L 9 (12-64)

Income Tax Determinations
A-Z

BUREAU OF LAW

MEMORANDUM Moonelis, Edgar H.

TO: Commissioners Murphy, Palestin & MacDuff

FROM: Solomon Sies, Hearing Officer

SUBJECT: EDGAR H. MOONELIS

1951 Assessment No. AA-[illegible]416
1952 Assessment No. AA-[illegible]417

Article 16

A hearing with reference to the above matter was held before me at 80 Centre Street, New York, N.Y. on September 18, 1963. The appearances and the evidence produced were as shown in the stenographic minutes and exhibits submitted herewith.

The issues involved herein are: (1) timeliness in the filing of the applications for revision or refund; (2) the disallowance of the deduction claimed for "loss on loans and advances" in the sum of $4,125.00 for the year 1951; and (3) disallowance of expenses in excess of reimbursement for the year 1951 and disallowance of a portion of business expenses for the year 1952.

The assessments for the years 1951 and 1952 were issued on March 8, 1955 and are based on the taxpayer's failure to furnish information requested in office letter of December 28, 1954 which taxpayer claims he did not receive. However, the taxpayer's accountant wrote the Department on March 15, 1955 protesting the assessments which was acknowledged by the Department and letter was sent on July 13, 1955 requesting the accountant and the taxpayer to contact the New York office for the purpose of submitting information requested. The taxpayer and his accountant did not comply with the request but testified that IT-113's were mailed on January 15, 1956. However, a search of the records failed to disclose receipt of said forms.

I am of the opinion that the letter of the taxpayer's representative protesting the assessments within one year from the date of the issuance thereof, constituted a timely application for revision or refund in accordance with Section 376 of the Tax Law.

On his 1951 return, the taxpayer deducted the sum of $4,125.00 as "loans and advances to Aswell Brief Press, Inc.--not recovered." In addition, the taxpayer also claimed a capital loss of $5,000.00 representing 50 shares of stock owned in Aswell Brief Press, Inc., which corporation was discharged in bankruptcy in August, 1951. Aswell Brief Press, Inc. filed a petition in bankruptcy in the United States District Court for the Southern District of New York on October 2, 1948. It appears that the taxpayer was an employee, officer and stockholder of Aswell Brief Press, Inc.

The taxpayer's representative stated at the hearing on December 16, 1963 (Minutes of Hearing, Page 19) that the taxpayer "made personal guaranties to a number of creditors and as a result of such guaranties he advanced the monies to the corporation who in turn satisfied these guaranties which were made by Mr. Mochelis." The taxpayer's representative further stated that Axwell Brief Press Inc. began business in 1946 (Minutes of Hearing, Page 21). The taxpayer subsequently submitted an affidavit in which he claimed that the "loans were made directly by creditors but guaranteed by my wife and me personally during years 1943-1947--National Bronx Bank ($4,000.00) and M.S. Keller, Esq. ($2,500.00). That the corporation was in fair financial condition and during years 1943-1947 partially paid me the loans so I could repay National Bronx Bank $1,000.00 and M.S. Keller $500.00. This reduced the indebtedness to $5,000.00 and when the corporation went into bankruptcy in 1951, I started to personally repay the loans because of my guaranties. I settled these obligations for $4,125.00." The taxpayer has failed to furnish details regarding the alleged "guaranties" although he was afforded ample opportunity to do so.

In order to claim a deduction of a bad debt for income tax purposes, the taxpayer has the burden of proving: (a) that the debt was a bona fide obligation; (b) that it became worthless; (c) that its worthlessness was ascertained in the taxable year in which it was sought to be charged off.

In the case of Mather v. C.I.R., 149 F 2d 393, certiorari denied 326 U.S. 767, 66 S. Ct. 169, 90 L. Ed. 463, it was held that where one attempts to deduct as bad debts amounts which he has paid as endorser or guarantor, it must be shown that he was legally bound to pay.

In the case of U.S. v. Goldblatt Bros., 188 F 2d 776, cert. denied, 317 U.S. 662, 87 L. Ed. 532, 63 S. Ct. 63, it was held that the right to claim a deduction for income tax purposes is a statutory privilege and in order to have the benefit of the deduction, the taxpayer had the burden of proving that the debt was a bona fide obligation and that it became worthless in the tax year in question.

