BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
MORRIS M. AND JOYCE E. COHEN)

Appearances:

For Appellants: Alan L. Belinkoff
Certified Public Accountant

For Respondent: Richard A. Watson
Counsel

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This appeal is made pursuant to section 19059 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying to the extent of $347.53 the claim of Morris M. and Joyce E. Cohen for refund of personal income tax in the amount of $454.11 for the year 1968.

Appellants own a 40 percent interest in Redondo-Wilton Property Co., a partnership. On June 28, 1968, the partnership acquired a new apartment complex

located at 1630 Calle Vaquero in the City of Glendale. The apartment building is of wood and stucco construction. The cost basis of the apartment building itself was approximately $677,000. The remaining components of the apartment complex, which include a swimming pool, elevator, air conditioning, carpets and drapes, were segregated for depreciation purposes. The cost basis of these components was approximately $230,000.

Appellants have owned and operated apartment houses for over 20 years. Based upon this experience, and considering the type of construction, appellants assigned a useful economic life of 25 years to the building and computed depreciation using the double declining balance method. The remaining components of the apartment complex were depreciated on the basis of shorter lives. The 25-year life assigned to this apartment building is the same as the depreciable lives assigned to other apartment buildings of similar design and construction owned and operated by appellants which have been approved during previous audits by both respondent and the Internal Revenue Service.

Appellants' 1968 personal income tax return was audited and a notice of proposed assessment containing several adjustments was issued on September 30, 1971. Appellants acquiesced in all of the proposed adjustments except the one concerning depreciation. Upon review of the proposed depreciation adjustment appellants noted that, although the propriety of the useful economic life assigned to the apartment building was not questioned, respondent's agent had made an error in computing allowable depreciation. The original notice of proposed assessment stated that depreciation was reduced by one-half to reflect the fact that the property had been held for the production of income for only one-half the year. Appellants were aware of this and, in fact, had claimed depreciation for only one-half the year. However, appellants had used the 200 percent declining balance method while respondent, in computing the adjustment, erroneously used the 100 percent declining balance method.

Appellants notified respondent of this error. Thereafter, on January 24, 1972, the original notice of proposed assessment was withdrawn and a second notice of proposed assessment issued. This notice did correct the computational error but, without explanation, changed the useful economic life of the apartment building from 25 years to 40 years. At no time did respondent's agent ever make a physical examination of the premises. Appellants protested this change and submitted a claim for refund. The claim was partially denied and appellants appealed. It is the propriety of respondent's determination in this matter which is the sole issue on appeal.

A reasonable allowance for the exhaustion, wear and tear of property held for the production of income is allowed as a depreciation deduction. (Rev. & Tax. Code, § 17208.) The amount of this deduction is determined, in part, by the useful economic life of the property. However, the useful economic life of an asset is not necessarily the useful life inherent in the asset. Rather, it is the period over which the asset may reasonably be expected to be useful to the taxpayer in the production of his income. (Cal. Admin. Code, tit. 18, reg. 17203(a), subd. (2); see also, Massey Motors, Inc. v. United States, 364 U.S. 92 [4 L. Ed. 2d 15921.)

In support of its position that the apartment building has a useful economic life of 40 years, respondent merely cites Revenue Procedure 62-21 (1962-2 Cum. Bull. 418) and rests on the presumption that its action is correct.

Unquestionably, a determination by respondent is presumed correct and the burden of proof is on appellant to establish that it is incorrect. However, where respondent's determination is shown to be arbitrary or capricious no presumption of correctness attaches. (See Helvering v. Taylor, 293 U.S. 507, 514 [79 L. Ed. 623] and its progeny.) Respondent's agent acquiesced in the 25-year life assigned to the apartment at the time the first proposed assessment was issued and proposed to change the depreciable life, without further investigation or explanation, only after it was determined that appellants were due a refund. It is also noted that at no time has respondent offered any explanation for the action of its agent. In view of the

circumstances under which the second proposed assessment was issued we can only conclude that respondent's action in this matter was arbitrary and capricious. Under these circumstances no presumption of correctness attaches to respondent's determination.

Respondent asserts that Revenue Procedure 62-21, supra, states that 40 years is the guideline life given for apartment buildings. However, Revenue Procedure 62-21, like its predecessor Bulletin "F", is merely a guide and cannot be arbitrarily applied. It is not to be applied in any case as a matter of law. (See Estate of Mary Z. Bryan, T.C. Memo., June 27, 1963; Daniel S. W. Kelly, T.C. Memo., Jan. 15, 1957; see also, Massey Motors, Inc. v. United States, supra.) Inherent in these guidelines is the requirement that, prior to disturbing a taxpayer's determination of useful economic life based on his experience, some objective standard must be applied. Here, no such standard was ever applied. (See Rev. Proc. 62-21, 1962-2 Cum. Bull. 418, 429; Cal. Admin. Code, tit. 18, reg. 17208(a), subd. (2).)

When respondent's determination has been shorn of its presumption of correctness, and in the absence of any evidence supporting its position, we must decide the matter on the record before us. Therefore, we conclude that appellants properly assigned a 25 year useful economic life to the apartment building. Accordingly, respondent's determination must be reversed.

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,

Appeal of Morris M. and Joyce E. Cohen

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 19060 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying to the extent of $347.53 the claim of Morris M. and Joyce E. Cohen for refund of personal income tax in the amount of $454.11 for the year 1968, be and the same is hereby reversed.

Done at Sacramento, California, this 19th day of February, 1974, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: _____, Secretary