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7 **BOARD OF EQUALIZATION**
8 **STATE OF CALIFORNIA**

9
10 In the Matter of the Appeal of:) **HEARING SUMMARY**
11) **PERSONAL INCOME TAX APPEAL**
12 **LANE BRENNAN**¹) Case No. 557609
13)

14 Year Proposed
15 2005 Additional Tax
16 \$966

16 Representing the Parties:

17 For Appellant: Amanda Gau, Tax Appeals Assistance Program (TAAP)²
18 For Franchise Tax Board: Anjali Balasingham, Tax Counsel

19
20 QUESTION: Whether appellant has demonstrated error in the Franchise Tax Board’s (FTB or
21 respondent’s) assessment, which was based upon a federal adjustment.

22 HEARING SUMMARY

23 Introduction

24 Appellant asserts that he spent a total of \$10,403 for work on his Sausalito property
25 (hereinafter sometimes “property”) in 2005, of which appellant asserts that (i) \$10,207 was paid to a
26

27 ¹ Appellant currently resides in Marin County, California.

28 ² Appellant was previously represented by Tuong Quan Vu and Elizabeth “Libby” Rodoni at TAAP.

1 contractor, Robert Greenbury, as evidenced by cancelled checks set forth in Exhibit E of appellant's
2 opening brief, and (ii) \$196 was spent by appellant on "incidental expenses," for which appellant no
3 longer has receipts. Appellant sought to deduct the entire amount as repairs, which was disallowed by
4 the IRS. The FTB contends that the expenditures were capital expenditures, which must be depreciated
5 over time — not repairs, which can be deducted immediately in the year of payment. Further, while the
6 FTB does not dispute that appellant paid \$10,207 to the contractor, it contends that appellant has not
7 substantiated the \$196 amount allegedly spent on "incidental expenses" in 2005. In reply, appellant
8 concedes that the contractor both repaired and improved the Sausalito property; however, appellant
9 alleges that the contractor merely repaired the Sausalito property in 2005 (the tax year at issue) and all
10 improvements (which must be capitalized) were done in 2006. Appellant states that in 2006, the IRS
11 allowed him to deduct a 60 percent of amounts spent in that year as repairs, while respondent states that
12 this fact is not clear from the record and in any event each year stands on its own.

13 Procedural Background

14 Appellant filed a timely 2005 California income tax return, reporting, among other
15 things, California taxable income of \$98,176 and total tax liability of \$4,809. (FTB opening brief (FTB
16 OB), p. 1 & Ex. B.) After taking into account withholdings of \$5,043.84, the FTB issued a refund of
17 \$234.84 on March 16, 2006. (*Id.*)

18 Subsequently, the FTB learned that the Internal Revenue Service (IRS) increased
19 appellant's 2005 federal income by \$10,403 to account for disallowed Schedule E repair expenses
20 totaling \$10,403. (*Id.*, Ex D.)

21 On December 30, 2008, the FTB issued a Notice of Proposed Assessment (NPA) that
22 conformed to the federal adjustment by adding \$10,403 to appellant's 2005 California taxable income.
23 (*Id.*, Ex. E.) The NPA proposed an additional tax of \$966, plus interest. (*Id.*)

24 Appellant timely protested the NPA.³ (*Id.* p. 2.) The FTB affirmed the NPA in a Notice
25 of Action (NOA) dated November 18, 2010. (*Id.* & Ex. G.) This timely appeal followed. (*Id.* p. 2.)

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28 ³ A copy of appellant's protest letter is not provided in the appeal record.

1 Contentions

2 Appellant's Appeal Letter

3 Appellant asserts that (i) he made extensive repairs to his property to save it from water,
4 mold and insect damage, and (ii) the sums he paid were \$10,000 in 2005 and approximately \$50,000 in
5 2006. (Appeal Letter (AL), p. 2.) Appellant states, however, that (i) he discarded his files for the 2005
6 tax year, and (ii) he recently contacted the IRS in an attempt to obtain copies of his 2005 federal return
7 and schedules. (*Id.* p.1.)