In the case of Kniepp v. Burnet, 283 U.S. 140, 75 L. Ed. 911, 51 S. Ct. 373, it was held that a taxpayer cannot deduct, as "debt ascertained to be worthless and charged off within the taxable year," the amount of a note given in settlement of his liability as an endorser of a corporation's notes.

In the case of Zimmerman v. U.S., 318 F. 2d 611, it was held that only 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 qualifies for a bad debt deduction on income.

In the case of Pasbella's Estate v. C.I.R., 310 F 2d 815, it was held that a law partnership, which paid notes as a guarantor of the indebtedness of a cleaning corporation, was merely an accom-

modation maker, thereby obtaining a claim against the corporation and that non-payment of the claim gave rise to a non-business bad debt deductible by the law partnership only in the year during which the debt became worthless.

In the case of Markle v. Commissioner, 7 T.C. 1273, it was held that a loan to a debtor so insolvent that the debt is worthless when acquired cannot give rise to a non-business bad debt.

The U.S. Supreme Court, in the case of Putnam v. Commissioner, 352 U.S. 82, 1 L. Ed. 2d, 147, 77 S. Ct. 175, stated on pp. 87 and 88:

> "The familiar rule is that, instanter upon the payment by the guarantor of the debt, the debtor's obligation to the creditor becomes an obligation to the guarantor, not a new debt, but by subrogation, the result of a shift of the original debt from the creditor to the guarantor who steps into the creditor's shoes. Thus, the loss sustained by the guarantor unable to recover from the debtor is by its very nature a loss from the worthlessness of a debt. This has been consistently recognized in the administrative and the judicial construction of the Internal Revenue laws which, until the decisions of the Courts of Appeals in conflict with the decision below, have always treated guarantors' losses as bad debt losses. The Congress recently confirmed this treatment in the Internal Revenue Code of 1954 by providing that a payment by a noncorporate taxpayer in discharge of his obligation as guarantor of certain noncorporate obligations shall be treated as a debt."

And again at pp. 88 and 89, further stated:

> "Under the doctrine of subrogation, payment by the guarantor, as we have seen, is treated not as creating a new debt and extinguishing the original debt, but as preserving the original debt and merely substituting the guarantor for the creditor. The reality of the situation is that the debt is an asset of full value in the creditor's hands because backed by the guaranty. The debtor is usually not able to reimburse the guarantor and in such cases that value is lost at the instant that the guarantor pays the creditor. But that this instant is also the instant when the guarantor acquires the debtor cannot obscure the fact that the debt 'becomes' worthless in his hands."

In the case of Boehm v. Hoe, 326 U.S. 287, it was held that the taxpayer has the burden of establishing that a claimed deductible loss was sustained in the taxable year. To the same effect, see Burnet v. Houston, 283 U.S. 223, 227.

I am, therefore, of the opinion that the taxpayer has failed to establish that the deduction claimed as a "bad debt" was a bona fide obligation and that it became worthless during the taxable year of 1951 in accordance with subdivision 7 of Section 360 of the Tax Law and Article 161 of the Personal Income Tax Regulations.

The taxpayer was a sales representative for several firms during the years 1951 and 1952. During the year 1951, his gross commission income amounted to $9,930.13 and he deducted traveling expenses in the sum of $6,131.95 of which he was reimbursed to the extent of $3,835.00 from one of the principals, Steinhardt Novelty Co. The taxpayer reported commission income for 1952 in the sum of $10,088.86 and deducted expenses of $7,043.95, no part of which he claims was reimbursed by any of the firms who he represented.

The taxpayer was requested to explain in detail the basis for the reimbursement by one of the principals whom he represented, namely, Steinhardt Novelty Co., in 1951; also to indicate what portion of the expenses listed in his return was reimbursed; the basis for the reimbursement; why taxpayer was not reimbursed in 1952 upon the same conditions that existed in 1951. The taxpayer was also requested to submit a complete breakdown covering the various categories of expenses with substantiation of same. In addition, the taxpayer was requested to submit proof that the expenses claimed by him were ordinary and necessary in connection with his sales activities. The taxpayer submitted an affidavit in which he indicated that in 1951 he was employed solely by Steinhardt and received $75.00 per week expense allowance in addition to his salary; that "This practice relating to expenses was discontinued by Steinhardt at the end of 1951 whereupon I requested and received permission to handle other non-competitive lines (a usual practice for traveling salesmen). In 1952, I worked for three firms, Steinhardt, Friedman and Tiny Tot, Inc. I received no expense reimbursement from Steinhardt in 1952."

