91-SBE-007

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of	)	
	)	No. 87A-0224 and 90A-0061-CD
TRICO BANCSHARES	)	

Appearances:

For Appellant: Jan A. Rosati
Certified Public Accountant

Robert R. Rubin
Attorney at Law

For Respondent: Lorrie K. Inagaki
Counsel

O P I N I O N

This appeal is made pursuant to section 25666[1/] of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of TriCo Bancshares against proposed assessments of additional franchise tax in the amounts of $8,896, $41,596, $29,657, and $18,359 for the income years 1982, 1983, 1984, and 1985, respectively.

[1/] Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the income years in issue.

The issues in this appeal are: 1) whether an intangible asset that appellant characterizes as a "core deposit base" is "separate and distinct" from goodwill for purposes of tax amortization and 2) whether that asset had a limited useful life, the duration of which could be determined with reasonable accuracy. Because of our conclusion regarding the first issue, we shall not consider the second issue.

Appellant, a California bank holding company, acquired Tri Counties Bank ("Tri Counties"), a California bank, in September 1982. From the date of acquisition, appellant and Tri Counties have filed combined reports. In March 1981, Tri Counties had acquired Shasta County Bank ("Shasta"), a California bank. Tri Counties paid $5,236,000 for Shasta and, at the time of purchase, apparently allocated approximately $1,395,000 of the purchase price to goodwill. This amount allocated to goodwill appears to have represented a premium that Tri Counties was willing to pay over the value of the tangible assets of Shasta. For many years before the acquisition, Shasta was a profitable bank with a geographical diversification of branches in Northern California that Tri Counties thought would strengthen its competitive position.

On the combined report which appellant filed with Tri Counties for 1982, appellant reported no amortization expenses for Tri Counties. Later, however, appellant decided that it could amortize and deduct for income tax purposes the "core deposit base" associated with Tri Counties' purchase of Shasta. In essence, this intangible represents a bank's ability to generate income from "core deposits" by receiving them from depositors and then lending them at a higher rate than it paid. "Core deposits" are a relatively low-cost source of funds, reasonably stable over time, and relatively insensitive to interest rate changes. (Citizens & Southern Corp. v. Commissioner 91 T.C. 463, 465 (1988), affd. per curiam, 919 F.2d 1492 (11th Cir. 1990). See AmSouth Bancorporation and Subsidiaries v. United States, 681 F.Supp. 698, 699, 720 (1988).) Shasta's checking and savings accounts were the "core deposits" acquired by Tri Counties.

In January 1984, appellant engaged Patten, McCarthy and Associates, Inc. (PM), a financial management firm, to value the core deposit base and to distinguish this intangible for tax purposes from goodwill, an intangible which appellant properly understood to be nondeductible. PM calculated the present value of the future stream of income associated with investment of the acquired core deposits and concluded that $2,552,000 of the purchase price should be allocated to the core deposit base and was available to be amortized for tax purposes. As a result of PM's calculation, the original amount of approximately $1,395,000 allocated to goodwill was reduced to $48,000.

Relying on these determinations by PM, appellant filed an amended return for 1982 on which it claimed an amortization deduction of $538,028. Respondent treated the amended return as a claim for refund. Appellant filed returns for 1983, 1984, and 1985 on which it claimed amortization deductions of $375,701, $271,337, and $125,563, respectively. Respondent rejected appellant's claim for refund for 1982 and issued proposed assessments for all the appeal years.

There is allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business or held for the production of income. (Rev. & Tax Code, § 24349, subd. (a); I.R.C. § 167(a).) The term "property" includes

intangibles, and the rules for the allowance of the depreciation deduction for intangibles are stated in the Treasury regulations as follows:

> Sec. 1.167(a)-3. Intangibles
>
> If an intangible asset is known from experience or other factors to be of use in the business or in the production of income for only a limited period, the length of which can be estimated with reasonable accuracy, such an intangible asset may be the subject of a depreciation allowance. Examples are patents and copyrights. An intangible asset, the useful life of which is not limited, is not subject to the allowance for depreciation. No allowance will be permitted merely because, in the unsupported opinion of the taxpayer, the intangible asset has a limited useful life. No deduction for depreciation is allowable with respect to goodwill.