8 Appellant's Opening Brief

9 Timing of repairs and/or improvements

10 Appellant states that he began renting out the Sausalito property in 1999 and has
11 continuously rented out the property since then. (Appellant's opening brief (App. OB), p. 1.) Appellant
12 asserts that in 2005 he hired a contractor, Mr. Greenbury, to perform repairs to the Sausalito property
13 because "at that time" a tenant complained about strange smells and mold. (*Id.*) Appellant states that
14 the necessary repairs were the result of water damage, mold, and a beetle infestation. (*Id.*) Appellant
15 asserts that after hiring the contractor, appellant then decided (after "some time") that he would
16 "reconfigure a bedroom and do a slight remodel of a small bathroom." (*Id.* pp. 1-2.) Appellant
17 concedes that the contractor both *repaired* and *improved* the property; however, appellant alleges that
18 the contractor merely repaired the property in 2005 (the tax year at issue). (*Id.* p. 2.)

19 As for the timing of the repairs and/or improvements, appellant states that "[t]he
20 contractor began work in 2005 and continued to work through 2006" and "[t]he contractor estimated that
21 well over 60 percent of money spent was to repair the premises to its ordinary efficient operating
22 condition." (*Id.*) In addition, appellant states that in 2005, the contractor "focused on repairs [as
23 opposed to capital improvements] simply due to the fact that the contractor was hired in December of
24 2005 and only had just begun work before the year was over." (*Id.*)

25 Appellant states that on his 2006 federal return, he allocated 60 percent of the money
26 spent towards repairs. (*Id.*) Appellant contends that when the IRS audited his 2006 federal return, the
27 IRS originally took the position that appellant's allocation of 60 percent was too high. Appellant asserts,
28 however, that after he "sent in all the information required by the IRS, the IRS conceded the issue and

1 no further action was required.” (*Id.*) In support, appellant provides a letter dated February 23, 2010,
2 from IRS agent Brian K. Gilroy. (*Id.*, Ex. C.) Appellant asserts that in Mr. Gilroy’s letter, he
3 (Mr. Gilroy) acknowledges that (i) there is no deficiency or overassessment, and (ii) appellant correctly
4 allocated the funds for the 2006 tax year. (*Id.* p. 2 & fn. 3.) Mr. Gilroy’s letter states in part:

5 The agreement we reached has been approved and we will complete our processing of
6 your case.

7 Since there is no deficiency or overassessment, you do not need to take any further
8 action. . . .

9 *No general plan to improve property from the start of work*

10 Appellant contends that he decided to improve the bedroom and bathrooms after he hired
11 the contractor; thus, appellant asserts that the repairs were not part of a general plan to improve the
12 property, as appellant only contemplated capital improvements after he hired the contractor for the
13 repair work, citing *Moss v. Commissioner* (1987) 831 F.2d 833, 836. (*Id.* p. 3.) In short, appellant
14 asserts that the repairs began in 2005 and the remodeling portion of the job began in 2006. In support,
15 appellant provides various invoices and receipts, which are set forth in Exhibit D of appellant’s opening
16 brief. Appellant asserts that the invoices and receipts show “the remodel of the bedroom did not begin
17 until the end of March in 2006, and the bathroom fixtures were bought in February of 2006.” (*Id.* p. 3.)
18 As noted above, appellant asserts that (i) he spent \$10,403 for repairs in 2005, of which \$10,207 was
19 paid to the contractor (as evidenced by cancelled checks set forth in Exhibit E of appellant’s opening
20 brief), and (ii) he spent \$196 on “small improvements,” for which he no longer has receipts. (App. OB,
21 p. 4 & fn. 7.)

22 *Tenant remained on property, which (allegedly) shows that the repairs were ordinary*

23 Appellant’s final contention in his opening brief is that “the tenant remained on the
24 premises, with an abatement of rent during the entire process, which shows that the repairs were
25 ordinary.” (App. OB, p. 4.)

26 *Appellant’s exhibits*

27 In support of his arguments, appellant provides the following exhibits:

- 28 • Exhibit A—a statement dated March 8, 2011, from appellant’s neighbor, Thomas Mongan, who
asserts, among other things, that work on the Sausalito property began in December of 2005 and

1 continued through March of 2006.

- 2 • Exhibit B—a statement (undated and unsigned) from Robert Greenbury at Greenbury Building
3 Construction, who contends, among other things, that “[o]f the total costs expended during 2006,
4 . . . such costs were dedicated exclusively for repair and preservation and not for what might be
5 deemed capital improvements.”
- 6 • Exhibit C—a letter dated February 23, 2010, from IRS agent Brian K. Gilroy, who states that for
7 appellant’s 2006 tax year, (i) appellant and the IRS had reached an agreement, and (ii) appellant
8 has “no deficiency or overassessment”.
- 9 • Exhibit D—various receipts and invoices for work conducted on the Sausalito property by
10 various contractors.
- 11 • Exhibit E—two checks dated December 2005 (totaling \$10,207), made out to “Bob Greenbury.”
- 12 • Exhibit F—a substitute federal Schedule E that appellant created in an effort to list his alleged
13 2005 expenses.

