

Appeal of Hubacher Holding CO.

The question presented by this appeal is whether **appellant is entitled to an abandonment loss for the unamortized basis of leasehold improvements where the lease was discharged upon appellant's liquidation.**

Appellant, a California corporation, was incorporated in -1969. Mr. Elmer R. Hubacher was the sole shareholder of appellant. Appellant was **formerly known as Rubacher Cadillac, Inc.,** and continued filing **its returns** under said former name. On Hatch 30, 1972, appellant **entered into a written lease with Elmer and Rita Hubacher for the rental of land, buildings, and improvements.** The lease **term was ten years** with an option to extend for two five-year periods. Appellant was obligated to construct **various leasehold improvements** which cost \$377,872 upon construction. On October 30, 1981, appellant **resolved** that it be liquidated in accordance with Internal Revenue Code section 337. On **November 18, 1981,** appellant **signed a sales agreement and bill of sale** whereby it sold the assets set forth therein to Hubacher Cadillac, Inc., a Delaware corporation (hereinafter referred to as Hubacher-Delaware). Also, on November 18, 1981, Elmer and Rita Hubacher entered into a written lease with Hubacher-Delaware for the rental of apparently **the same** properties previously leased to appellant. **On** appellant's tax **return** for the period ending December 31, 1981, appellant reported a net loss of \$76,607. The loss included **an 'Abandoned Leasehold Improvements' loss in the amount of \$185,377,** representing the unamortized **cost of the improvements** to the leased premises. Respondent determined that appellant **was not entitled** to any **of the** abandonment loss deduction.

Generally, costs incurred by a lessee for leasehold improvements are required to be recovered through depreciation or amortization over the **term of the lease or useful life of each improvement.** (Treas. Reg. S 1.167(a)-4; Rev. & Tax. Code, S 24349.) During the appeal year, Revenue and Taxation Code section 24349 was substantially similar to Internal **Revenue Code section 167.** **Therefore, construction of the federal statute is very persuasive in interpreting the California section.** (Holmes v. McColgan, 17 **Cal.2d** 426 (110 P.2d 4281 cert. den., 314 **U.S.** 636 (86 L.Ed. 5101 (1941)).) Where the basis for the claim of loss is abandonment **of depreciable property,** the taxpayer must irrevocably discard the asset so that it will neither be **used by the taxpayer again nor be retrieved by the taxpayer for sale, exchange, or other disposition.** (See **Treas. Reg. S 1.167(a)-8(a)(4).**) Normally, any unamortized balance **of income-producing assets is deductible** by the lessee as a loss in the year the lease is terminated. (Cassatt v. Commissioner, 137 **F.2d** 745 (3rd Cir. 1943).) However, where **an income-producing asset is distributed**

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to shareholders upon liquidation, the rule is that no deduction for the loss of the unamortized balance of the cost of such asset may be taken by the liquidating corporation. (Wolan v. Commissioner, 184 F.2d 101 (10th Cir. 1950).) The same rule of nondeductibility applies whether it is the leasehold improvements or the leases themselves which are distributed in liquidation. (Cooper Foundation v. O'Malley, 221 F.2d 279 (8th Cir. 1955); Action Distributing Company, Inc. v. Commissioner, ¶ 87,377 T.C.M. (P-H) (1987); Tom L. Burnett Cattle Co. v. Commissioner, ¶ 60,015 T.C.M. (P-H) (1960).)

The appellant contends that it is entitled to deduct the unamortized balance of its costs of the leasehold improvements in accordance with the general rule in Cassatt v. Commissioner, supra. Respondent asserts that the appellant has not established its intent to abandon the leasehold improvements. The respondent also contends that the net effect of appellant's actions in liquidation was to distribute its leasehold improvements, which had value, to its sole shareholder and lessor.

Where, as here, the basis of the claim of loss is abandonment, appellant must establish an intent to abandon the property coupled with an act of abandonment. Appellant has not established an intent to abandon the leasehold improvements. Appellant did resolve to liquidate and then proceeded to do so. On November 18, 1981, appellant sold its assets, including leasehold improvements, to Hubacher-Delaware. However, on the same day, appellant's sole shareholder entered into a lease agreement with Hubacher-Delaware purportedly leasing the same premises that had been leased to appellant. Without any other proof of abandonment, we are compelled to conclude that appellant made a liquidation distribution of its lease and/or leasehold improvements to its sole shareholder, who, in turn, executed a new lease with Hubacher-Delaware. Under these circumstances, it is plain that the leasehold improvements were not irrevocably discarded. Accordingly, no abandonment loss deduction is allowable. (Wolan v. Commissioner, supra.)

