BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )
)
WESLEY D. AND ELEANOR P. FOWLER )

For Appellants: Wesley D. Fowler, in pro. per.

For Respondent: Bruce W. Walker
Chief Counsel

Kathleen M. Morris
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 protest of Wesley D. and Eleanor P. Fowler against a proposed assessment of additional personal income tax in the amount of $373.46 for the year 1973.

Appeal of Wesley D. and Eleanor P. Fowler

The issue presented is whether legal and surveying expenses incurred because of a land boundary dispute were proper additions (either entirely or partially) to the basis of timber subsequently sold.

Appellant Wesley D. Fowler and his brother, Emerson A. Fowler, own timber land in northern California. 1/ This real Property is located in the County of Siskiyou and consists of the north one-half of section 24, township.47 north, range 7 west. Appellant and his brother have been engaged in the business of selling timber and wood products for many years. The land is of no value for any use other than production of timber because of its location and inaccessibility. Information submitted by appellant, as part of the record, seems to indicate that the fair market value of the marketable timber on the property approximately equaled the value of the land.

In 1954 when appellant and his brother attempted to sell all the existing marketable timber on the land, appellant was advised by an experienced timber operator that before the purchaser would cut and acquire it, appellant would have to establish a "cutting" line on all sides to avoid the possibility of the commission of a trespass or conversion. When appellant could not locate the section corners for his western boundary, this operator (a timber cruiser with previous experience in locating section lines in township 47 north) advised appellant that he should search for the corners approximately one-half' mile further west. This was based upon the operator's understanding that section 24 was approximately one and one-half miles rather than one mile in width. However, since time demands precluded a present search, a conservative "temporary" western cutting line was established.

In order to clearly establish the exact area and location of the north one-half of section 24 owned by him, appellant thereafter commenced a thorough search. In 1960, appellant, a civil engineer, completed his land survey and filed the necessary map, in endeavoring to establish what he concluded was the correct western boundary, considerably to the west of the temporary line.

Southern Pacific Land Company (Southern Pacific) owned the real property described as section 23, township 47 north, range 7 west, lying immediately to the west of appellant's land. Because appellant concluded that the correct boundary between appellant's land and that of Southern Pacific was further west, a trespass and conversion appeared to have

1/ For simplicity, we shall hereafter refer to appellant as sole owner of the land.

been committed when Southern Pacific sold timber east of the western boundary claimed by appellant in 1960. Southern Pacific regarded the boundary between it and appellant's land as approximately one-half mile east of the new western line claimed by appellant.,

Inasmuch as both parties asserted ownership of the land and timber in a particular area, appellant deemed it necessary to resolve the matter by litigation. Therefore, he sought declaratory relief to establish the location of the disputed boundary. It was subsequently judicially determined that the boundary claimed by Southern Pacific was the correct one. The adjudication of the claim became final prior to 1973. Appellant and his brother incurred expenditures of $10,181.72 (legal and surveying costs) as a consequence of the boundary dispute during the years 1962, 1966, and 1968 through 1971.

In 1973 pursuant to a new timber contract, appellant and his brother sold all the marketable timber they owned in section 24. In computing his 1973 state tax liability, appellant added his one-half share of the aforementioned expenditures to the basis of his share of the timber sold in 1973. This resulted in reporting a taxable loss from the sale because the basis of the timber thereby exceeded his share of the proceeds from the sale. Respondent determined that these costs were proper additions to the basis of the unsold land rather than to the basis of the timber, and consequently made no allowance for the expenditures, in revising appellant's tax liability for that year. Since the basis of the timber was thereby reduced by respondent, it determined that the timber sale in 1973 produced a capital gain.

Appellant states that in the previous years when he originally attempted to deduct his share of these costs when paid, as ordinary and necessary business expenses, the Internal Revenue Service ruled that they could "not be deducted as ordinary business expenses and could only be treated as part of the cost of a capital asset, which cost could be recovered at the time of the sale of the capital asset." He maintains that respondent then also claimed a tax deficiency because of the IRS ruling and that he was thereby led to believe that respondent "concurred with the ruling of the IRS."

