

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

Department of the Treasury

Date: November 9, 2010

Donald R. Signer

[REDACTED]
Fremont CA 94539

Taxpayer Identification Number:

[REDACTED]

Tax Form:

1040

Tax Year Ended:

2005 & 2006

Person To Contact:

[REDACTED]

Contact Telephone Number:

510-[REDACTED]

Employee Identification Number

[REDACTED]

Telephone Hours:

8:30 AM to 4:00 PM

Dear Mr. Signer:

We're pleased to tell you that we've accepted your claim for the tax year shown above.

I have provided Form 4549 with supporting lead sheets to explain the examination findings.

If you have any questions, please call or write to the contact person listed in this letter.

Sincerely yours,

[REDACTED]
[REDACTED]

Internal Revenue Agent

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

Examiner: [REDACTED]
 Date: 2/9/10, 2/10/10, 2/11/10, 3/1/10, 3/5/10, 3/10/10, 3/11/10,
 3/12/10, 3/18/10, 3/24/10, 3/25/10, 4/5/10, 4/6/10,
 4/16/10, 5/26/10, 5/28/10, 6/11/10, 6/15/2010, 6/21/10,
 7/7/10, 7/20/10, 7/27/10, 7/28/10, 8/4/10, 8/9/10, 8/10/10,
 8/18/10, 8/19/10,

401- Claim for Bad Debt				
Tax Period	Per Return	Per Exam	Adjustment	Reference
200512	.00	(329,250.00)	(329,250.00)	
Conclusion: <i>(Reflects the final determination on the issue.)</i>				
<p>The Tax Year 2005 claim for the Bad Debt deduction was allowed. It has been determined that (1) a business bad debt, per "Dominant Motive," (2) had become worthless through various factors and (3) in 2005, the C-Corporation did not have the available funds to pay off the debt rendering the debt to be worthless.</p> <p><i>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.</i></p>				
Audit Steps: <i>(Document audit steps taken or to be taken.)</i>				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: <i>(Document the relevant facts.)</i>				
<p>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".</p> <p>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.</p> <p>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.</p> <p>The loans were created from 1986 through 1990 and made when there was still enough capital in the</p>				

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401- Claim for Bad Debt

- (I) the existence and character of the debt (ref. Lead Sheet 500)
- (II) the fact of worthlessness and (ref. Lead Sheet 501)
- (III) the year of worthlessness. (ref. Lead Sheet 502)

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.

(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 2005, 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". Don Signer Buick, Inc. had funds to pay through its consulting agreement and did not have the means of earning income to pay back its liability (the loan to Mr. Signer) when the Service had deemed that the payments were not for business, resulting in the Don Signer Buick Cadillac (the S-Corporation) ceasing all to Don Signer Buick Inc (the C-Corporation). 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.