BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter 04 the Appeal of)
) No. 84R-109-PD
FERBAR CORPORATION OF)
CALIFORNIA, INC.)

For Appellant: Merrill J. Schwartz
Attorney at Law

For Respondent: Lorrie K. Inagaki
Counsel

O P I N I O N

This appeal is made pursuant to section 26075, subdivision (a),[1/] of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claim of Ferbar Corporation of California, Inc., for refund of franchise tax in the amounts of $232.50 and $648.00 for the income years ended June 30, 1980, and June 30, 1981, 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.

On May 5, 1980, appellant contracted with George A. Lascurettes to buy Lascurettes' interest in a corporation doing business as Superior French Laundry. Lascurettes covenanted not to compete with appellant in the laundry business from May 5, 1980, through December 31, 1990. Appellant agreed to pay Lascurettes $75,000 for the covenant. Appellant was to pay $15,000 at the time the shares were sold as the stated consideration for the period of the covenant through December 1980. Appellant was to pay the $60,000 balance in $500 payments each month during the years 1981 through 1990. On its tax returns, appellant amortized $15,000 of the covenant for its income year ended June 30, 1980, and amortized $3,500 of the covenant for its income year ended June 30, 1981.

Respondent disallowed the whole amount so amortized. After appellant failed to supply a copy of the covenant, respondent issued notices of tax proposed co be assessed for those income years. After appellant failed to pay or to protest, respondent collected the amount of the assessments. Appellant then supplied a copy of the covenant and filed claims for refund with respondent for those income years on the ground that the times and amounts of the payments for the covenant should determine the allowable amortization. In effect, appellant maintains that $3,750 should be amortized in the first appeal year ($15,000 ÷ 8 months) x 2 months, and $14,250 in the second year ($15,000 ÷ 8) x 6 months + ($500 x 6 months).

After examining the covenant, respondent amortized $75,000 evenly over the approximate ten-year period of the covenant, resulting in a $625 monthly amortization. Accordingly, respondent allowed $1,250, two months' amortization, for the May 5, 1980, through June 30, 1980, period in appellant's income year ended June 30, 1980. Respondent allowed $7,500, twelve months' amortization, for the covenant during appellant's income year ended June 30, 1981. The amortization amounts allowed by respondent resulted in small refund credits for appellant. This appeal followed.

Under section 24349(a), a depreciation deduction is allowed for exhaustion, wear, and tear of property used in the trade or business of the taxpayer. This section is substantially similar to section 167(a) of the Internal Revenue Code. Thus, federal regulations and case law are persuasive as to the proper interpretation of the California statutes. (Meanley v. McColgan, 49 Cal.App.2d 203 [121 P.2d 45] (1942); Holmes v. McColgan, 17 Cal.2d 426 [110 P.2d 4281, cert. den., 314 U.S. 636

[86 L.Ed. 510] (1941).) Indeed, in the absence of state regulations, federal regulations interpreting the Internal Revenue Code govern the interpretation of comparable provisons of the Revenue and Taxation Code. (Cal. Admin. Code, tit. 18, § 26422.)

Treasury Regulation § 1.167(a)-3 states, in part:

> 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.

A covenant not to compete is an intangible asset in the hands of its purchaser. (Hamlin's Trust v. Commissioner, 209 F.2d 761 (10th Cir. 1954).) Accordingly, consideration paid for a covenant not to compete may be depreciated (amortized). (Better Beverages, Inc. v. United States, 619 F.2d 424 (5th Cir. 1980); Lazisky v. Commissioner, 72 T.C. 495 (1979); Appeal of Estate of Joseph J. Gerhart, deceased, et, al., Cal. St. Bd. of Equal., Aug. 18, 1982.)

Appellant appealed from the denial of its claims for refund on the ground that $15,000 should be amortized over the eight-month period from May 5, 1980, through December 31, 1980, and $60,000 should be amortized over the remaining covenant period adhering to the amounts and timing of those payments by appellant to Lascurettes. As indicated above, this would amortize $3,750 for appellant's income year ended June 30, 1980, and would amortize $14,250 for appellant's income year ended June 30, 1981.

Respondent's determintion of a proper depreciation allowance is presumptively correct. The taxpayer bears the burden of proving that this determination is incorrect. (Appeal of John W. and Jean R. Patierno, Cal. St. Bd. of Equal., June 30, 1980; Appeal of Peninsula Savings & Loan Association, Cal. St. Bd. of Equal., Jan. 2, 1974.) Respondent's position is that, in the absence of evidence to-the contrary, the covenant has a depreciable life over the entire term stated in the covenant agreement and is to be amortized on a level basis. Respondent's position is supported by authority. (Andrew Newman, Inc. v. Commissioner, ¶ 57,224 T.C.M. (P-H)

(1957); Williamson and Waite, Inc. v. Commissioner, 9 A.F.T.R.2d (P-B) ¶ 62-315; Feaster v. United States, 311 F.Supp. 1368 (D.C. Kan. 1969); Appeal of Kramer Ink Co., Inc., Cal. St. Bd. of Equal., Oct. 26, 1983.)

Appellant argues that the covenant's payment provisions constitute evidence that the covenant should be properly amortized in accordance with those payments. We cannot agree. There is no evidence which even tends to demonstrate that the different rates of those payments truly reflect a varying value of the covenant in the hands of the buyer. Nothing demonstrates that the payment schedule of the covenant is anything more than a financial arrangement between the buyer and the seller. The covenant's recitation that the $15,000 of the $75,000 is in consideration for the covenant through December 1980, which may be effective for purposes of contract administration between the parties, is insufficient to overcome the tax administrator's determination that the amortization for that period should be at a different amount. (Feaster v. United States, supra.)

Since appellant has not demonstrated that respondent's determination was incorrect, we must sustain respondent's action.

Appeal of Ferbar Corporation of California, Inc.

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 Ferbar Corporation of California, Inc., for refund of franchise tax in the amounts of $232.50 and $648.00 for the income years ended June 30, 1980, and June 30, 1981, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 10th day of June , 1986, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Collis, Mr. Bennett, Mr. Dronenburg and Mr. Harvey present.

Richard Nevins, Chairman

Conway H. Collis, Member

William M. Bennett, Member

Ernest J. Dronenburg, Jr., Member

Walter Harvey*, Member

*For Kenneth Cory, per Government Code section 7.9