

**Internal Revenue Service  
Small Business and Self-Employed**

**Department of the Treasury**

Date: August 30, 2010

Donald R. Signer  
[REDACTED]  
Fremont CA 94539

Taxpayer Identification Number:  
[REDACTED]

Form:  
1040

Tax Period(s) Ended and Claim Amount:  
December 31, 2005      \$99,112.00

Date Claim Received:  
April 20, 2009

Person to Contact:  
[REDACTED]

Contact Telephone Number:  
510-[REDACTED]

Employee Identification Number:  
[REDACTED]

Last date to Respond to this Letter:  
September 29, 2010

Dear Donald R. Signer:

We examined your claim and propose:

- Partial disallowance, as shown in the enclosed examination report. If you accept our findings, please sign and return the enclosed Form 2297, *Waiver Form* and Form 3363, *Acceptance Form*.
- Full disallowance, as shown in the enclosed examination report or at the end of this letter. If you accept our findings, please sign and return the enclosed Form 2297, *Waiver Form* and Form 3363, *Acceptance Form*.
- Full disallowance with additional tax due, as shown in the enclosed examination report. If you accept our findings, please sign and return the enclosed Form 2297, *Waiver Form* and the examination report.

*Note: If your claim involves a joint return, both taxpayers must sign the form(s).*

If you are a "C" Corporation filer, Section 6621(c) of the Internal Revenue Code provides for an interest rate 2% higher than the standard interest rate on deficiencies of \$100,000 or more.

If you don't agree with our findings, you may request a meeting or telephone conference with the supervisor of the person identified in the heading of this letter. If you still don't agree with our findings, we recommend that you request a conference with our Appeals Office. If you request a conference, we will forward your request to the Appeals Office and they will contact you to schedule an appointment.

If the proposed change to tax is:

- \$25,000 or less for *each* referenced tax period; you may send us a letter requesting Appeals consideration, indicating what you don't agree with and the reasons why you don't agree.
- More than \$25,000 for *any* referenced tax period; you must submit a formal protest.

The requirements for filing a formal protest are explained in the enclosed Publication 3498, *The Examination Process*. Publication 3498 also includes information on your *Rights as a Taxpayer* and the *IRS Collection Process*.

If you don't respond by the date shown in the heading of this letter, we will process your case based on the adjustments shown in the enclosed examination report or the explanations given at the end of this letter.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter. Thank you for your cooperation.

Sincerely yours,

A large black rectangular redaction box covers the signature of the Internal Revenue Agent.

Internal Revenue Agent

Enclosures:

- Examination Report  
Form 2297
- Form 3363  
Publication 3498
- Envelope

Taxpayer Name: Signer, Donald R.  
 TIN: [REDACTED]  
 Tax Form: 1040  
 Tax Year (s): 200512

Examiner: [REDACTED]  
 Date: 6/15/2010, 7/27/10

### 401- Claim for Bad Debt

Tax Period	Per Return	Per Exam	Adjustment	Reference
200512	.00	.00	.00	

**Conclusion:** *(Reflects the final determination on the issue.)*

The Tax Year 2005 claim for the Bad Debt deduction was disallowed. It has been determined that (1) a business bad debt, per "Dominant Motive," (2) had become worthless through various factors and by "De Facto Dissolution," (3) in 1995, when an "Identifiable Event" of worthlessness had been "ascertained by the taxpayer."

*The following techniques are not intended to be all-inclusive nor are they mandatory steps to be followed. Judgment should be used in selecting the techniques that apply to each taxpayer.*

**Audit Steps:** *(Document audit steps taken or to be taken.)*

**Workpaper Reference**

1. Review prior agent lead sheets and case file.	401-1
2. Review taxpayer's rebuttal.	401-2
3. Interview taxpayer on issue.	125-2
4. Review loan documents and payment substantiation.	401-3
5. Research court cases and determine factors of bad debt vs. losses.	401-4
6. Review court cases cited by taxpayer.	650
7. Research other court cases and issues that may apply.	401-5
8. Review of GM "Operating Report" and LIFO valuation	401-6
9. Determine timing of the bad debt, consider ownership in corporation and authorization of payments.	401-7
10. Determine adjustment of previous audit.	401-8
11. Apply facts to research and respective IRC sections.	401-1

**Facts:** *(Document the relevant facts.)*

The taxpayer filed a claim for reconsideration of the adjustments made by prior auditor for the 2005 bad debt deduction disallowance. The taxpayer provided documentation showing the agreement between Motor Holding and Donald Signer Buick, Inc. regarding the consulting agreement. As a precaution Motor Holdings asked for an indemnification letter from the taxpayer relinquishing them from any future tax liability from the consulting arrangement. The mention of the agreement was not in the minutes, but the documents were kept in the books as "Action by Board of Directors by Written Consent".

The loans made by the shareholder, Donald Signer, to Don Signer Buick, Inc were for operating expenses and for the acquisition of automobiles as per flooring arrangements. There was no security attached to the notes that the taxpayer and the corporation had drafted, the taxpayer has shown that his intentions were for the production of income.

