

Appeal of Fred and Barbara Baumgartner

Appellants reside in Los Angeles, California, where Mr. Baumgartner is employed by Pan American World Airways. On the dates indicated they made the following advances to the individuals listed:

<u>Date</u>	<u>Name</u>	<u>Amount</u>
12-20-62	George Kuehner	\$2,510.65
2-15-67	Michael Schwandtner	5,045.00
3-15-67	Albert Maier	506.65
7-24-67	Michael Schwandtner	2,006.65
1-22-68	Albert Maier	1,004.30
1-10-69	George Kuehner	6,262.75
	Total	\$17,336.00

The three recipients are personal friends of appellants who own and operate small farms in Germany. All of the transfers were effected by bank draft sent via registered mail. No other writings were made contemporaneously with the advances and no repayment schedule was ever established. No payments of principal or interest have ever been made on any of the advances, nor have appellants ever made demands for such payments.

In the course of an audit of appellants' 1969 tax return, respondent determined that a computational error had resulted in an underpayment of tax in the amount of \$3,869.43. Respondent issued a notice of proposed assessment in that amount. Appellants protested, asserting for the first time that the above mentioned advances constituted business debts which became worthless in 1969. Although they had not claimed a bad debt deduction on their original 1969 tax return, appellants claimed the debts were properly deductible in 1969 and should therefore be offset against the proposed assessment. At the same time appellants attempted to claim as a deduction the cost of a trip to Germany in the summer of 1969, allegedly made for the purpose of attempting to enforce payment on these advances.

Respondent's refusal to allow the deduction of either of the above items resulted in this appeal. Appellants do not dispute respondent's initial calculation of the proposed deficiency. Their sole dispute is with respondent's refusal to allow the alleged bad debt and travel expense deductions as an offset against the deficiency.

Appeal of Fred and Barbara Baumgartner

We turn first to the question of whether appellants were entitled to a bad debt deduction for the year 1969.

Section 17207, subdivision (a)(1), of the Revenue and Taxation Code provides:

There shall be allowed as a deduction any debt which becomes worthless within the taxable year;...

This section is the counterpart of section 166 of the Internal Revenue Code of 1954. Two tests must be satisfied in order for the taxpayer to take a bad debt deduction. First, a bona fide debt must exist. (Cal. Admin. Code, tit. 18, reg. 17207(a), subd. (3).) Secondly, the debt must have become worthless in the taxable year for which the deduction is claimed. (Redman v. Commissioner, 155 F.2d 319; Appeal of Grace Bros. Brewing Co., Cal. St. Bd. of Equal., June 28, 1966; Appeal of Isadore Teacher, Cal. St. Bd. of Equal., April 4, 1961.) The taxpayer has the burden of proving that both of these tests have been satisfied. (Appeal of Andrew J. and Frances Rands, Cal. St. Bd. of Equal., Nov. 6, 1967.)

A bona fide debt is a debt which arises from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money. (Cal. Admin. Code, tit. 18, reg. 17207(a), subd. (3).) In view of the absence of any notes or other evidence of indebtedness, the lack of any repayment schedule and the fact that no payments of principal or interest were ever received by appellants, we have serious doubts as to whether valid debts existed. Assuming without deciding, however, that bona fide debts did exist, we next focus on the question of whether appellants have established that the debts became worthless in 1969.

Whether a debt has become worthless in a given year is to be determined by objective standards. (Redman v. Commissioner, supra; Appeal of Cree L. and June A. Wilder, Cal. St. Bd. of Equal., Sept. 15, 1958.) No deduction may be allowed for a Particular year if the debt became worthless before or after that year: (Redman v. Commissioner, supra.) To satisfy their burden, therefore, appellants must show that the alleged debts had value at the beginning of the taxable year (W. A. Dallmever, 14 T.C. 1282, 1291), and

Appeal of Fred and Barbara Baumgartner

that some identifiable event occurred during 1969 which formed a reasonable basis for abandoning any hope that the debts would be paid. sometime in the future.. (Bruce V. Green, T.C. Memo, -, April 22, 1976; Appeal of Samuel and Ruth Reisman, Cal. St. Bd. of Equal..., March 22, 1971; Appeal of George H. and G. G. Williamson, Cal. St. Bd. of Equal., April 24, 1967.)

In the present case, appellants. **have** provided no evidence that establishes **1969** as the year in which the alleged debts became worthless. The only event that appellants describe that took place in 1969 is their trip to Germany. While in Germany they became aware of the long standing existence of prior creditors' liens on their friends' farms.. At most, this establishes that appellants ascertained the worthlessness of these alleged debts in **1969**, not that the debts became worthless in 1969. In our opinion., appellants have failed to establish that the alleged debts became worthless in 1969. Respondent's action in denying the bad debt deduction was therefore correct.

The next **issue**. to be decided is whether appellants are entitled to deduct the cost of their trip to Germany **in 1969**. Section 17252 of the Revenue and Taxation Code allows a deduction **for** " ..ordinary and necessary expenses paid or incurred.., (a) For the production or collection of income; . . ."

Appellants have made no attempt to explain why they believe the cost of the trip was an ordinary and necessary expense for the collection of **these** alleged debts, and the facts before us do not support such a conclusion. It certainly was not necessary for appellants to go personally to Germany in order for their friends to inform them that **the** farms were subject to the liens of prior creditors. Nor is it ordinary practice to travel to Germany to **collect** payment on a debt before any demand for payment has been made, especially when a payment schedule **has** never been set up. Furthermore, appellants' failure to demand some payment from their **friends** while they were in Germany is inconsistent with the alleged purpose for the trip. Under the **circumstances**, we cannot conclude that the cost of the trip to Germany was an ordinary and necessary expense incurred for the production or collection of income. Respondent's disallowance of the travel expense deduction was therefore proper.

Appeal of Fred and Barbara Baumgartner

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 Fred and Barbara Baumgartner against a proposed assessment of additional personal income tax in the amount of **\$3,869.43** for the year 1969, be and the same **is** hereby sustained.

Done at Sacramento, California, this 6th day of October, 1976, by the State Board of **Equalization**.

William W. Reynolds, Chairman
George R. Jones, Member
Philip Lee, Member
_____, Member
_____, Member

ATTEST: *W. W. Reynolds*, Executive Secretary