



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
OAKWOOD BARBECUE)

Appearances:

For Appellant: Adam Schaefer, Accountant

For Respondent: James J. Arditto, Franchise Tax Counsel

O P I N I O N

This is an appeal taken pursuant to the provisions of Section 25 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes of 1929, as amended) from the action of the Franchise Tax Commissioner in overruling the protest of The Oakwood Barbecue to the Commissioner's proposed assessment of additional tax in the amount of \$826.88 for the taxable year ended November 30, 1940.

On February 15, 1940, the Appellant filed with the Respondent a return for income year ended November 30, 1939, disclosing a net loss. Among other deductions, the Appellant claimed the sum of \$42,506.43 for alleged depreciation and obsolescence on a frame building and on furniture and equipment located therein. The depreciable property was located on Treasure Island, in San Francisco Bay, and was used by Appellant to operate a restaurant during the Golden Gate International Exposition.

The Exposition was operated in the years 1939 and 1940, and in each of those years the Appellant conducted its business, using the property in question. Appellant claims that it was entitled to depreciate fully this property (less a 10 per cent salvage value) during the income year in question, for the reason that at the end of its fiscal year, November 30, 1939, there could be no assurance that the Exposition would resume operations in 1940. On the contrary, Appellant points out that the creditors of the San Francisco Bay Exposition, the corporation sponsoring the Exposition, had initiated bankruptcy proceedings in October 1939, and that in November it seemed unlikely that there would be a fair on Treasure Island in 1940. The Appellant contends that the building and equipment were purchased for operation only in the one year 1939, and that at the end of its fiscal year, Appellant did not know that it would operate during a 1940 fair, which, Appellant states was but a vision in the minds of a few individuals and groups at that time. It is, therefore, claimed that the useful economical life of the property terminated as of November 30, 1939.

It should be noted that the corporate existence terminated as of November 28, 1940, and that, therefore,, if the deduction for de-

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preciation and obsolescence is to be spread over a period of two years, Appellant cannot take a deduction for the second year. There was no corporate franchise to be taxed for the fiscal year commencing after November 30, 1940, to be measured by the 1940 income.

The Respondent states in his brief that he disagreed with the conclusions of the Appellant and issued his notice of proposed additional assessment on the theory that as of November 30, 1939, it could not be determined that the Fair would not reopen in 1940, and that, therefore, it could not be determined that the useful life of the property in question was ended on November 30, 1939. Both the Appellant and the Respondent agree that the Appellant is not limited under the circumstances of this case by the usual rules in regard to physical exhaustion of property. The Respondent acknowledges that the Appellant may claim extraordinary depreciation or obsolescences. They differ solely on the point as to whether the deduction should be spread over two years or whether it should be applied to the year 1939 alone.

We are of the opinion that the Respondent properly determined that the useful economical life of the Appellant's property was not limited to the period ended November 30, 1939, and that the Appellant failed to show that the Respondent acted unreasonably in disallowing the total claimed deduction.

Among the deductions to be allowed in computing net income, as provided in Section 8 of the Bank and Corporation Franchise Tax Act is:

"A reasonable allowance for exhaustion, wear and tear and obsolescence of property used in the trade or business."

The purpose of allowing a deduction for depreciation and obsolescence is to permit capital invested in assets to be returned to a taxpayer out of earnings over the life of the property used in the business. If property is becoming obsolete, by the time it reaches that state the entire cost thereof will be restored.

As stated in Corsicana Gas and Electric Co., 6 B. 'I'. A., 565, 568, 569;

"In order that the taxpayer may be entitled to the obsolescence deduction in the years involved, there must have been substantial reasons for believing that the assets would become obsolete prior to the end of their ordinary useful life, and second it must have been known, or believed to have been known, to a reasonable degree of certainty, under all the facts and circumstances, when that event would likely occur."

The determining of what is a reasonable allowance for depreciation or obsolescence is a matter of fact to be established in

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each case by all of the circumstances. Standard Oil Co. v. Southern Pacific Co., 268 U.S. 146, 69 L. Ed. 890; First National Bank in Mobile, 30 B. T. A. 632.

The Appellant has failed to sustain the taxpayer's burden of showing the necessary elements for the depreciation and obsolescence allowance as of the end of the income year in question. It is true that creditors of the San Francisco Bay Exposition had placed it in bankruptcy by October 29, 1939, but that seems to be the sole circumstance on which the Appellant relies. Sight must not be lost of other facts which took place at the time. All civic organizations, many of the bankrupt's creditors, and all newspapers in the San Francisco Bay area, together with a group of influential men of that area, were advocating the continuance of the Exposition in 1940. It is true that as of November 30, 1939, the Appellant was uncertain as to whether it would operate on Treasure Island during 1940, but it is also true that the Appellant was by no means certain that it would not operate in that year. As a matter of fact, the minutes of the corporation show that its directors knew that there was a possibility of operating in 1940. We conclude, therefore, that the Appellant has not sustained its burden of showing that the Respondent's action was reasonable, or its burden of showing that the useful economic life of Appellant's property was limited to the period ending at the termination of its 1939 fiscal year.

Since we have concluded that the deduction for depreciation and obsolescence is not to be confined to *one* year, other questions relating to computing the allowance must be answered. Both parties agree that in this computation consideration should be given only to the number of days that the property was actually in use in each of the years. The Respondent first determined that the property was used for 254 days in 1939 and 128 days in 1940. The Respondent now stipulates that the property was actually used during 288 days in 1939, making a total of 416 days in which the property was used during the two years together. Therefore, he should allocate 288/416ths of the cost basis of the property to the income year ended November 30, 1939, and allow a deduction of that Percentage of the cost basis for that period.

Appellant claimed that a reasonable allowance to be given to it as a deduction for the first year would be 90 per cent of the cost of the property. In making its estimate of the allowance, it thus subtracted ten per cent from the cost of the property as a reasonable amount for salvage value. The cost of the property in 1939 was \$47,229.38. In subtracting the salvage from the cost of the property, the Respondent used the figure of \$1,925.00, which is the actual salvage value received by the Appellant, and which is considerably less than the 10 per cent figure as estimated by the Appellant. The Respondent's action in this respect is not prejudicial to the Appellant, but actually increases the allowable deduction over that as calculated by the Appellant.

As computed according to the foregoing paragraph, the total depreciable value of the property is \$45,304.38. Taking 288/416ths

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of that figure, the deduction for depreciation or obsolescence in the year ending November 30, 1939, is the sum of \$29,249.19.

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 the Oakwood Barbecue to a proposed assessment of additional tax in the amount of \$836.88 for the taxable year ended November 30, 1940, pursuant to Chapter 13, Statutes of 1929, as amended, is hereby modified in accordance with the said opinion, and as so modified, the same is hereby affirmed.

Done at Los Angeles, California, this 18th day of June, 1943, by the State Board of Equalization.

R. E. Collins, Chairman
Geo. R. Reilly, Member
J. H. Quinn, Member
Wm. G. Bonelli, Member

ATTEST: Dixwell L. Pierce, Secretary