



83-SBE-212

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
RAYMOND AND ROSEMARIE J. PRYKE)

Appearances:

For Appellants: James M. Quinn
 Certified Public Accountant

For Respondent: Carl G. Knopke
 Counsel

O P I N I O N

This appeal is made pursuant to section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Raymond and Rosemarie J. Pryke against proposed assessments of additional personal income tax in the amounts of **\$1,428.39** and **\$1,731.38** for the years 1976 and 1977, respectively.

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The issue for determination is whether appellants have furnished proof that **respondent's adjustments** were in error.

Appellants purchased a small-town **newspaper** in July 1976 for \$22,941. The newspaper also published a Bargain Bulletin. The bill of sale stated that the sale included stock in trade, fixtures, goodwill, and trade name, including, but not limited to, items listed. For tax purposes, appellants allocated approximately 50 percent of the purchase price to a subscription list and deducted the full amount so allocated, \$11,227, as an amortization deduction in the year of purchase. Another \$11,227 was allocated to equipment and \$500 was allocated to furniture and fixtures. None of the purchase price was allocated to goodwill or the trade name.

On audit, respondent determined that the subscription list was part of goodwill and, therefore, not subject to amortization. Respondent also determined that the equipment, which consisted mainly of two used typewriters, a stencil cutter, an addressing machine, an old refrigerator, and various art books and supplies, was worth \$1,000. On the basis of these **determinations**, respondent disallowed the claimed \$11,227 subscription list amortization deduction and reduced by \$2,458 the equipment depreciation deduction that appellant had also claimed.

In 1977, sixteen months after appellants had purchased the **newspaper**, the same was sold for \$70,000, with a \$20,000 down payment. The bill of sale for the 1977 transaction included a covenant not to compete for which appellants were given a separate note. The contract of sale indicated that \$5,000 was to be paid for the covenant not to compete.

During audit, respondent adjusted the basis of equipment and goodwill in line with the adjustments for 1976. Also, some travel expense, entertainment expense, rental expense, and cost of goods sold deductions were disallowed as being unsubstantiated. The total adjustments in 1977 amounted to \$17,503.

Although appellants submitted some records at the protest level, respondent determined that none of them substantiated any of the disallowed items for 1976 or 1977. Consequently, the proposed assessments based on the aforementioned disallowances were affirmed.

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After the filing of this appeal, copies of a federal audit were furnished by appellants. Appellants submit that the federal audit allowed their 1976 return as filed and revised their 1977 return to a lesser degree than proposed by respondent. Respondent disagrees.

Appellants' initial argument, that the federal audit should control or otherwise dictate the outcome in this appeal, at least with respect to 1976, is without merit. In the first instance, there is no proof that the federal audit covered the year 1976. It only indicates a review of 1977. Since the federal statute of limitations with respect to 1976 had expired by the time the federal audit was commenced, this undoubtedly is why the federal audit report submitted by appellants only covers 1977. Secondly, as will be seen below, even if the federal audit reflects an approval of appellants' attempted amortization of the subscription list or their valuation of the equipment and supplies, there is no legal or factual foundation for such opinion.

Revenue and Taxation Code sections 17208 and following deal with the allowance of depreciation for **exhaustion, wear and tear of property** used in a trade or business. The provisions of those sections are substantially similar to the provisions of section 167 of the Internal Revenue Code. Under these circumstances, interpretations placed on section 167 by the federal courts and administrative bodies are persuasive as to the proper interpretation and application of the parallel California code sections. (Andrews v. Franchise Tax Board, 275 Cal. App.2d 653 [80 Cal.Rptr. 403] (1969); Rihn v. Franchise Tax Board, 131 Cal.App.2d 356, 360 [280 P.2d 8931 (1955)]; Meanley v. McColgan, 49 Cal.App.2d 203 [121 P.2d 453 (1942)]; Holmes v. McColgan, 17 Cal.2d 426 [110 P.2d 428] (1941).)

The first question claimed to be resolved by the federal audit, whether a customer or subscription list constitutes an asset which may be amortized, has received consideration by the courts for many years. Early in such consideration it was established that such lists represent the customer structure of a business, their value lasting until an indeterminate time in the future. As such, they were seen to be in the nature of goodwill or otherwise to have indeterminable lives and were not, therefore, subject to depreciation. (Ralph W. Fullerton Co. v. United States, 550 F.2d 548 (9th Cir. 1977); Marsh & McLennan, Inc. v. Commissioner, 420 F.2d 667 (3d Cir. 1969); Commissioner v. Killian, 314 F.2d 852

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(5th Cir. 1963); National Weeklies v. Commissioner, 137 F.2d 39 (8th Cir. 1943), affg. ¶ 41,096 P-H Memo. B.T.A.; National Weeklies v. Reynolds, 43 F.Supp. 554 (D.C. Minn. 1942); Alfred H. Thorns, 50 T.C. 247 (1968); The Danville Press, Inc., 1 B.T.A. 1171 (1925).) Revenue Rulings 65-175 and 65-180 reflected the adherence of the Internal Revenue Service to a similar view. (See 1965-2 Cum. Bull. 41 & 279.) However, by the late 1960's and into the early 1970's, an exception to the above view started coming into play. Essentially, it came to be recognized that if an asset of this sort, or a portion thereof, did not possess the characteristics of goodwill, was susceptible of valuation, and was of use to the taxpayer in its trade or business for only a limited period of time, a depreciation deduction would be allowable.. (Houston Chronicle Publishing Co. v. United States, 481 F.2d 1240 (5th Cir. 1973); Skilken v. Commissioner, 420 F.2d 266 (6th Cir. 1969); Manhattan Co. of Virginia, Inc., 50 T.C. 78 (1968).)