To qualify under the foregoing regulation for a depreciation deduction with respect to the core deposit base, appellant must show that the core deposit base (1) had an ascertainable value separate and distinct from the acquired goodwill of Shasta and (2) had a limited useful life, the duration of which could be ascertained with reasonable accuracy. (Houston Chronicle Publishing Co. v. United States, 481 F.2d 1240, 1250 (5th Cir. 1973); AmSouth Bancorporation and Subsidiaries v. United States, supra, 681 F.Supp. at 712.)

Appellant contends that ascertaining a value for the core deposit base, as it maintains that PM had done, is sufficient to establish that the core deposit base is separate and distinct from goodwill for purposes of the pertinent test. Respondent argues that, while appellant may have shown that the core deposit base is identifiable, appellant still has the burden of showing that the core deposit base is separate and distinct from goodwill. Respondent contends that the business opportunities and advantages inherent in the deposit relationships represented by the core deposits make the core deposit base so intertwined with goodwill that they are inseparable and, therefore, the core deposit base, like the good- will, is nondepreciable.

We agree with respondent's contention. The essence of the concept of goodwill is a preexisting business relationship, based on a continuous course of dealing, which may be expected to continue indefinitely. (AmSouth Bancorporation and Subsidiaries v. United States, supra; Computing & Software, Inc. v. Commissioner, 64 T.C. 223, 233 (1975).) Core deposit relationships are typically retained over time and tend to be the focal point for other bank customer relationships (AmSouth Bancorporation and Subsidiaries v. United States, supra, 681 F.Supp. at 705). In discussing the relationship between the core deposit base of an acquired bank and its goodwill, the court in AmSouth stated:

> Ultimate Finding and Conclusion

> The court ultimately finds and concludes that BEA had goodwill and that plaintiff has not met its burden of proving that the [core] deposit base had a value which was separate and distinct from the goodwill of BEA. As stated in the Association's brief, "a deposit relationship becomes a point of contact with customers for selling the bank's income-producing services." (Page 4). The Association further argues that the deposits are "an avenue for selling the bank's income producing services (i.e. safe deposit rentals, safe-keeping services, discount brokerage services, trust services, installment loans, and the myriad of services for commercial customers.)" (Page 8). The court agrees and further concludes that this tends to make the deposit relationship inseparable from goodwill when it exists.

(AmSouth Bancorporation and Subsidiaries v. United States, supra, 681 F.Supp. at 719-720.)

In explicitly rejecting the position that is basically equivalent to that of appellant, the AmSouth court also stated:

> For accounting purposes, a bank may be able to "identify" a [core] deposit base even though it may not be separate and distinct from goodwill. To the extent that deposits remain after some contractually stipulated period, they result from, "continued patronage." The mere fact that the deposits themselves are identifiable, does not make their "value" separate and distinct from goodwill. Other facets of bank activities such as safe deposit "expectations," loan "expectations," etc. could perhaps be similarly "identified" so as to phase out the concept of goodwill. There is no indication that tax law permits or contemplates this result.

(AmSouth Bancorporation and Subsidiaries v. United States, supra, 681 F.Supp. at 720.)

In considering this same issue, The United States Tax Court in Citizens & Southern Corp. concluded that the petitioner-bank there had met its burden of showing that the core deposit base that it had acquired was separate and distinct from the goodwill of the acquired banks. However, the court in Citizens itself cited AmSouth with approval and emphasized that the different results reached in the two cases were compelled by the differences between their respective records. (Citizens & Southern Corp. v. Commissioner, supra, 91 T.C. at 481.) In addition, the rationale stated in the majority opinion in Citizens for its holding in favor of the taxpayer is extremely unclear and, in our view, less persuasive than the rationale stated for the result reached in AmSouth. Therefore, we believe that AmSouth provides appropriate support for respondent's contention here.

In view of the foregoing, we conclude that the core deposit base is an inseparable part of the goodwill acquired by appellant, and, like the goodwill, may not be amortized and deducted.

Accordingly, respondent's actions 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 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of TriCo Bancshares against proposed assessments of additional franchise tax in the amounts of $8,896, $41,596, $29,657, and $18,359 for the income years 1982, 1983, 1984, and 1985, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 21st day of November, 1991, by the State Board of Equalization, with Board Members Mr. Sherman, Mr. Dronenburg, Mr. Bennett, Mr. Davies, and Mr. Fong present.

Brad Sherman, Chairman

Ernest J. Dronenburg, Jr., Member

William M. Bennett, Member

John Davies*, Member

Matthew K. Fong, Member

*For Gray Davis, per Government Code section 7.9
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