



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
DESERT HOT SPRINGS WATER CO.)

Appearances:

For Appellant: Daniel L. Stack, Attorney at Law
For Respondent: Burl D. Lack, Chief Counsel;
A. Ben Jacobson, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 26077 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claims of Desert Hot Springs Water Company for refund of franchise tax in the amounts of \$206.34, \$112.29 and \$37.85 for the income years 1950, 1951 and 1952, respectively.

During the years in question Appellant was engaged in the business of furnishing water to the community of Desert Hot Springs, California. At the same time Mr. A. Wardman was actively promoting and developing the area. As an inducement for Appellant to maintain and extend its water service, Mr. Wardman at various times transferred to Appellant certain property (principally machinery) as well as money with which Appellant purchased other property to be used for additions to its distribution system.

In reporting its net income for each of the years in question, Appellant claimed a deduction in the amount of \$7,987.99 as a depreciation allowance on the aforementioned property. This amount was computed on the assumption that the basis for depreciation of the property in Appellant's hands was the same as it would have been in Mr. Wardman's hands. The Franchise Tax Board has disallowed the deductions.

During the years in question the basis for depreciation of property was, as a general rule, its cost (former Sections 25122 and 25071 of the Revenue and Taxation Code). In the case of property acquired by a corporation as a contribution to capital, however, the basis was the same as it would have been in the hands of the transferor (former Section 25071f). These provisions were substantially the same as provisions of the Internal Revenue Code of 1939.

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In support of its position, the Franchise Tax Board cites Detroit Edison Co. v. Commissioner, 319 U.S. 98. It was there held that payments to a company by prospective customers for the cost of having the company's facilities extended to supply them were not donations or contributions to capital but the price for service and since the company had made no outlay for the property it was not entitled to depreciation.

Appellant contends that the property in question was a contribution to capital, citing the case of Brown Shoe Company, Inc. v. Commissioner, 339 U.S. 583, which held that assets transferred to a corporate taxpayer by community groups as an inducement to the location or expansion of the taxpayer's factory operations in the respective communities represented contributions to capital. In that case the court found that the contributions were made "by citizens of the respective communities who neither sought nor could have anticipated any direct service or recompense whatever, their only expectation being that such contributions might prove advantageous to the community at large." The court concluded that under those circumstances "the transfers manifested a definite purpose to enlarge the working capital of, the company,"

The circumstances under which Mr. Wardman's transfers to Appellant were made do not indicate that Mr. Wardman's only expectation was that such transfers might prove advantageous to the community at large. It is reasonably inferred from Mr. Wardman's operations as the developer of Desert Hot Springs that his special interests were to be served by the extension of water service in that community. The availability of water had a direct bearing on the success of his business. We conclude that the situation before us is more nearly comparable to Detroit Edison Co. v. Commissioner (*supra*) than to the case cited by Appellant.

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, pursuant to Section 26077 of the Revenue and Taxation Code that the action of the Franchise Tax Board in denying the claims of Desert Hot Springs Water Company for refund of franchise

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tax in the amounts of \$206.34, \$112.29 and \$37.85 for the income years 1950, 1951 and 1952, respectively, be and the same is hereby sustained,

Done at Sacramento, California, this 20th day of May, 1959, by the State Board of Equalization.

Paul R. Leake _____, Chairman

John W. Lynch _____, Member

Richard Nevins _____, Member

Geo. R. Reilly _____, Member

_____, Member

ATTEST: Dixwell L. Pierce _____, Secretary