BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
SOLANA BEACH DRUG CO.)

Appearances:

For Appellant: W. B. Kurtz, President of corporation

For Respondent: Chas. J. McColgan, Franchise Tax Commissione

O P I N I O N

This is an appeal pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Stats. 1929, Chapter 13, as amende from the Action of the Franchise Tax Commissioner in overruling the protest of Solana Beach Drug Co., a corporation, against a proposed assessment of additional tax in the amount of $41.04 with interest.

The only problem involved in this appeal is whether in computing Appellant's net income for the year ended December 31, 1929, deductions should have been allowed on account of amortization of incorporation expense, and amortization of good will.

It is true, as Appellant claims, that the Act does not expressly provide that the above items should not be allowed as deductionsin computing net income. But, it is to be noticed that net income is defined in Section 7 of the Act as "gross income less the deductions allowed". Hence, unless the above items can be brought within the allowable deductions from gross income as provided in the Act, the deduction of.these items should not be allowed.

The only provision of the Act which could at all be considered as authorizing the.deduction of incorporation expense is Section 8a which provides that from gross income there shall be deducted

> "All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on business, including a reasonable allowance for salaries or other compensation for personal services actually rendered, and rentals or other payments required to be made as a condition to the continued use of possession for business purposes of property to which the taxpayer has not taken or is not taking title or in which it has no equity."

We are of the opinion that the expense of organizing or incorporating a corporation cannot reasonably be considered as

a necessary expense paid or incurred in carrying on the business of that corporation after it is organized. Rather, we think it is to be considered in the nature of a capital outlay, or a capital investment. This, it is to be noticed, is the view which has been followed uniformly by the Board of Tax Appeals in construing deduction provisions in various Federal Revenue Acts. (See appeal of F. Tinker & Sons Co., 1 B.T.A. 799; appeal of Emerson Electric Mfg. Co., 3 B.T.A. 932; appeal of Simmons Co., 8 B.T.A. 631; and Southeastern Express Co. vs. Comm. of Internal Revenue, 19 B.T.A. 490.)

No authority or reason for our adopting a different attitude from that adopted by the Board of Tax Appeals has been called to our attention. Consequently, we conclude that a deduction should not be allowed on account of amortization or incorporation expenses.

We are also of the opinion that a deduction should not be allowed on account of amortization of good will. The only provision of the Act which is at all pertinent in this respect is Section 8f which provides that a deduction shall be allowed from gross income on account of:

> "Exhaustion, wear and tear and obsolescence of property to be allowed upon the basis provided in sections 113 and 114 of that certain act of Congress of the United States known as the 'Revenue Act of 1928', which is hereby referred to and incorporated with the same force and effect as though fully set forth herein, or upon the basis provided in section 19 hereof."

Unless a deduction for amortization of good will can be allowed under the above quoted provision, we are of the opinion that it cannot be allowed at all. It is possible that good will should be considered property within the meaning of the term as used in the above section. But it is not property which is subject to wear and tear or which normally becomes obsolescent. It does not necessarily diminish in value either with the passage of time or with use. Hence, it would seem that depreciation cannot be charged against it.

Under particular circumstances it may be shown, it is true, that the value of good will, at some future time will be extinguished, or greatly reduced. In such a case, it is arguable that a deduction should be allowed for the amortization of the good will. But we are not presented with such a case. Here there is not the slightest evidence that the value of appellant's good will will be extinguished or reduced at the expiration of any particular future period.

It is to be noticed that the Circuit Court of Appeals for the Eighth Circuit in Red Wing Malting Co. vs. Willcuts, 15 Fed. (2d) 626 (writ of certiorari denied, 273 U.S. 763) held that a deduction, under the Federal Revenue Act should not be allowed for the obsolescence of good will because it was not property

which would be entitled to an allowance for depreciation due to exhaustion, wear or tear. Largely on the basis of this decision, deduction for obsolescence of good will was denied in Haberle Crystal Springs Brewing Co. vs. Clarke 280, U. S. 384, and Renziehausen vs. Lucas, U. S. 387.

In view of the above, we consider that we are amply justified in holding that a deduction should not be allowed in computing Appellant's income for the year ended December 31, 1929, on account of amortization of good will.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, that the action of Chas. J. McColgan, Franchise Tax Commissioner, in overruling the protest of Solana Beach Drug Co., a corporation, against a proposed assessment of an additional tax of $41.04, with interest under Chapter 13, Statutes of 1929, be and the same is hereby sustained.

Done at Sacramento, California, this 11th day of May, 1932, by the State Board of Equalization.

R. E. Collins, Chairman
Fred E. Stewart, Member
H. G. Cattell, Member
Jno. C. Corbett, Member

ATTEST: Dixwell L. Pierce, Secretary