

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)  
WALKER & LEE, INC. ) No. 84A-962-SW  
)

For Appeilant: Jack S. McClam  
Vice President  
Great Western Financial  
Corporation

For Respondent: Patricia I. Hart  
Counsel

O P I N I O N

This appeal is made pursuant to section 25666<sup>1/</sup> of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Walker & Lee, Inc., against a proposed assessment of additional franchise tax in the amount of \$28,031 for the income year -1976.

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 sole issue presented in this appeal is whether appellant has shown its entitlement to a bad debt deduction taken during the 1976 income year.

Appellant is a California corporation which uses an accrual method of accounting. Since its incorporation in 1958, appellant has been primarily engaged in the operation of a real estate brokerage firm both within and without the state.

In 1972, appellant incorporated an Oregon subsidiary under the name of Wildlife Safari, Inc. (Wildlife), and acquired an 80-percent interest in it. Wildlife's purpose was to develop a planned community which was to be centered around a wild animal park. The first phase of the project was the completion and functional **operation** of a wild animal park, and this phase had been completed in 1971.

The second phase of the project was to be the **development** of a campground, golf course, motels, restaurants, condominiums, apartments, and single family homes. Appellant was to be directly involved in this phase of the project. **The** second phase was never started.

Wildlife, in pursuit of this **project**, made numerous land acquisitions. The **financing** for these purchases consisted of small loans from various sources and one **large** loan from First **National** Bank of Oregon. As a condition of these loans, appellant was required to guarantee **payment** in the event Wildlife was unable to make its payments.

In 1974, Frank Hart, a former president of appellant, became the manager of the wild animal park. **The** park had been operating at a loss, and Hart **was** hopeful that under his management the park would become profitable. **But** by the **end** of 1975, Wildlife was still operating at a loss. Consequently, the board of **directors** decided to liquidate Wildlife. At this time a group of investors proposed to purchase appellant's interest in the park. Appellant agreed to the sale; however, **before** the National Bank of Oregon would refinance its loans in favor of the new investors, appellant was obligated to remain as guarantor of all the obligations incurred prior to the transfer.

At the end of the 1976 income year, Wildlife, although still operational, was still operating at a

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loss. Appellant determined its advances to Wildlife to be worthless and wrote off the loss. Respondent audited appellant's tax returns for income years 1976 through 1978 and concluded that there was insufficient evidence to substantiate the worthlessness, during the 1976 income **year**, of the advances made to Wildlife. A notice of proposed assessment was issued and, after a hearing, the assessment was affirmed. This affirmation was followed by appellant's timely appeal.

Respondent determined that the advances should not have been considered to be bad debts in 1976 because notes in appellant's 1977 and 1978 financial statements indicated the possibility of collection on the advances made to Wildlife. It further found that Wildlife remained operational, did not file for bankruptcy **or** reorganization, and continued to make payments on its other **obligations**. **Furthermore**, there was no **identifiable** event that established the debt **as** worthless during 1976.

Appellant considered the advances to be worthless because (1) **wildlife had only losses since its inception**; (2) Wildlife was heavily in debt; (3) appellant was subordinated to Wildlife's other creditors; (4) the land was **allegedly** declining in value; and (5) Wildlife's liabilities exceeded its assets by the end of 1976.

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

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(1954); Mellen v. Commissioner, ¶ 68,094 T.C.M. (P-Y (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., 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.)

Appellant, in support of its position, has stated that the account receivable from Wildlife was not written off until its board received the financial statements for Wildlife for the period ended June 30, 1976. At this time, appellant realized that Wildlife would again be unprofitable in spite of Hart's prediction that a profit could be realized. Appellant contends that it then exercised sound business judgment and wrote off a debt for which there was no prospect of being paid. We cannot agree. The facts indicate that Wildlife had not filed for bankruptcy or reorganization or ceased its operations during the period in issue. Rather, it remained operational and continued to make payments on its other obligations. As late as 1975, private investors considered it financially sound enough to invest their money into the business. None of these investors were writing off Wildlife's obligations. There is also evidence that in 1981 and 1982, Wildlife had a positive net worth. These facts lead us to conclude that Wildlife's debt to appellant would have been at least partially collectible had appellant made some effort to obtain payment. It is evident that Wildlife was not a profit-making business during the period in issue; however, appellant has not met its burden of showing that the debt had become wholly worthless during 1976. For the foregoing reason, we must sustain respondent's action.

