BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Hatter of the Appeal of)
)
KEE DEE, INC.)

Appearances;

For Appellant: Ralph A. Zenger

For Respondent: Kendall E. Kinyon
Supervising Counsel

O P I N I O N

This appeal is made pursuant to section 25666 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Kee Dee, Inc., against proposed assessments of additional franchise tax in the amounts of $223, $231, and $124 for the income years ended June 30, 1980, June 30, 1981, and June 30, 1982, respectively.

Appeal of Kee Dee, Inc.

Appellant is a California corporation engaged in the sheet metal business at Canoga Park, California. Prior to incorporation in June 1979, the business was operated as a proprietorship by the parties to the covenant not to compete at issue in this appeal.

In January 1977, Kelly J. Hansen sold his sheet metal business, Kee-Dee Precision Sheet Metal, to John and Gloria Perry. The sale of the business took place pursuant to a written agreement consisting of escrow instructions and accompanying deposit receipt executed by Hansen and the Perrys in October 1976. This purchase agreement provided for a 90-day escrow period. By its terms, Hansen agreed to sell the stock in trade, fixtures, equipment, and good will of Kee-Dee Precision Sheet Metal to the Perrys for a total purchase price of $90,000. The escrow instructions stated that the purchase price included all machinery, materials, fixtures, and equipment of the business. In addition, the escrow instructions, and deposit receipt contained general language of a covenant not to compete without specifying any territorial limitations, term, or consideration for the covenant. On the date set for the close of escrow, the parties executed a one-page covenant not to compete as a rider to the purchase agreement documents. As part of the sale of the equipment and good-will of his business, Hansen agreed not to compete within 100 miles of Canoga Park for a term of five years. This covenant document similarly did not allocate any portion of the purchase price of the business to the covenant not to compete.

After the consummation of the sale, Hansen moved to the Lake Tahoe area. The Perrys continued to conduct the business of Kee-Dee Precision Sheet Metal as a proprietorship for the next two and one-half years. During that time period, the Perrys apparently claimed deductions for amortization of the covenant not to compete in the total amount of $5,893.

In July 1979, appellant began doing business following its incorporation and transfer of the assets of Kee-Dee Precision Sheet Metal to the corporation. John L. Perry became the president of the corporation. On its returns for its income years ended in 1980, 1981, and 1982, appellant claimed deductions for amortization of the covenant not to compete in the amounts of $2,397, $2,397, and $1,298, respectively. Respondent disallowed appellant's additional amortization of the covenant not

to compete based upon the failure to assign a value to the covenant in the original purchase agreement.

Appellant filed a protest against the resulting proposed assessment of additional franchise tax, contending that the value of the covenant was $11,985 which was computed by subtracting the cost of equipment from the lump-sum purchase price of the business. Respondent denied appellant's protest, noting that the purchase agreement did not show a. separate valuation for the equipment, and, consequently, the covenant did not have an ascertainable value subject to amortization. Appellant then filed this timely appeal.

At the oral hearing on this appeal, this board granted appellant additional time to provide further information relevant to the value of tha covenant not to compete. Subsequently, appellant obtained supplemental information indicating that the parties to the purchase agreement at the time of its execution may have intended to allocate $5,000 of the total purchase price to the covenant. Appellant now contends that the covenant should be valued at $5,000 for purposes of amortization.

Based upon this new information provided by appellant, respondent has apparently stipulated to appellant's valuation of the covenant. Nevertheless, respondent contends that its proposed assessments should be sustained, for the stipulated value of the covenant was more than fully amortized by the Perrys prior to the incorporation of appellant and the income years at issue in this appeal. Respondent argues that the disallowance of appellant's claimed deductions for amortization of the covenant was entirely proper, since no part of its value remained to be amortized'by appellant.

In the present appeal, because respondent has apparently stipulated to a value for the covenant not to compete, the sole issue remaining for our decision is whether appellant should be allowed depreciation deductions for amortization of the covenant during the years in question. It is well settled that deductions are a matter of legislative grace, and the burden is on the taxpayer to show that he is entitled to the deductions claimed. (New Colonial Ice Co. v. Helvering, 292 U.S. 435 [78 L.Ed. 1348] (1934); Appeal of James C. and Monablanche A. Walshe, Cal. St. Bd. of Equal., Oct. 20, 1975.) Moreover, we have long held that respondent's determinations that deductions should be disallowed are presumptively correct, and the taxpayer has the burden of

proving them erroneous. (Appeal of John A. and Julie M. Richardson, Cal. St. Bd. of Equal., Oct. 28, 1980; Appeal of Ronald W. Matheson, Cal. St. Bd. of Equal., Feb. 6, 1980.) Appellant herein has presented information evidently sufficient to convince respondent that the covenant had an ascertainable value allocable from the lump-sum purchase price. However, appellant has altogether failed to demonstrate error in respondent's determination that the value of the covenant had been fully amortized prior to the income years in question.

Based on the record before us, we find that appellant has failed to carry its burden of justifying the claimed deductions. Accordingly, respondent's action must be sustained.

Appeal of Kee Dee, Inc.

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 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Kee Dee, Inc., against proposed assessments of additional franchise tax in the amounts of $223,$231, and $124 for the income years ended June 30, 1980, June 30, 1981, and June 30, 1982, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 12th day of September, 1984, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Dronenburg, Mr. Colfis and Mr. Bennett present.

Richard Nevins, Chairman

Ernest J. Dronenburg, Jr., Member

Conway H. Collis, Member

William M. Bennett, Member

_____, Member