. We finally note that because loans to relatives are carefully scrutinized, appellant must not only show that the guarantee was made for reasonable consideration, but must also show that it was evidenced by a note or made at a time when the borrower was solvent. (See **Hauser** v. Commissioner, ¶ 60,162 T.C.M. (P-H) (1960); Freer v. Commissioner, ¶ 78,282 T.C.M. (P-H) (1978); Constantin v. Commissioner, ¶ 66,027 T.C.M. (P-H) (1966); Tanner v. Commissioner, ¶ 62,123 T.C.M. (P-H) **(1962).)** There is no evidence that a note was given or that at the time the guarantee was made appellant's sister was in a sound financial situation.

For the reasons discussed above, the action of respondent must be sustained.

Appeal of Constance Y. Chung

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 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Constance Y. Chung against a proposed assessment of additional personal income tax in the amount of $5,587 for the year 1980, be and the same is hereby sustained.

Done at Sacramento, California, this 6th day of May, 1986, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Collis, Mr. Bennett, Mr. Dronenburg and Mr. Harvey present.

Richard Nevins, Chairman

William M. Bennett, Member

Walter Harvey*, Member

_____, Member

_____, Member

*For Kenneth Cory, per Government Code section 7.9