BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
BART C. AND DANEEN M. RAINONE)

For Appellants: Morris Glasser
Certified Public Accountant

For Respondent: James C. Stewart
Counsel

O P I N I O N

This appeai is made pursuant to section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Bart C. and Daneen M. Rainone against a proposed assessment of additional personal income tax in the amount of $2,111.35 for the year 1979.

Appeal of Bart C. and Daneen M. Rainone

The question presented by this appeal is whether appellants were entitled to use the half-year convention under the Asset Depreciation Range (ADR) system of determining the useful life of an asset for purposes of depreciation.

Appellants acquired a one-half interest in an aircraft on December 19, 1979. On their California personal income tax return for that year, they claimed an ordinary depreciation deduction in the amount of $19,547. (Additional first-year depreciation of $4,000 was also claimed, but that amount is apparently not in dispute in this appeal.) On their return, appellants elected the 150-percent declining balance method of depreciation and used a useful life for the aircraft of eight years. No additional elections or explanations of the method used to compute depreciation were included in their return.

Upon auditing appellants' return for 1979, respondent determined that their ordinary depreciation deduction should be limited to $1,285, the figure resulting from use of the 150-percent declining balance method for the 12-day period from the date of acquisition of the aircraft to the end of appellants' taxable year. After a notice of proposed assessment reflecting this adjustment was issued, appellants protested and stated that the Internal Revenue Service (IRS) had also conducted an audit and had determined that a partnership return was required in connection with the acquisition of the aircraft. The federal partnership return was filed on January 27, 1982, and a copy of the return, along with the final federal audit report, was sent to respondent on May 24, 1982. As part of the federal partnership return, IRS form 4832 was used to specifically elect the ADR system and the half-year convention.1/ This election was allowed by the IRS.

However, after reviewing the information submitted, respondent affirmed its proposed assessment. Respondent contends that appellants did not elect the use

1/ The half-year convention is one of two methods used to determine the date that an asset is considered placed in service for purposes of computing the depreciation deduction under the ADR system. Under the half-year convention, the taxpayer treats all assets as placed in service at the midpoint of the year, so that one-half year of depreciation is deductible even if the property was not actually in service for that length of time. (Treas. Reg. § 1.167(a)-11(c)(2)(iii).)

cf ADR and the half-year convention on their 1979 state tax return as required by regulations and, therefore, are limited to a depreciation deduction for the actual period the property was held during the taxable year.

Regulation 17208(j), effective during 19'79, stated in part:

> (2) The period for depreciation of an asset shall begin when the asset is placed in service and shall end when the asset is retired from service. A proportionate part of one year's depreciation is allowable for that part of the first and last year during which the asset was in service.

(Former Cal. Admin. Code, tit. 18, reg. 17208(j), repealer filed April 16, 1981 (Register 81, No. 16).)

California adopted by reference Treasury regulation § 1.167(a)-11, the federal ADR system regulation, subject to certain exceptions. (Former Cal. Admin. Code, tit. 18, reg. 17208(m), repealer filed April 16, 1981 (Register 81, No. 16); new regulation 17208 filed April 21, 1982 (Register 82, No. 17).) Under the federal regulation, an annual election had to be made in order to use the ADR system. (Treas. Reg. § 1.167(a)-1?(a)(l).) The election made had to specify the first-year convention (i.e., the half-year or modified half-year convention) adopted by the taxpayer. (Treas. Reg. §§ 1.167(a)-11 (c)(2)(i); 1.167(a)-11(f)(2)(iv).)

One of the exceptions in the California regulation was in regard to the time and manner of electing the ADR system:

> (C) An election to apply this subsection to eligible property shall be made with the return filed for the income year in which the property is first placed in service by the taxpayer. ... The election may be made with an amended return only if such amended return is filed no later than the time prescribed by law (including extensions thereof) for filing the return for the income year of election. ... If an election is not made within the time and manner prescribed in this subparagraph, no election may be made for such income year (by the filing of an amended return or any other manner) with respect to any eligible property placed in service in the income year.

> (D) Form FTB 3888 will be provided for the submission of required information to the Franchise Tax Board.

(Former Cal. Admin. Code, tit. 18, reg. 17208(m), subds. (l)(C), (1)(D), supra.)

The federal ADR regulation contained the same basic rules for the time of election as those stated above, but also provided:

> If the taxpayer does not file a timely return (taking into account extensions of the time for filing) for the taxable year in which the property is first placed in service, the election shall be filed at the time the taxpayer files his first return for that year.

(Treas. Reg. § 1.167(a)-11(f)(1)(i).)

Appellants clearly failed to make the election of the half-year convention on their 1979 state tax return as specified in regulation 17208(m). Mere entry of the end result of a computation using the half-year convention is insufficient to constitute a proper election. (See Thomas C. Regan, ¶ 82,733 P-H Memo. T.C. (1982).) Appellants never filed a California amended return, so could not have made the election in that manner. The California regulation clearly provides that if an election is not made in the original return or in a timely amended return, the election may not be made for that year.

Appellants appear to contend that they should be allowed to use the half-year convention because they properly made the election on the federal partnership return which they filed in 1982, the IRS allowed the use of the convention, and they submitted the federal partnership return to respondent. These facts, however, do not make them eligible to use the convention.

The partnership return was for federal purposes: a similar state return was never made. Informally submitting the federal partnership return to respondent does not constitute an election for state purposes. In addition, that return was not filed until 1982, while the property was placed in service in 1979, and the election had to have been made in an original or amended return filed in 1980. The IRS allowance of the convention is irrelevant for state purposes since Treasury regulation § 1.167(a)-11(f)(1)(i), quoted above, allowed the election for

federal purposes on the first return filed if no timely return was made. The state regulation had no similar provision. The state regulation requires that the election be made on the original return for the year the property was placed in service or on a timely amended return and no other manner of making the election is allowed.

We find that appellants did not properly elect the half-year convention for state income tax purposes and must compute their depreciation for the aircraft pursuant to former regulation 17208(j), supra. Respondent's action, therefore, must be sustained.

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 Bart C. and **Daneen M. Rainone** against a proposed assessment of additional. personal income tax in the amount of **$2,111.35** for the year 1979, be and the same is hereby sustained.

Done at Sacramento, California, this 8th day of May, 1984, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Dronenburg, Mr. Collis, Mr. Bennett and Mr. Harvey present.

Richard Nevins, Chairman

Ernest J. Dronenburg, Jr., Member

Conway H. Collis, Member

William M. Bennett, Member

Walter Harvey*, Member

*For Kenneth Cory, per Government Code section 7.9