

Appeal of Zuckerman-Mandeville, Inc.

The issue for determination is whether appellant was **entitled** to depreciation deductions for its tomato equipment during the appeal years. This equipment consisted of a tomato grading station and certain mobile tomato equipment. The mobile equipment included six tomato harvesters with modifications, 28 trailers and a tomato **washer**. For the year ended June 30, 1972, appellant claimed depreciation in the amount of \$44,269 for the entire remaining depreciable basis of the grading station. For the years ended June 30, 1972 and June 30, 1973, appellant claimed depreciation on the mobile tomato equipment in the approximate amounts of \$16,400 and \$19,500, respectively.

As the result of an audit, respondent concluded that the grading station was obsolete and had been **retired** by appellant so that it should have been fully depreciated not later than the income year ended June 30, 1971. Respondent also concluded that the mobile tomato equipment had been permanently retired from appellant's business not later than June 30, 1971. Accordingly, respondent disallowed the depreciation deductions and issued deficiency assessments. The assessments were paid and appellant filed a claim for refund. Respondent denied the claim and this appeal followed.

Appellant has been conducting farming operations in the Stockton area for many years. In 1969 appellant was on the verge of bankruptcy as a result of large losses incurred in preceding years. Early in 1970, a voluntary creditors' committee was formed to develop a plan to stave off bankruptcy. Pursuant to the plan, appellant was required to shift to less labor-intensive crops, to adopt a "bare bones" operating budget and to liquidate portions of its real property for the benefit of creditors.

In the course of retrenching its operations, appellant discontinued growing high acreage cash outlay crops, including tomatoes, after the 1969 harvest. This retrenchment is described in the 1970 report to the **board** of directors where appellant's president Alfred R. Zuckerman stated, in part, that appellant "went out of the seed potato business" and "went out of the tomato business."

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The tomato grading station which had an estimated life of 20 years was acquired during 1968 and 1969 at a cost of **approximately \$56,650**. In 1970 the station was put up for sale. When it failed to sell, the station was written off in the year ended June 30, 1972, by charging its remaining cost basis of \$44,269 to depreciation. Prior to that year appellant contends it still considered the station to be a business asset. According to appellant it was written off because discussions with various tomato buyers during that year convinced appellant that the facility had no future use.

The mobile tomato equipment was acquired at various times from June 1964 through July 1968 at a total cost slightly in excess of \$180,000. The six harvesters with estimated lives of seven years were designed to collect and deliver tomatoes to the grading station. Four were central sort type harvesters while the remaining two were of a different design. While not in use the six harvesters were kept under cover where they remained in operable condition and did not deteriorate appreciably. After the termination of the tomato business which appellant contends was not until 1973, **some of the mobile equipment, presumably the 28 trailers, were** used in other farming operations, such as 'grapes. However, for accounting purposes, appellant continued to carry all the equipment in the tomato equipment account. Although appellant stated that the harvesters were scrapped during the year ended June 30, 1973, it continued to claim depreciation deductions on all the mobile equipment, including the harvesters, until the six harvesters were sold for scrap at their approximate salvage values in 1975. Two trailers were also sold at their approximate salvage values at about the same time.

Section 24349 of the Revenue and Taxation Code provides for the deduction, as depreciation, of a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) of property used in the trade or business. The phrase "used in the trade or business" is generally construed to mean "devoted to the trade or business." Thus, depreciation is allowable on assets which are idle or the use of which is temporarily suspended. Such assets are still regarded as being used in the trade or business. Property once used in the business remains in such use

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until it is shown to have been withdrawn from business purposes. If the property is abandoned, however, it is no longer deemed to be devoted to the trade or business. (4 Mertens, Law of Federal Income Taxation § 23.11a.)

The deduction for depreciation includes obsolescence. Two forms of obsolescence are recognized: (1) a gradual reduction of usefulness; and (2) a **sudden** loss of useful value brought about by a radical change. In this appeal we are concerned with obsolescence of the second type which may be referred to as "abnormal" or "extraordinary obsolescence." Deductions for obsolescence of this type must commence at the time such obsolescence becomes apparent and end when the property becomes obsolete. The burden of proof is entirely upon the taxpayer to establish a claim for obsolescence by facts and evidence that are reasonably indisputable. (4 Mertens, Law of Federal Income Taxation § 23.40.) It is incumbent upon appellant to establish substantial reasons for believing that the property would become obsolete and when that event occurred. (See Celluloid co., 9 B.T.A. 989 (1927).)

