

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
MERCHANTS FURNITURE WAREHOUSE) No. **84A-1009-SW**
OF LONG BEACH, 'INC.)

For Appellant: Barry Potechin
Representative

For Respondent: Bill Heir
Counsel

O P I N I O N

This appeal is made pursuant to section **25666^{1/}** of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Merchants Furniture Warehouse of Long Beach, Inc., against a proposed assessment of additional franchise tax in the amount of \$2,286 for the income year ended May 31, 1981.

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

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The issue presented in this appeal is whether appellant has shown that a worthless debt deduction in the amount of \$46,798 is proper for the income year ended May 31, 1981.

Appellant was a corporation that experienced insolvency in 1981. On its California franchise tax return for the year ended May 31, 1981, it claimed a bad debt deduction for \$46,798. Upon audit, respondent requested additional substantiation of this deduction. Based on the information received, the amounts were substantiated except for **\$40,978.69**, which involved the trade accounts of **Avanti**, Sam Lopez Enterprises, Our Very Own, and Gils Custom Frame. When respondent affirmed its assessment, appellant filed this timely appeal.

Appellant concedes that its books **and** records were not adequately maintained once it could not afford to keep its bookkeeper; however, it contends that the debts all became worthless during the period in issue.

Section 24348, subdivision (a), provides that a corporate taxpayer may deduct all debts which become worthless within the income year. Deductions, however, are a matter of legislative grace and the burden is on appellant to prove that it is entitled to such deduction. (New Colonial Ice Co. v. Helvering, 292 U.S. 435 [78 L.Ed. 1348] (1934); Mayes v. Commissioner, 21 T.C. 286 (1953).)

Initially, we note that section 24348 is substantially identical to section 166 of the Internal Revenue Code of 1954. Accordingly, federal case law is highly persuasive in interpreting the California statute. (Rihn v. Franchise Tax Board, 131 **Cal.App.2d** 356, 360 [280 p.2d 893] (1955).)

In order to be entitled to a deduction for a bad debt, appellant must demonstrate that the debt became totally **worthless** during the income year. Whether a debt is totally worthless within a particular year is a question of fact. (Perry v. Commissioner, 22 T.C. 968 (1954); Mellen v. Commissioner, ¶ 68,094 **T.C.M.** (P-H) (1968).) The burden is on appellant to prove that the debt for which the deduction is claimed had some value at the beginning of the year in which the deduction is claimed, and that it became worthless during that year. (Cittadini v. Commissioner, 139 **F.2d** 29 (4th Cir. 1943); Appeal of Knollwood West Convalescent Hospitals, Inc.,

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Cal. St. Bd. of Equal., Mar. 3, 1982.) The standard for the determination of worthlessness is an objective test of actual worthlessness. (Appeal of Parabam, Inc., Cal. St. Bd. of Equal., June 29, 1982.) The time for worthlessness must be fixed by an identifiable event or events in the period in which the deduction is claimed which furnish a reasonable basis for abandoning any hope of future recovery. (United States v. White Dental Mfg. Co., 274 U.S. 398 [71 L.Ed. 1120] (1927); Appeal of B & C Welding, Inc., Cal. St. Bd. of Equal., Oct. 26, 1983.)

The facts available indicate that the debt owed by **Avanti** did not become worthless during the year in issue. **Avanti** had a fire in 1979 and closed its business. Appellant contends that this debt was not written off sooner because of assurances from **Avanti** personnel that once the **insurance** money **was** received, the proceeds would be used to pay appellant. Appellant **did** not, therefore, write off the debt until it ceased its own operations. We further note that **Avanti** did not file for bankruptcy until 1982. In sum, the evidence does not support a finding that any of the debt was worthless at the end of the period in issue. There is, in fact, evidence to support a finding that the debt did not become worthless until the bankruptcy court acted.

As to the debt owed by Sam Lopez Enterprises, appellant's own records indicate that the debt was written off in May of 1980. Appellant asserts that this date is incorrect but has not submitted any evidence to show that the debt became worthless during the income year in question.

With respect to the debt owed by Our Very Own, appellant has submitted evidence that this debtor filed for bankruptcy in 1979. No other evidence was submitted as to the action taken by the bankruptcy court on any claims which may have been submitted by appellant. As in the case of Sam Lopez Enterprises, appellant has not met its burden of showing that the debt became worthless in the period at issue.

Finally, the evidence shows that Gils Custom Frame was discharged in bankruptcy on April 19, 1980, which is before the period in issue. The fact that appellant did not become aware of this fact until it began its 1981 fiscal year is immaterial. A debt must be deducted in the income year in which it becomes worthless.

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Because appellant has failed to show that the debts owed by the four companies discussed above became worthless during the income year ended May 31, 1981, the action of respondent 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 Merchants Furniture Warehouse of Long Beach, Inc., against a proposed assessment of additional franchise tax in the amount of \$2,286 for the income year ended May 31, 1981, be and the same is hereby sustained.

Done at Sacramento, California, this 10th day of June , 1986, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Collis, Mr. Bennett, Mr. Dronenburg and Mr. Harvey present.

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

*For Kenneth Cory, per Government Code section 7.9