STATE BOARD OF EQUALIZATION

June 25, 1965

--- --- ---
--- --- ---
--- --- ---

Gentlemen:

The claim for refund of the above-named taxpayer was not as simple and straight forward as we had at first supposed. Because of the large amount of the refund, I felt it necessary to investigate with various state agencies respecting the corporation's status. While we feel that on the basis of the argument presented at the preliminary hearing the corporation may be entitled to a part of the bad debt claimed, we must recommend, for other reasons, that the claim be denied.

We obtained from the Corporations Commissioner's office a balance sheet of the taxpayer dated June 30, 1961. Their chief assets at this time were their accounts receivable. These amounted to $266,848.97; inventory was $18,722.43, cash on hand was $9,513.97 and fixed assets were $12,350.96. We believe it is clear from this that the taxpayer did not pay off "X"'s note in full by transferring its assets. The assets other than the notes and accounts receivable were insufficient. We feel this explains why "A" did not return the note to the taxpayer.

However this may be, it would seem on the authority of Putnam v. Commissioner (1956) 352 U.S. 82, the taxpayer might have claimed a bad debt deduction to the extent that it paid "A" and was subrogated to its rights. We cannot recommend a refund even to this extent however, for two reasons.

Section 6055 of the California Sales and Use Tax Law requires the accounts to be charged off for income tax purposes. In checking the taxpayer's franchise tax return for the fiscal year ended April 30, 1962, we find no bad debt loss was taken. By taxpayer we are, of course, referring to "Y". The joint return of "C" showed the bad debt loss in question. Even if "C" was the sole stockholder of the corporation, this would be erroneous. In fact, "C" was not the sole owner. Both the application to the Corporations Commissioner for permit to issue stock and the corporation's franchise tax return indicate that "C" held no more than 50 percent ownership in the corporation. A "Z" and a "W" are listed as each entitled to a one-fourth interest in the corporation in the application for a permit to issue stock. This application was verified by "C".

The Secretary of State informs us that the corporation was suspended for nonpayment of franchise taxes on January 4, 1965. A suspended corporation is under a disability from exercising its corporate powers, rights and privileges by Revenue and Taxation Code Section 23301. Accordingly, it cannot maintain its claim for refund before the Board during the period of suspension.

The above are our reasons for recommending to the Board that the claim be denied. It may be the defects can be remedied and a bad debt allowed to the corporation to the extent of assets transferred to "A".

The views expressed above are the position of the staff and if you disagree with them, your recourse is to appear before the Board at an oral hearing. Please let me know within 30 days whether you will attempt amendment of the franchise tax return to claim a bad debt loss and obtain a Certificate of Revivor under Revenue and Taxation Code Section 23301, which will cure the defects we have noted. If you disagree with our conclusion and wish to appear before the Board, please let us know this within 30 days so that we may make the necessary arrangements. Board hearings are held monthly in Sacramento.

Very truly yours,

John H. Knowles
Associate Tax Counsel

JHK:cw [1b]