In support of its position with respect to the claimed **obsolescence of** both the tomato grading station and the mobile equipment, respondent relies on a statement of appellant's controller to the effect that most buyers had refused to purchase tomatoes sorted and packed by the central sort method after 1969. As we have indicated, four of the six tomato harvesters were of the central sort type and were designed to operate with the grading station. Appellant, while not denying that the statement was made, points out that the statement was made during the course of the audit in 1974 and referred to the income year ended June 30, 1972, and thereafter, at which time appellant admits that the grading station, at least, was no longer usable. Respondent also relies on the 1970 report to the board of directors where appellant's president stated that appellant "went out of the tomato business" after the 1969 harvest.

Subsequent to the hearing, in response to these assertions by respondent, appellant's president submitted a letter which stated, in effect, that:

1. After 1969 appellant was prevented from growing tomatoes and using the tomato equipment solely by virtue of its

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inability to finance such high cost operations.

2. Because of the limited operating restrictions placed upon it by creditors appellant not only went out of tomato and seed potato operations, as stated in the 1970 president's report, but also out of other high cost operations such as grapes, onions, asparagus and sugar beets, although in subsequent years appellant once again grew all those crops except tomatoes.
3. The reason for not going back into the tomato business and deciding to sell the harvesters was predicated upon the fact that the lands were being used 'successfully for other crops and appellant did not think it would be economical to grow tomatoes at the price being offered by the canneries.

The key to resolving this appeal is whether the central sort type of tomato harvesting equipment was obsolete before June 30, 1971 as contended by respondent or became outmoded during subsequent years as claimed by appellant. Unfortunately, the record in this regard is inadequate and in some respects contradictory. Although, subsequent to the hearing appellant submitted a **self-serving** letter attempting to counter respondent's position, it was phrased in the most general terms and did not address the pivotal question of when central sort tomato harvesting equipment became outmoded. In this regard, however, the fact that appellant put the grading station up for sale in 1970 militates against its contention that the station did not become useless until the year ended June 30, 1972, and that it intended to reinstitute tomato operations at some unascertained future date. Furthermore, appellant put the grading station, which had a **20-year** life, up for sale only one year after it was acquired. This fact also lends support to respondent's contention that by 1970 the grading station was either obsolete or had been retired in view of appellant's intent not to reenter the tomato business,. We also note that the year ended June 30, 1972, was the first year

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appellant had net income since before its financial condition became acute prior to 1969. This fact adds **credence** to respondent's contention that appellant **merely** desired to delay the deduction for obsolete or retired property until a tax benefit could be obtained. In the absence of a definitive answer to the key question of when the tomato equipment became outmoded, we must reluctantly conclude that appellant has failed to carry its burden of proof and apply the presumption that respondent's action with respect to the tomato grading station is correct. (See Appeal of Peninsula Savings and Loan Association, Cal. St. Bd. of Equal., Jan. 2, 1974; Appeal of Darr and Patricia Jobe, Cal. St. Bd. of Equal., July 7, 1967.)

Since the tomato harvesters were designed to operate with the grading station, it follows that they **were also** obsolete or retired prior to the years in issue. Although two of the six harvesters were not of the central sort type, there is no evidence that they were either used or usable in appellant's other farming operations during the appeal years. This conclusion, however, does not apply to the 28 trailers with a cost basis of **\$23,461.40**. Apparently, these trailers were available for and were used in other farming operations. Therefore, depreciation on the trailers was properly claimed and should have been allowed during the appeal years, .

Appellant has cited three cases in support of its position. (Kittredge v. Commissioner, 88 **F.2d** 632 (2d Cir. 1937); P. Dougherty Co., 5 T.C. 791 (1945), affd., 159 **F.2d** 269 (4th Cir. 1946), cert. den. 331 U.S. 838 [91 L. Ed. 18501 (1947)]; Appeal-of Grace Bros. Brewing Co., Cal. St. Bd. of Equal., June 28, 1966.) We find these cases distinguishable. Central to the decision in each case was the taxpayer's established intent to devote temporarily idled assets which were entirely functional to productive use as soon as conditions permitted. In the instant appeal, based on the limited record before us, appellant has not established that it intended to return to the tomato business or that the assets were capable of being used during the period they **were** idled.

Accordingly, **we** conclude that respondent's action in this matter, as modified with respect to the

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allowance for depreciation of the trailers, 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 26077 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of Zuckerman-Mandeville, Inc. for refund of franchise tax in the amounts of **\$4,393.35** and **\$1,485.43** for the income years ended June 30, 1972 and June 30, 1973, respectively, be and the same is hereby modified in accordance with this opinion and in all other respects the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 16th day of August, 1979, by the State Board of Equalization.

William B. Smith, Chairman

David H. [unclear], Member

Geoff Kelley, Member

_____, Member

_____, Member