

BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of )  
 )  
REGAL GOLD LOAN AND RENTAL COMPANY )

For Appellant: Levon M. Azhderian,  
President  
For Respondent: Crawford H. Thomas  
Chief Counsel  
John D. Schell  
Counsel

O P I N I O N

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Regal Gold Loan and Rental Company against proposed assessments of additional franchise tax in the amounts of \$451.05, \$320.40, \$289.68, and \$1,110.07 for the income years 1957, 1958, 1959, and 1960, respectively.

The question presented for decision is the propriety of proposed assessments which were based upon a federal determination partially disallowing claimed depreciation deductions on farm equipment and including additional income from the sale of pumps.

Appellant engaged in the business of renting farm equipment to corporations and partnerships owned by its stockholders and officers. In 1965 the federal Internal Revenue Service issued a Revenue Agent's Report covering appellant's income years 1957 through 1962. Adjustments were made by the Internal Revenue Service to appellant's depreciation expense deduction for many pieces of equipment, including tractors, bulldozers, pickup trucks, and automobiles. Appellant used the

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straight-line method of depreciation, and adjustments were made where salvage value was not taken into consideration. The Internal Revenue Service allowed the depreciation taken through 1956, determined a salvage value for each of the various pieces of equipment, and prorated the balance of the existing adjusted cost, less the salvage value, over the remaining useful life. Furthermore, with respect to at least 17 pieces of equipment, the federal auditors revised the estimated useful life. The original designation of useful life varied from four to eight years, and the revisions made by the Internal Revenue Service varied from one-year increases to two-year decreases. In some instances the adjustment made by the Service was to prorate a portion of a full year's depreciation, rather than to allow a full year, where a particular asset was acquired or sold during an income year. Also included as taxable in 1960 was appellant's alleged gain from the sale of pumps by a related corporation where the sales price was entered on appellant's books as owed to appellant.

Appellant appealed the federal audit, and after a detailed examination of appellant's records, the Internal Revenue Service made certain revisions. Appellant agreed to the federal determination, paying deficiencies for 1957 and 1958. Net operating loss carrybacks completely offset the deficiencies for 1959 and 1960.

Respondent' subsequently issued proposed assessments for income years 1957 through 1960. For 1957 and 1958 these were based upon the final federal action and correctly reflect the net effect of the original federal action and the subsequent revisions. For 1959 and 1960 the proposed assessments were based upon the original federal action but do not reflect the final federal revisions. Appellant protested the proposed additional assessments for the four years and a denial of the protest gave rise to this appeal. Respondent concedes that the proposed assessments for the last two years should be revised to reflect a lesser liability of \$111.39 for 1959 and \$1,031.96 for 1960 in accordance with the federal revisions.

Section 24349 of the Revenue and Taxation Code allows as a depreciation deduction "a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) -- (1) Of property used in the trade or business. " The annual allowance for depreciation is that amount which should be set aside for the income year in accordance with a reasonably consistent

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plan so that the aggregate of the amounts set aside, plus the salvage value, will at the end of the estimated useful life equal the cost or other basis of the property. (Cal. Admin. Code, tit. 18, reg. 24349(a), subd. (1).)

Appellant contends that a retroactive recomputation of depreciation is improper, except with respect to the final year of useful life, where there is an adjustment for salvage value and there is no revision in useful life. Appellant also maintains it properly took a full year's straight-line depreciation in the calendar year of purchase of certain farm equipment, claiming the equipment was only to be used seasonally during the year and received such complete seasonal use. Accordingly, appellant argues it was error to revise the starting and ending dates of depreciation with respect to such equipment. Appellant also objects to the other changes made in useful life, alleging they were insignificant and therefore should not have been made.

The Franchise Tax Board's determination of a deficiency, based upon a federal audit, is presumed to be correct, and the burden is upon the taxpayer to establish that it is erroneous.: (Appeal of Samuel and Ruth Reisman, Cal. St. Bd. of Equal., March 22, 1971; Appeal of Nicholas H. Obritsch, Cal. St. Bd. of Equal., Feb. 17, 1959.) In this connection it is further noted that the appellant acquiesced in the revised federal determination.

It is well settled that there may be a retroactive adjustment of depreciation accounts where both salvage value and useful life are revised. (Massey Motors, Inc. v. United States, 364 U.S. 92 [4 L. Ed. 2d 1592-j; Bay Sound Transportation Co. v. United States, 20 Am. Fed. Tax R.2d 5418, modified on other grounds, 410 F.2d 505, cert. denied, 396 U.S. 928 [24 L. Ed. 2d 226]; Catherine F. Dinkins, 45 T.C. 593, aff'd, 378 F.2d 825.) It is also well settled that there may be such an adjustment where just useful life is being revised. (New England Tank Industries, Inc., 50 T.C. 771, aff'd, 413 F.2d 1038; Stevens Pass, Inc., 48 T.C. 532; Bell Electric Co., 45 T.C. 158; Appeal of Continental Lodge, Cal. St. Bd. of Equal., May 10, 1967.)