In the case of Commissioner v. Flowers, 326 U.S. 465, the Court stated, at page 470:

> "Three conditions must thus be satisfied before a traveling expense deduction may be made under Sect. 23 (a) (1) (A):
>
> (1) The expense must be a reasonable and necessary traveling expense, as that term is generally understood. This includes such items as transportation fares and food and lodging expenses incurred while traveling.
>
> (2) The expense must be incurred while away from home.
>
> (3) The expense must be incurred in pursuit of business. This means that there must be a direct connection between the carrying on of the trade or business of the taxpayer or of his employer. Moreover, such an expenditure must be

necessary or appropriate to the development and pursuit of the business or trade.

Whether particular expenditures fulfill these three conditions so as to entitle a taxpayer to a deduction is purely a question of fact in most instances. See Commissioner v. Heininger, 320 U.S. 467, 475".

In Norton's "Law of Federal Income Taxation," Volume 4, at Page 260, Sect. 25.90, it is stated:

"As in case of business expenses generally, the burden is upon the taxpayer to prove that entertainment expenditures constitute ordinary and necessary expenses.** Of course, no entertainment expenditure will be deductible if the taxpayer is reimbursed, or there is an obligation to reimburse the taxpayer."

And again at page 262, it is further stated:

"Failure to show any itemization or corroborative evidence of the expenditures may result in full or partial disallowance."

In the case of Arthur L. Elkin, 20 T.C.M. 1657, at page 1660, the Tax Court said:

"With respect to the deduction in issue, the burden rests with the petitioner to establish that the claimed expenses were actually paid and were both ordinary and necessary to petitioner's business. Interstate Transit Lines v. Commissioner (43-1 U.S. T.C. ¶ 9468), 319 U.S. 590, 593; Deputy v. DuPont 308 U.S. 488, 493."

I am of the opinion that the taxpayer has failed to establish that the portion of business expenses disallowed by the Income Tax Bureau for the years 1951 and 1952 were ordinary and necessary in accordance with the intent and meaning of subdivision 1, Section 360 of the Tax Law. The statement of the taxpayer in his affidavit to the effect that he only represented Steinhardt Novelty Co. during the year 1951 is erroneous. He reported commissions from other principals on Item #29 of page 2 of his return for said year in the sum of $4,440.13. During the year 1952, the condition was the same; in other words, the taxpayer represented three (3) principals. It was incumbent upon the taxpayer to fully explain the arrangement or agreement with Steinhardt Novelty Co. regarding the reimbursement of expenses. Although the taxpayer's representative stated at one of the hearings (Minutes of Hearing, page 26) that he had substantially all of the vouchers, cancelled checks, traveling expenses, etc. for the years 1951 and 1952, he never offered them in

evidence although asked to submit a breakdown of said expenses. It is to be noted that this is not a question involving the complete disallowance of business expenses. The Income Tax Bureau only disallowed the expenses for both years in excess of the amount for which the taxpayer was reimbursed during the year 1951.

For the reasons stated above, I recommend that the determination of the Tax Commission in the above matter be substantially in the form submitted herewith.

SOLOMON SIES

MAY 25 1965 (Oct. 22, 1965)

Hearing Officer

/s/ MARTIN SCHAPIRO

Approved

/s/ E. H. BEST

Approved

STATE OF NEW YORK

STATE TAX COMMISSION

IN THE MATTER OF THE APPLICATION

OF

EDGAR H. MOONELIS

FOR REVISION OR REFUND OF PERSONAL INCOME TAXES UNDER ARTICLE 16 OF THE TAX LAW FOR THE YEARS 1951 AND 1952.

Edgar H. Moonelis, the taxpayer herein, having filed timely applications for revision or refund of personal income taxes under Article 16 of the Tax Law for the years 1951 and 1952 and a hearing having been held in connection therewith at the office of the State Tax Commission, 80 Centre Street, New York, N.Y. on September 12, 1963 before Solomon Sies, Hearing Officer of the Department of Taxation and Finance, at which hearing the taxpayer appeared personally and was represented by Ben S. Agren, C. P. A. of the accounting firm of Agren, Lehman & Co. and the record having been duly examined and considered,

The State Tax Commission hereby finds:

(1) That the taxpayer filed income tax returns for the years 1951 and 1952 reporting commission income as a sales representative; that in 1951 he reported salary income from Steinhardt Novelty Co. as a salesman in the sum of $5,490.00; that on page 2 of said return he reported commissions earned as salesman for principals other than Steinhardt Novelty Co. in the sum of $4,440.13; that he further deducted as business expenses in connection with the production of income the sum of $6,131.95 and indicated that he was reimbursed for expenses by Steinhardt Novelty Co. to the extent of $3,385.00; that the taxpayer deducted at Item 31d "Loans and advances to Aswell Brief Bress Inc.--not recovered, $4,125.00;" that for the year 1952, the taxpayer reported commission income from Steinhardt Novelty Co. Inc. and two other principals aggregating the sum of $10,088.86 and deducted expenses in the sum of $7,043.95, no part of which he claimed was reim-

bursed by any of the firms whom he represented; that on March 8, 1955, the Department of Taxation and Finance issued additional assessments against the taxpayer for the years 1951 and 1952 (Assessment Nos. AA-834416 and AA-834417, respectively) disallowing the deduction of $4,125.00 for loss on loans and advances to Aswell Brief Press Co, Inc. and further disallowing a portion of business expenses in the sum of $2,296.95 for 1951 and $3,300.00 for the year 1952 because of the failure of the taxpayer to furnish information as requested.

(2) That the taxpayer was an officer, stockholder and employee of Aswell Brief Press Co. Inc. during the year 1948 and prior thereto; that Aswell Brief Press Co. Inc. filed a petition in bankruptcy in the United States District Court, Southern District of New York on October 2, 1948 and was discharged in bankruptcy in August, 1951; that the representative for the taxpayer stated at the hearing (Minutes of Hearing, Page 19) that the taxpayer "made personal guaranties to a number of creditors and as a result of such guaranties he advanced the monies to the corporation who in turn satisfied these guaranties which were made by Mr. Mocnelis"; that the taxpayer's representative further stated that Aswell Brief Press Co. Inc. began business in 1946 (Minutes of Hearing, Page 21); that the taxpayer submitted an affidavit in which he claimed that the "loans were made directly by creditors but guarantied by my wife and me personally during years 1943-1947--National Bronx Bank ($4,000.00) and M.S. Heller, Esq. ($2,500.00). That the corporation was in fair financial condition and during years 1943-1947 partially paid me the loans so I could repay National Bronx Bank $1,000.00 and M.S. Heller $500.00. This reduced the indebtedness to $5,000.00 and when the corporation went into bankruptcy in 1951, I started to personally repay the loans because of my guaranties. I settled these obligations for $4,125.00."

(3) That the taxpayer has failed to establish that the sum of $4,125.00 claimed as a "bad debt loss" actually represented a bona fide obligation which subsequently became worthless and that it was ascertained to be worthless and required to be charged off in the year 1951 in accordance with the intent and meaning of subdivision 7,

Section 360 of the Tax Law and Article 161 of the Personal Income Tax Regulations.

(4) That the taxpayer has failed to satisfactorily explain the basis of the reimbursement of traveling expenses and why it was necessary to incur additional expenses; that he has failed to establish that the portion of the expenses disallowed by the Department of Taxation and Finance for the years 1951 and 1952 constituted ordinary and necessary expenses.

Based upon the foregoing findings and all of the evidence presented herein, the State Tax Commission hereby

DETERMINES:

(A) That the disallowances of a portion of business expenses claimed by the taxpayer in the sum of $2,296.95 for 1951 and in the sum of $3,300.00 for the year 1952 were proper since they were not shown to be ordinary and necessary for the production of gross income by the taxpayer in accordance with subdivision 1, Section 360 of the Tax Law and Article 118 of the Personal Income Tax Regulations.

(B) That the deduction by the taxpayer in the sum of $4,125.00 for the year 1951 did not constitute a proper deduction as a worthless debt ascertained to be worthless and required to be charged off within the taxable year 1951 in accordance with Finding #3 above and within the intent and meaning of subdivision 7 of Section 360 of the Tax Law and Article 161 of the Personal Income Tax Regulations.

(C) That, accordingly, the additional taxes assessed against the taxpayer for the years 1951 and 1952 (Assessment Nos. AA-834416, AA-834417, respectively) are correct; that said assessments do not include any tax or other charge which could not have been lawfully demanded and that the taxpayer's applications for revision or refund with respect thereto be and the same are hereby denied.

DATED: Albany, New York, on the 19th day of November , 1965.

STATE TAX COMMISSION

/s/ JOSEPH H. MURPHY
President

/s/ IRA J. PALESTIN
Commissioner

James F. Macdonald
Commissioner