



BEFORE THE STATE BOARD OF EQUALIZATION .
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }
ALBINA G. CRUZ }

Appearances:

For Appellant: John P. Tobin,
Attorney at Law

For Respondent: Wilbur F. Lavelle,
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 Albina G. Cruz against proposed assessments of additional personal income *tax* in the amounts of \$1,023.23 and \$1,262.98 for the years 1957 and 1958, respectively,

In 1953 appellant Albina G. Cruz acquired a frame building located in Los Angeles for \$30,000 and operated a restaurant there.

Prior to 1957 appellant spent \$16,339.69 for fixtures, equipment, and improvements to the building. This amount was treated *as* a capital expenditure by adding it to the cost basis of the building. At the beginning of 1957, the cost basis of the building, fixtures, equipment, and improvements, as adjusted for additions and depreciation, was \$35,651.01.

Pursuant to an architect's general plan, appellant contracted with a building contractor who remodeled and expanded the building during 1957 and 1958. The cost of the completed project was \$79,126.13. The remodeling entailed

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removing one of the walls and annexing the old building to a new structure, creating a restaurant facility with over three times the former seating capacity. The kitchen was moved to the new area; the older floor was raised to alter the plumbing; new kitchen equipment, booths, and fixtures were installed; and the walls and ceilings of the older portion were redecorated. The remodeling and expansion represented a single integrated plan and greatly enhanced the value of the property.

Of the total remodeling cost incurred in 1957 and 1958, appellant capitalized \$34,126.13, the amount the contractor attributed to the creation of the newer part. Under the description "alterations and repairs" the remaining \$45,000 was treated as deductible expense in appellant's returns, resulting in deductions of \$22,100 for 1957 and \$22,900 for 1958. Upon audit, respondent allowed only \$2,711.90 of the \$45,000 as deductible expense. Respondent disallowed the deduction of the balance on the ground that it represented a capital expenditure which should be added to the cost basis of the entire structure.

The question presented is whether any or all of the disallowed amounts represent deductible expenses rather than capital expenditures. Appellant contends that the amounts deducted as repair expenses represent expenditures required to keep the old building in operating condition. Respondent, on the other hand, contends that the amounts were not deductible as current expenses because the expenditures were pursuant to a single integrated plan of reconditioning and enlarging the restaurant facility. In addition, respondent urges that the expenses were too large to be considered incidental and that they substantially increased the value of the property and materially prolonged its life,

Section 17202 of the Revenue and Taxation Code allows the deduction of "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business." Section 17283, on the other hand, prohibits the deduction of amounts "paid out for new buildings or for permanent improvements or betterments made to increase the value of any property" or "expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made."

The regulations of the Franchise Tax Board do not provide that the cost of every repair may be deducted, but only "incidental repairs which neither materially add to the value of the property nor appreciably prolong its life...." (Cal. Admin. Code, tit. 18, reg. 17202(d).)

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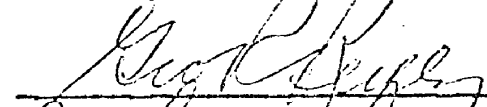
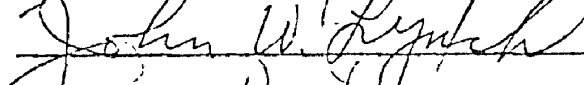


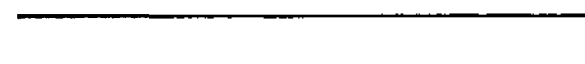
The expenditures involved herein were not made for "incidental repairs" but were part of an overall plan for the general rehabilitation, enlargement and improvement of the restaurant facility. Interpreting statutory and regulatory provisions substantially the same as those which concern us here, the federal courts have held consistently that expenditures which under other circumstances would be deductible as ordinary and necessary expenses should be treated as capital expenditures when they are part of a general betterment program. (Joseph Merrick Jones, 24 T.C. 563, aff'd, 242 F.2d 616; I. M. Cowell, 18 B.T.A. 997; Home News Publishing Co., 18 B.T.A. 1008; California Casket Co., 19 T.C. 32.) Accordingly, we conclude that the Franchise Tax Board properly considered the expenditures in question as capital in nature.

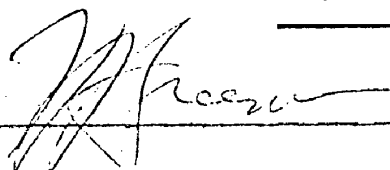
O R D E R

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 Albina G. Cruz against proposed assessments of additional personal income tax in the amounts of \$1,023.23 and \$1,262.98 for the years 1957 and 1958, respectively, be and the same is hereby sustained.

Done at Sacramento California, this 6th day of October, 1966, by the State Board of Equalization.

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|  | Chairman |
|  | Member |
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Attest:  , Secretary