In Massey Motors, Inc. v. United States, supra, 364 U.S. 92 [4 L. Ed. 2d 1592], at p. 1600, in referring to salvage value, it is stated:

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Obviously a 'meaningful annual accrual requires an accurate estimation of how much the depreciation will total. The failure to take in-to account a known estimate of salvage value prevents this, since it will result in an understatement of income during the years the asset is employed and an overstatement in the year of its disposition. The practice has therefore grown up of subtracting salvage value from the purchase price to determine the depreciation base.

It is provided on page 1601:

Accounting for financial management and accounting for federal income tax purposes both focus on the need for an accurate determination of the net income from operations of a given business for a fiscal period.

As is logically indicated in Massey Motors, Inc. v. United States, supra., 364 U.S. 92[4 L. Ed. 2d 1592], there is considerable distortion of income of previous years where a significant amount of salvage value is ignored. This is true even where no adjustment of useful life is required. The reasoning in Massey Motors, Inc. v. United States, supra, is indicative of the fact that retroactive adjustment should not be prohibited. It is further noted that the limitation on making changes in salvage value, expressed in respondent's regulations, refers to subsequent revisions in salvage value where salvage value was determined at the time of acquisition. (Cal. Admin. Code, tit. 18, reg. 24349(a), subd. (3).)

With respect to the question concerning proration, it is provided in respondent's regulations that the period for depreciation of an asset shall begin when the asset is placed in service, shall end when the asset is retired, and that a proportionate part of one year's depreciation is allowable for that part of the first and last year during which the asset was in service. (Cal. Admin. Code, tit. 18, reg. 24349(j), subd. (2).) It is further provided that under the straight-line method the depreciation is deductible in equal amounts over the period of the estimated useful life. (Cal. Admin. Code, tit. 18, reg. 24349(1), subd. (a).) To allow the full year's depreciation requested by appellant for the first partial year would prevent the proportionate

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spreading which is contemplated in the regulations for the straight-line method. Respondent's regulations are presumed valid, and appellant has not presented authority disputing them. With respect to the other useful life changes, it is true that redeterminations in useful life are to be made only when the change is significant, and there is a clear and convincing basis for the redetermination. (Cal. Admin. Code, tit. 18, reg. 24349(a), subd. (2).) However, appellant has not presented any facts which would establish that respondent did not comply with its own regulations. It is noted that while the changes in useful life were for periods from one to two years, the total useful life of each piece of equipment was relatively short. On the state of the record we are unable to conclude that appellant has rebutted the presumption of the validity which attached to the assessments.

With respect to the transaction involving pumps, respondent relies upon the federal audit which treated the sale of pumps in 1960 by Layco Farms, a related corporation, as a sale by appellant where the sales price was entered on appellant's books as an account receivable. Subsequently, appellant introduced facts into the record which support a finding that appellant was on a cash receipts basis with respect to any such sale and had not actually received any income therefrom. No facts to the contrary have been presented by respondent, and the record does not reveal any agreement or relationship between appellant and Layco Farms which would indicate that appellant had constructive receipt of the sale proceeds. We conclude that no taxable income was derived by appellant from the sale of the pumps.

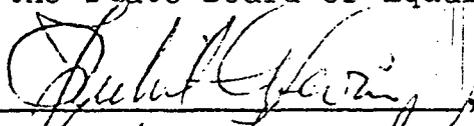
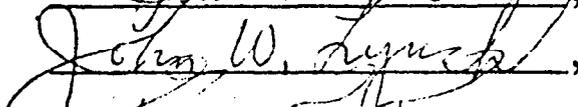
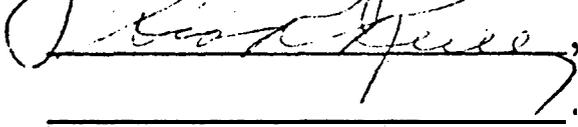
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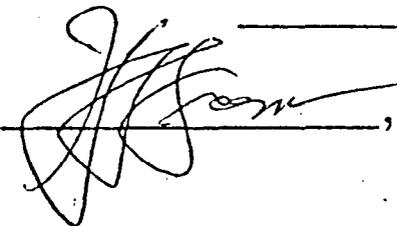
Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

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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 Regal Gold Loan and Rental Company against proposed assessments of additional franchise tax in the amounts of \$451.05, \$320.40, \$289.68, and \$1,110.07 for the income years 1957, 1958, 1959, and 1960, respectively, be and the same is hereby modified in accordance with respondent's concession relative to income years 1959 and 1960 and in view of our conclusion herein that appellant did not receive taxable income from a sale of punps in income year 1960. In all other respects the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 2nd day of June, 1971, by the State Board of Equalization.

  
\_\_\_\_\_, Chairman  
  
\_\_\_\_\_, Member  
  
\_\_\_\_\_, Member  
\_\_\_\_\_, Member  
\_\_\_\_\_, Member

ATTEST:  \_\_\_\_\_, Secretary