The loans were made by the taxpayer to the corporation as a hybrid of flooring and acquisition loans for operating capital. The taxpayer got into the agreement because he had additional personal capital from his income from the corporation to loan back into the corporation. Taxpayer figured why should he be paying the auto financier's interest when he would be paying himself the interest with additional capital the taxpayer did not readily need. The notes were on demand notes with an interest rate that fluctuated with the flooring interest rates for a set determinable amount of money. The dates were unclear on The annual interest due was reported on the taxpayer's 1040 and reinvested in the Corporation.

The loans were created from 1986 through 1990 and made when there was still enough capital in the Corporation to pay off the loans. The taxpayer was able to show that sufficient capital through financial reports generated showing LIFO reserves for cars that would be recognized. The tax returns do not

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## 401- Claim for Bad Debt

### Government's Position:

It is the Government's position that the deduction per the amended return filed is not allowable. The Government has concluded that the debt **(I)** was a business bad debt that **(II)** had become worthless in **(III)** 1995 when Donald Signer Buick, Inc. had ceased being a business.

**(I) Existence and Character of Debt:** *Did the debt exist and what was the character of the debt?*  
(ref. Lead Sheet 500)

It is the Government's positions that the debt did exist and that it was in fact a business bad debt. It has also been determined that the taxpayer had the dominant motive that the loans were business related and not personal. Although the taxpayer was not in the business of loaning money, we can see that the Corporation had need for working capital to keep doing business and thereby protecting the taxpayer's employment.

**(II) Fact of Worthlessness:** *Was the debt in fact worthless?*  
(ref. Lead Sheet 501)

It is the Government's position that the loans to Don Signer Buick, Inc did, in fact, become worthless. To determine worthlessness we must see **1)** how worthlessness is defined, **2)** factors that should be considered, and **3)** the evaluation of relevant factors. Based on Reg. 1.166-2(a) with the support of judicial authority, the determination worthlessness are evidenced by factors **(a)** debtor's financial reserves, **(b)** insolvency, **(c)** lack of assets, **(d)** bankruptcy and **(e)** receivership, while also providing factors that may prove there is still worth such as **(f)** creditor's failure to press for payment, **(g)** willingness to make further advances, **(h)** availability of collateral or third party guaranties, **(i)** debtor's earning capacity, **(j)** payments of interest, and **(k)** sluggish business conditions. It has also been determined that in effect Don Signer Buick, Inc had, in effect, ceased business operations by means of "De facto Dissolution", where the coporation ceased to be a going concern, as demonstrated by the removal of assets and inventory and the ceasing of business operations as an automobile dealership.

**(III) Timing of Worthlessness:** *When did the debt become worthless?*  
(ref. Lead Sheet 502)

It is the Government's Position that the worthlessness had occurred in 1995, which has been determined that through certain identifiable events and the ascertainment of the taxpayer. We must refer to Reg. §1.166-2 for the timing of being fully worthless and Reg. § 1.166-3 for the treatment of such debt. When considering timing, Reg. § 1.166-2(a) states that "all pertinent evidence" be considered as well as "the financial condition of the debtor". Mr. Signer had realized the inability to pay off the debt when the vehicle for the payment, Don Signer Buick, Inc., through its consulting agreement, did not have the means of earning income to pay back its liability (the loan to Mr. Signer). It had been stated that Don Signer Buick, Inc had switch from a car dealership to a consulting business in 1995 and Don Signer Buick, Inc's assets were taken by Don Signer Buick-Cadillac Inc. The only thing left in Don Signer Buick, Inc was the debt it owed Mr. Signer because Motors Holdings, the 53.59% shareholder, did not want to assume the liability.

**Law:** (Tax Law, Regulations, court cases, and other authorities. If Unagreed, include Argument.)

IRC Section: 166, 165

Reg Section: 1.166-2,3 & 5

Specific citations:

- IRC § 166 provides a deduction for bad debt when the debt is totally and partially worthless. It also defines non-business bad debt and how that bad debt should be treated.
- Reg § 1.166-5(b) provides more detail on business and non-business losses. The business losses are supposed to be treated in accordance with IRC § 165(c)(1).
- IRC § 165(c)(1) provides that losses incurred in a trade or business be allowed if deduction occurred in the taxable year and not compensated for by insurance or otherwise.
- Reg. 1-166-3 determines "total worthlessness" as being deductible in the year incurred.
- Reg. 1-166-2 provide evidence of worthlessness where it is defined under section (a) of the regulation as considering "all pertinent evidence" and "the financial condition of the debtor."

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## 401- Claim for Bad Debt

### Taxpayer Position: *(If applicable)*

The taxpayer's position is that the worthlessness of the loans would be 2005 when payments had stopped and realized by both parties and not in 2003 since the taxpayer had not amended or adjusted the amounts of interest reported from the loans on his return. The taxpayer had also stated that the bad debt should not have been in 1995 because the business was still making money and the money was paying off the debt. The taxpayer had also stated that the C-Corporation had also leased a computer to the S-Corporation and the taxpayer could not have claimed a bad debt in 1995 because the C-Corporation was producing income.

Taxpayer vehemently disagrees with the Government's position and would like to go to appeals.