As a consequence of the action taken by the IRS and respondent, appellant explains that he thereafter refrained from deducting these expenses as they were incurred and paid in the subsequent years through 1971. He now asserts that he has complied with the IRS ruling by regarding these expenditures as part of the basis of the timber sold in 1973. He claims that if respondent is not now ordered to allow appellant's treatment of the expenditures, the result "would be tantamount to entrapment."

He urges that all the legal and surveying costs should be added to the basis of the timber, rather than all, or a portion thereof, being allocated to the land, because there could have been no sale of the timber in 1973 without first establishing "cutting lines" agreed upon by the adjacent owners or established by law.

We first conclude that it is correct to treat these costs as capital expenditures, rather than expenses to be deducted when paid. It is a fundamental principle of income tax law that amounts paid to acquire real property, or to improve it, represent capital expenditures to be added to the basis of the property, rather than deductible ordinary and necessary.business expenses. (See Appeal of George S. and Mable L. Duke, Cal. St. Bd. of Equal., Nov. 6, 1967.) Moreover, sums expended for the protection', preservation or perfection of title to real property, as well as for its original acquisition, are capital expenditures to be added to its basis. (See Jones' Estate v. Commissioner, 127 F.2d 231 (5th Cir. 1942); Cal. Admin. Code, tit. 18, reg. 17283(b).) Consequently, we conclude that these costs should have been capitalized as they were paid. (See Jones' Estate v. Commissioner, supra; Farmer v. Commissioner, 126 F.2d 542 (10th Cir. 1942); Lincoln L. McCandless, 5 B.T.A. 1114 (1927); Katherine B. Lowry, ¶ 68,173 P-H Memo. T.C. (1968).)

The subject matter of the litigation, in essence, was a determination of the exact area and location of appellant's land and timber. Consequently, we next find that the costs related to the protection, preservation and perfection of title both to the land and to the timber thereon. Therefore, we conclude that these costs should have been allocated, in a reasonable proportion, partially to the basis of the unsold land and partially to the basis of the timber. (See Rev. Rul. 68-528, 1968-2 Cum. Bull. 331.)

Inasmuch as the timber was subsequently sold, appellant is entitled to deduct as part of the basis of such timber, from the selling price, his share of the costs that should reasonably have been allocated to it. (See Rev. Rul. 68-528, supra; Rev. Rul. 55-557, 1955-2 Cum. Bull. 60: see also William H. and Donnalie W. McPherson, Cal. St. Bd. of-Equal., May 9, 1968.) Because the land was not sold in 1973, the expenditures reasonably allocable to the land are not deductible. Consequently, we do not find any inconsistency between respondent's present determination and the position previously taken by the IRS and respondent.

A reasonable allocation of these total costs is accomplished by using the approximate ratio of the fair market values of the marketable timber and land at the time the costs

were incurred. (See Rev. Rul. 68-528, supra.) The record is not totally clear, but it seems to indicate that during all the years when the costs were incurred and paid, the fair market value of the marketable standing timber at least equaled the fair market value of the land. Under the circumstances, we conclude that one-half of the expenditures in question should be added to the basis of the timber sold in 1973, and deducted from its selling price.

Respondent contends, relying upon the decision in Farmer, supra, that all of the expenditures should be allocated to the basis of the land because appellant was litigating title thereto, and "without the land [he] would not have any timber." We conclude that respondent's reliance upon the Farmer case is misplaced. In that decision, the court merely determined that attorney fees incurred in defending title to land were not deductible as ordinary and necessary business expenses by the assignee of the lessor of an oil and gas lease.

For the foregoing reasons, we conclude that respondent's action should be modified to reflect the allocation of one-half of the total legal and surveying costs to the basis of the timber sold in 1973. Therefore, appellant should be allowed to deduct from his proceeds of the timber sold in 1973 one-half **of his share of the legal and surveying costs.**

Appeal of Wesley D. and Eleanor P. Fowler

## 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 Wesley D. and Eleanor P. Fowler against a proposed assessment of additional personal income tax in the amount of $373.46 for the year 1973, in totally disallowing any portion of the expenditures as an addition to the basis of the timber sold, is hereby modified in accordance with the views expressed in this opinion. In all other respects, the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 8th day of February, 1979, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member