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2023 – OTA – 336
Nonprecedential

OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **B. PATEL AND** **S. PATEL**	OTA Case No. 20076372

OPINION

Representing the Parties:

For Appellants:	Wendy Abkin, Attorney Andrew D. Allen, Attorney B. Patel
For Respondent:	David Hunter, Tax Counsel IV Marguerite Mosnier, Tax Counsel V
For Office of Tax Appeals:	David Kowalczyk, Tax Counsel

H. LE, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19045, B. Patel and S. Patel (appellants) appeal an action by respondent Franchise Tax Board (FTB) proposing additional tax, plus applicable interest, of $345,531 for the 2013 tax year, $631,947 for the 2014 tax year, and $240,367 for the 2015 tax year.

Office of Tax Appeals (OTA) Administrative Law Judges Huy "Mike" Le, Sara A. Hosey, and Josh Lambert held an oral hearing for this matter in Sacramento, California, on February 21, 2023. At the conclusion of the hearing, OTA closed the record and submitted this matter for an opinion.

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ISSUE

Whether appellants have established that they are entitled to claim a business bad debt deduction for the 2013 tax year.[1]

FACTUAL FINDINGS

Background

1. B. Patel (appellant-husband) was in the business of real estate development and hotel ownership and management.
2. Signet Solar, Inc. (Signet) was initially formed as Signet Solar, LLC on September 13, 2006.
3. Appellant-husband, P. Goel, and R. Lahri founded Signet to raise funds for Signet Solar Gmbh, which was Signet's wholly owned subsidiary.
4. Signet Solar Gmbh designed, developed, manufactured, and marketed thin silicon film photovoltaic modules.
5. Appellant-husband was a director on Signet's Board of Directors. Appellant-husband was not Signet's employee and was not involved in Signet's day-to-day operations.
6. Appellant-husband initially invested $1,000,000 in Signet. Appellant-husband owned 1,000,000 shares of series A stock, 22,978,330 shares of common stock, and 63,635 warrants.

Appellant-Husband's Bad Debts with Signet

7. In July 2007, Bank of America provided Signet with a $15,000,000 line of credit and appellant-husband, P. Goel, and R. Lahri guaranteed the line of credit.[2]

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[1] Appellants concede that $950,000 of their claimed $7,998,294 business bad debt deduction was nonbusiness bad debt. Appellants have not provided arguments and also appear to concede the $35,077 of advances appellants made to Signet Solar, Inc. (Signet) for insurance premiums and employee compensation. Accordingly, this Opinion will analyze the remaining $7,013,217 ($7,998,294 - $950,000 - 35,077) of appellants' business bad debt deduction, which is appellants' payments towards Signet's line of credit with Bank of America. In addition, both parties agree that a determination regarding the claimed business bad debt deduction for the 2013 tax year will resolve the NOL carryover adjustments made for the 2014 and 2015 tax years. Thus, OTA will not separately analyze NOL carryovers.

[2] Both parties agree that appellant-husband was a guarantor, or essentially equivalent to a guarantor, to Bank of America.

8. In 2009, Bank of America increased Signet's line of credit to $16,500,000. Appellant-husband was responsible for $7,000,000 of Signet's outstanding debt with Bank of America.
9. In January 2010, Signet had drawn down the entire $16,500,000 line of credit with Bank of America.
10. In June 2010, Signet ceased operations and Signet Solar Gmbh commenced insolvency proceedings.
11. By November 5, 2010, appellant-husband remitted $7,013,217 towards Signet's outstanding debt with Bank of America.
12. In 2012, Signet filed for bankruptcy in the United States. Appellant-husband was a creditor in the bankruptcy proceedings. Appellant-husband claimed that Signet was indebted to appellant-husband for $7,998,294, which included $7,013,217 for payments appellant-husband remitted for Signet's line of credit with Bank of America.

Procedural History

13. Appellants filed a 2013 California Resident Income Tax Return. Appellants reported a $7,998,294 loss related to Signet.
14. FTB issued a Notice of Proposed Assessment (NPA) for the 2013 tax year, proposing to increase appellants' taxable income by reclassifying appellants' $7,998,294 business bad debt deduction as nonbusiness bad debt, among other adjustments.
15. FTB issued NPAs for the 2014 and 2015 tax years, proposing to deny appellants' respective $5,080,576 and $1,541,218 NOL carryovers based on FTB's adjustments for the 2013 tax year.
16. FTB subsequently issued Notices of Action affirming the NPAs for the 2013, 2014, and 2015 tax years.
17. Thereafter, appellants timely filed this appeal.

DISCUSSION

FTB's determinations are generally presumed correct, and the taxpayer bears the burden of proving otherwise. (*Appeal of Vardell*, 2020-OTA-190P.) Income tax deductions are a matter of legislative grace, and a taxpayer who claims a deduction has the burden of proving entitlement to that deduction. (*Ibid*.) The applicable standard of proof is by a preponderance of the

evidence. (Cal. Code Regs., tit. 18, § 30219(c).) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Appeal of Vardell*, *supra*.)

