

M e m o r a n d u m**130.0100**

3039 Bad-debt deduction where compromise-payment is made on behalf of debtor.

To: Headquarters – Petition Unit

Date: October 18, 1966

From: Tax Counsel (GAT) - Headquarters

This is in reply to the memorandum which you submitted to Mr. E.H. Stetson on July 22, 1966, regarding the claim for refund of sales tax filed by ---, receiver in bankruptcy, on behalf of ---.

It is our understanding that prior to 1962, --- made taxable sales of tangible personal property to ---. --- reported tax on these sales measured by gross receipts totaling \$612,579.44. The tax amounted to \$24503.18. --- made no payments on these sales to ---.

In September of 1962, ---, principal officer and stockholder in ---, together with --- (his wife) executed a guaranty of payment of the --- account in favor of ---.

On November 5, 1963, --- executed an assignment to --- of its share of the proceeds due to --- from a construction contract in which it was a joint venturer with ---.

In 1964, --- went through receivership under Chapter XI of the Bankruptcy Act. Mr. --- was appointed receiver of ---'s assets and made a demand on ---'s payment of the amount due to ---. He also made a demand of --- and --- as guarantors of the debt. --- determined that ---'s liabilities exceeded its assets, that ---'s interest in the joint venture contract was worthless, and that the --- were financially unable to pay the amount of the guaranty.

Apparently, in order to protect its interest in the joint venture by preventing --- from going into bankruptcy, --- offered to compromise the debt by paying --- \$87,500 together with a payment of \$12,500 from the --- in consideration of --- transferring its claims against --- to ---. Pursuant to the recommendation of the receiver and ---'s creditors' committee, the offer of compromise was approved by the bankruptcy court.

On June 30, 1965 subsequent to the court approval of the compromise, ---'s receiver filed a federal income tax return in which the ---'s debt was deducted as a bad-debt loss. The receiver then filed a claim for refund of sales tax totaling \$24,503.18.

The audit staff has recommended disallowance of the claim for refund on the grounds that --- did not suffer a bad-debt loss on account of this transaction, but rather merely sold the ---'s account receivable at a discount to --- and ---.

Although the court order approving the compromise speaks of the transaction in terms of an account receivable to --- and --- and the ---'s for \$100,000, it appears to us that the amount was paid by --- and the ---'s merely for the purpose of extinguishing claims which might otherwise endanger the financial position of the ---. If the statements appearing in the receiver's application for leave to compromise and the court's order are accepted as being true and correct, the account receivable was only worth the amount which the ---'s, as guarantors, would be able to pay and all that --- gained from --- was assurance that the claim would be extinguished. There is no indication in the documents which have been examined that --- expect to collect anything from ---.

In view of the foregoing, to the extent that the difference between the original debt and the \$100,00 paid by the ---'s and --- represents the selling price of tangible personal property sold to --- on which --- has reported tax, it is our opinion that it represents a bad-debt loss. Accordingly, we would recommend that the claim for refund be granted upon verification of the selling price of the goods sold to --- and the amounts paid by the ---'s and --- and --- which are attributable to such sales.

GAT:md

cc: --- - Subdistrict Administrator