

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
DAVID O. AND PHYLIS I. SELZNICK)

For Appellants: O'Melveny & Myers and Maynard J. Toll,
Attorneys 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 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of David O. and Phylis I. Selznick against proposed assessments of additional personal income tax in the amounts of \$9,263.33, \$9,238.47 and \$9,603.50 for the years 1956, 1957 and 1955, respectively.

Appellants, who were husband and wife in 1951 and during the years in question, owned all of the stock of a corporation which they liquidated on June 9, 1951. In the liquidation they received 21 items consisting of motion picture films, participating rights in other films and story rights. The films were of various ages and in various stages of exhibition. Appellants derived income from the assets for several years. Part of the assets were sold in 1956 and the rest in 1959.

In 1955, for purposes of computing appellants' gain on the liquidation and establishing bases for depreciation or amortization, the United States Internal Revenue Service determined the fair market value of the assets as of the date of the liquidation. The Service assigned to each asset a value based on domestic receipts from, exhibition and other uses

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and a value based on foreign receipts. A uniform period of amortization was fixed with respect to the values of **all** of the assets based on domestic receipts and other uses and a different period with respect to the value based on foreign receipts. Appellants argued that the assets had no fair market value and, in the alternative, that the values or bases should be recoverable under a "cost recovery" method of amortization, through which the proceeds from the assets would be excluded from income until the bases were completely recovered. They finally agreed, however, to the federal tax liability for **1951** and refunds for 1952, 1953, and 1954, resulting from the determinations by the Service.

For state income tax purposes, which were substantially the same as the federal purposes, respondent Franchise Tax Board and appellants agreed upon the same aggregate value as that arrived at with the federal authorities. Whether or not the values of individual assets were discussed or specifically agreed upon is not clear from the record before us. Regarding amortization, appellants argued that defects in the method imposed by the Internal Revenue Service would be offset by federal statutes allowing the carryover of losses from year to year, but that the state statutes contained no such carryover provision. Ultimately, respondent agreed to allow a cost recovery method of amortization.

The dispute *in* this appeal concerns the manner in which the cost recovery method should be applied. Appellants contend that they should be allowed to offset all income from the assets until the aggregate bases have been recovered, while respondent's position is that the basis of each asset, as determined in the federal proceedings, may be recovered **only** from the income produced by that particular asset. The aggregate approach sought by appellants would permit the income derived from one asset in excess of its basis to be offset by the unrecovered bases of other assets, resulting in amortization at a faster rate than that achieved under respondent's method.

Appellants assert that they are asked to pay a tax on income from a film after its basis is exhausted even though a large part of the aggregate basis remains unrecovered. They state that **the federal** law allows the carryover of losses from year to year, permitting them to recover their aggregate

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basis without federal tax. Their conclusion is that respondent's method imposes an equivalent inequity in place of that which their settlement with respondent sought to eliminate.

Section 17208 of the Revenue and Taxation Code permits **as a** depreciation deduction "**a** reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance **for obsolescence**)" of property used in business or held for the production of income. This language is the same as that in section 167 of the Internal Revenue Code of 1954.

The case of Inter-City Television Film Corp., 43 T.C. 270, involved a taxpayer who made several purchases of rights to exhibit films on television. In each purchase, the rights to a number of films were acquired as a single package at one overall price. The taxpayer sought to amortize all of the rights as a unit under the cost recovery method. The commissioner, however, was sustained in requiring that each group of rights acquired in one purchase be amortized ratably over an estimated useful life.

We are not called upon to determine whether appellants may use a **cost** recovery method. There is no valid reason, however, why a taxpayer who has been allowed to use such a method must necessarily be allowed to aggregate his assets in applying the method. The purpose of depreciation or amortization is to achieve a **meaningful allocation** of the cost entailed in the use of an asset to the periods to **which it** contributes. (Massey Motors, Inc. v. United States, 364 U.S. 92 [4 L. Ed. 2d 1592].) Income from an asset **reflects** its use and its contribution. When amortization is **keyed to income**, **as in** this case, it is clearly more meaningful to recover the basis of a particular asset from **the income** derived from that asset than it is to recover the basis of one asset against income derived from another.

The assets here in question were not purchased as a single package at one overall price. Although they were acquired at one time, their individual bases depended upon their separate and independently determinable values. They are no more appropriately combined for amortization than were the separately purchased groups of rights in the Inter-City Television case.

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Appellants' arguments that their bases will never be recovered under respondent's method and their emphasis on the difference between the California and federal law as to loss carryovers cannot properly affect our conclusion. When the assets were sold, the bases, as adjusted by amortization, were presumably taken into account in determining gain or loss. If disadvantages did occur, they must be accepted together with the advantages of the cost recovery method. The difference between the California and federal law with respect to loss carryovers marks a legislative policy entirely apart from the issue at hand.

As an alternative to aggregate amortization of their assets, appellants seek to reallocate the total of the bases for all the assets among individual assets based on a television market which, according to appellants, was unknown at the time the original valuations were made. But the critical valuation date is the time of the liquidation. Factors which were not foreseeable at that time are irrelevant. (Grill v. United States, 303 F.2d 922, 927.)

Since appellants have not established that respondent's requirement of separately amortizing the assets involved was improper, or that the valuations relied upon by respondent were erroneous, the proposed assessments must be affirmed.

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 18595 of the Revenue and Taxation Code; that the action of the Franchise Tax Board on the protests of David O.

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and Phylis I. Selznick against proposed assessments of additional personal, income tax in the amounts of \$9,263.33, \$9,238.47 and \$9,603.50 for the years 1956, 1957 and 1958, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 30th day of November, 1965, by the State Board of Equalization.

John W. [Signature], Chairman
Hubert [Signature], Member
[Signature], Member
[Signature], Member
[Signature], Member

ATTEST: *[Signature]*, Secretary