California conforms to Internal Revenue Code (IRC) section 166, except as otherwise provided. (R&TC, § 17201(a).) IRC section 166(a)(1) provides a deduction for any debt which becomes worthless within the taxable year. However, the IRC distinguishes between business bad debts and nonbusiness bad debts. (IRC, § 166(d); Treas. Reg. § 1.166-5(b).) A nonbusiness bad debt is a debt other than: (A) a debt created or acquired (as the case may be) in connection with a trade or business of the taxpayer; or (B) a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business. (IRC, § 166(d)(2).) A nonbusiness bad debt shall be treated as a short-term capital loss if the debt becomes entirely worthless during the year it is claimed. (IRC, § 166(d)(1).)

A business bad debt deduction is unavailable unless the taxpayer can establish that (1) he or she was engaged in a trade or business, and (2) the acquisition or worthlessness of the debt was "proximately related" to the conduct of such trade or business. (*Harsha v. U.S.* (10th Cir. 1979) 590 F.2d 884, 886; Treas. Reg. § 1.166-5.)

A guarantee is "proximately related" to a taxpayer's trade or business based on the taxpayer's dominant motivation for providing the loan or becoming a guarantor at the time of the loan or guaranty rather than the date upon which a payment in discharge is made. (*U. S. v. Generes* (1972) 405 U.S. 93, 104; *Weber v. Commissioner*, T.C. Memo. 1994-341.) The taxpayer's dominant motivation must be trade or business related, as opposed to investment related. (*Putoma Corp. v. Commissioner* (1976) 66 T.C. 652.) The taxpayer's motive is investment related when the taxpayer aims to increase or protect the value of the taxpayer's stock in the debtor corporation. (*Whipple v. Commissioner* (1963) 373 U.S. 193, 202.) A taxpayer's dominant motivation can be determined by examining how the taxpayer would have benefited from the loan or guarantee had the loan not gone bad. (*Smartt v. Commissioner*, T.C. Memo. 1993-65.) The taxpayer's dominant motive is identified by examining the objective facts rather than subjective intent. (*Weber v. Commissioner*, *supra*.)

Here, appellant-husband was the guarantor for Signet's line of credit with Bank of America. Appellant-husband remitted $7,013,217 in satisfaction of Signet's line of credit with Bank of America. The parties do not dispute that this debt became entirely worthless in 2013. The issue in this appeal is whether this debt was business or nonbusiness bad debt. Appellant-

husband's trade or business was hotel and real estate development when he became the guarantor for Signet's line of credit with Bank of America. Accordingly, appellants must establish that this bad debt was proximately related to appellants' hotel and real estate development business.

Appellants argue that appellant-husband's dominant motivation in guaranteeing Signet's line of credit with Bank of America was to protect his relationship with Bank of America and his ability to obtain financing from Bank of America for his hotel and real estate development business. In support of this argument, appellants only offer appellant-husband's declaration and testimony. However, appellant-husband's testimony establishes, at best, a tenuous connection between the Signet line of credit with Bank of America and appellants' hotel and real estate development business. Appellant-husband testified that if Signet succeeds, Bank of America would succeed, which would then provide appellant-husband with good credibility with Bank of America, and then appellant-husband would use this good credibility to obtain more financing for his hotel and real estate development business. This testimony, however, is contradicted by appellants' representative's prior statement during audit that the dominant motivation was investment related: "[Appellant-husband] agreed to be a guarantor of the Loan in order to facilitate Signet's profitable performance, which would have accrued eventually to his own benefit and profit as a shareholder." Notably, the record contains no documentation or statements from Bank of America or other evidence to prove appellants' argument. Thus, OTA finds that appellants have not established by the preponderance of the evidence that appellant-husband's dominant motivation for becoming a guarantor on Signet's line of credit with Bank of America was to finance his hotel and real estate development business.

Appellants also argue that since the value of the guarantee far exceeded the value of their investment in Signet, this suggests their dominant motive was not to protect their investment in Signet. In support of their argument, appellants cite to *Litwin v. U.S.* (10th Cir. 1993) 983 F.2d 997 and *Estate of Allen v. Commissioner*, T.C. Memo. 1982-303. However, although appellants invested $1,000,000 in Signet, appellants have not established the value of their investment at the time appellant-husband made the guarantee in 2007. In addition, this is only one of several factors the courts in *Litwin* and the *Estate of Allen* used to determine a taxpayer's dominant motivation. The determination of the taxpayer's dominant motive is identified by examining all of the objective facts surrounding the transaction. (*Weber v. Commissioner*, *supra*.)

Finally, if Signet's line of credit with Bank of America had not gone bad, Signet's stock would have increased in value. This indicates that appellant-husband's dominant motivation for guaranteeing Signet's line of credit with Bank of America was for investment purposes.

Therefore, appellants have not established that the debt related to Signet's line of credit with Bank of America was a business bad debt.

HOLDING

Appellants have not established that they are entitled to claim a business bad debt deduction for the 2013 tax year. Based on the disallowance of appellants' business bad debt for the 2013 tax year, FTB properly denied NOL carryovers for the 2014 and 2015 tax years.

DISPOSITION

OTA sustains FTB's actions in full.

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Huy "Mike" Le
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Huy "Mike" Le
Administrative Law Judge

We concur:

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Sara A Hosey
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Sara A. Hosey
Administrative Law Judge

DocuSigned by:
Josh Lambert
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Josh Lambert
Administrative Law Judge

Date Issued: 5/22/2023