'In 1974, the Internal Revenue Service issued Revenue Ruling 74-4.56 which incorporated this latter concept and modified the above referenced rulings, at least insofar as they had indicated that subscription lists were, as a matter of law, indistinguishable from goodwill. Revenue Ruling 74-456 states, in part, as follows:

The depreciability of assets of this nature is a factual question, the determination of which rests on whether the taxpayer establishes that the assets (1) have an ascertainable value separate and distinct from goodwill, and (2) have a limited useful life, the duration of which can be ascertained with reasonable accuracy.

(1974-2 Cum. Bull. 65, 66.)

The rule set out above recognizes that in certain situations a purchased asset such as a **subscription** list may be amortizable. However, the particular court cases to which the recognition of that principle is credited all involved the purchase of customer or subscription lists from businesses that immediately thereafter ceased existing. With the cessation of the business from which the list had been purchased, the courts concluded that the purchased lists were more readily distinguishable from the goodwill of such discontinued businesses.

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This rationale, however, does not apply in the instant matter. In the case before us, appellants purchased an ongoing business which appellants continued to operate. Furthermore, the business name of the acquired business, The Hesperia Resorter and Bargain Bulletin, was not changed under appellants' ownership. This, coupled with the specific reference in the July 6, 1976, bill of sale to the purchase of "goodwill and trade name" of the newspaper and the fact that appellants did not have the value of the customer listing separately appraised, certainly appears to refute appellants' position that the subscription list should be evaluated separately from the newspaper's goodwill. After reviewing the entire record, we conclude that such evidence prevails over appellants' arguments. Appellants' contention that the subscription list had a separate value and a limited useful life consists of no more than a simple reference to the federal audit. But that audit contained nothing more than an unsupported, conclusory statement that appellants' amortization should have been spread over five years. No explanation for that statement appears in the federal document, and we perceive that none could be provided under the facts and the applicable principles of law discussed above. Respondent's action on this point comports with the law as enumerated in prior decisions of the federal courts and we find nothing in the federal audit report to show that respondent's position is erroneous. Under these circumstances, the rule that respondent and this board are not bound to adopt the conclusion reached by the Internal Revenue Service in any particular case, even when that determination results from a detailed audit (see Appeal of Der Wienerschnitzel International, Inc., Cal. St. Bd. of Equal., April 10, 1979) is particularly appropriate. **We** therefore reject the application of the federal audit to this issue and uphold respondent's disallowance of appellants' claimed amortization deduction,

The federal audit also contains no specific factual information in support of the valuation which appellants attributed to various physical assets. Furthermore, appellants have not presented any of their own data to corroborate that initial valuation. Under these circumstances, we have no choice **but to** uphold respondent's determination of worth for the various items of equipment and supplies purchased as part of the newspaper.

In regard to 1977, it is noted that a major portion of respondent's proposed adjustments has to do

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with travel and entertainment expenses. These are items as to which appellants failed to provide substantiation to respondent. However, the federal audit shows specifically that these items were considered and allowed. In the face of such a specific allowance, respondent has conceded to accept the federal audit determination as to those items and adjust its own proposed adjustments accordingly. This has the effect of reducing respondent's total proposed assessment of tax for 1977 from **\$1,773.38** to **\$1,016.25**.

Respondent's remaining adjustments for 1977 are derived, in part, from the 1976 adjustments. To that extent, we find them proper and in line with our previous discussion. One of the additional remaining items concerns the taxable portion of the separate \$5,000 note received by appellants in return for their covenant not to compete. Generally speaking, fair market value is the criterion by which such determination is made, and appellants have claimed that the note was worth considerably less than its face amount. They cite the federal audit in support of their contention. However, we find the federal audit documents to show acceptance of the note at full face value. This is reflected in the total sale price of \$75,000 used in the federal audit, rather than the \$70,000 figure used by respondent. Consequently, we reject appellants' contention.

The last item results from appellants' claim that respondent has ignored their \$5,200 payoff of a computergraphic lease. Appellants are mistaken. The action taken at the federal level was to reduce appellants' cost of goods deduction by the \$5,200 payoff amount, but at the same time, to increase appellants' basis in the computergraphic machine from zero to \$5,200. Respondent incorporated **the federal** adjustment into its own action. Consequently, there is no basis to appellants' complaint.

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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 protest of Raymond and Rosemarie J. Pryke against proposed assessments of additional personal income tax in the amounts of **\$1,428.39** and **\$1,731.38** for the years **1976** and **1977**, respectively, be and the same is hereby modified in accordance with respondent's conceded reduction of the proposed assessment for 1977. In all other respects, the action of respondent is sustained.

Done at Sacramento, California, this 15th day of September, 1983, by the State Board of Equalization, with Board Members Mr. Bennett, Mr. Collis, Mr. Dronenburg, Mr. Nevins and Mr. Harvey present.

<u>William M. Bennett</u>	, Chairman
<u>Conway H. Collis</u>	, Member
<u>Ernest J. Dronenburg, Jr.</u>	, Member
<u>Richard Nevins</u>	, Member
<u>Walter Harvey*</u>	, Member

*For Kenneth Cory, per Government Code **section 7.9**