14 FTB’s Opening Brief

15 *The federal adjustment*

16 The FTB notes that a California deficiency assessment based on a federal report is
17 presumptively correct and appellant bears the burden of proving error, citing *Appeal of Frank J. and*
18 *Barbara D. Burgett*, 83-SBE-127, decided on June 21, 1983.⁴ (FTB OB, p. 3.)

19 The FTB asserts that “appellant agreed to the 2005 federal changes . . . and made an
20 advance payment of the federal tax deficiency on June 12, 2007.” (*Id.* p. 3.) In addition, the FTB
21 asserts that “[t]he IRS Transcript of appellant’s 2005 year shows that the federal actions are final and
22 have not been revised or revoked.” (*Id.*) In support of this last assertion, the FTB provides a copy of
23 appellant’s federal transcript dated July 5, 2011, for the 2005 tax year. (*Id.*, Ex. I.)

24 Next, the FTB notes that although appellant argues that the IRS cancelled appellant’s
25 federal deficiency assessment for the 2006 tax year, the tax year at issue is 2005 (not 2006). (*Id.*) In
26 addition, the FTB argues that each tax year is considered separately, citing *Burnet v. Sanford & Brooks*
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⁴ Board of Equalization cases are generally available for viewing on the Board’s website (www.boe.ca.gov).

1 Co. (1931) 282 U.S. 359, 365-366; thus, the FTB argues that even if the IRS cancelled appellant's
2 federal deficiency assessment for the 2006 tax year, that fact does not reflect that the federal deficiency
3 assessment for the 2005 tax year was cancelled. (*Id.*)

4 Capital expenditures vs. repairs

5 The FTB notes that a taxpayer may deduct the cost of repairs which neither materially
6 add to the value of a property nor appreciably prolong a property's life; in short, the FTB argues that a
7 taxpayer may deduct the cost of repairs that simply keep a property in an ordinarily efficient operating
8 condition, citing to Treas. Reg. § 1.162-4. (FTB OB, p. 4.) In comparison, the FTB argues that
9 improvements cannot be deducted and must be capitalized, citing Internal Revenue Code (IRC) section
10 263(a). (*Id.*) The FTB states that examples of improvements which must be capitalized include the
11 costs of fixtures and furniture—in addition to similar property have a useful life substantially beyond the
12 taxable year, citing to Treas. Reg. § 1.263(a)-1, 2. (*Id.*) Furthermore, the FTB asserts that the IRS's
13 Instructions for Schedule E (for the tax year 2005) illustrate the distinction between repairs and
14 improvements with the following guidelines: "Examples of repairs are fixing a broken lock or painting a
15 room. Improvements . . . such as replacing a roof or renovating a kitchen, must be capitalized and
16 depreciated . . ." (*Id.*) Next, the FTB discusses five factors, which according to the FTB support a
17 finding that the amounts appellant spent in the 2005 tax year must be capitalized (as opposed to being
18 expensed).

19 1. Under a general plan of renovation, no items may be deducted.

20 The FTB asserts that repair expenditures made during the course of a remodeling are not
21 deductible because where there is a general plan of renovation or rehabilitation, all items of that plan
22 must be capitalized, citing to *Stoeltzing v. Commissioner*, T.C. Memo 1958-111, aff'd. (3rd Cir. 1959)
23 266 F.2d 374. (*Id.* p. 5.) The FTB contends that although appellant argues that the remodel portion of
24 the job began in 2006, the memo section of appellant's check dated December 30, 2005, states that the
25 payment was for a "remodel" through December 23, 2005; thus, the FTB asserts that the memo section
26 of appellant's check dated December 30, 2005, is an admission that the remodel started in 2005, which
27 contradicts appellant's contention the remodel began in 2006. (*Id.*) Furthermore, independent from the
28 alleged admission argument, the FTB asserts that (i) appellant has not provided a copy of the applicable

1 contract between appellant and the contractor, and (ii) appellant's failure to provide a copy of the
2 applicable contract gives rise to a presumption that such evidence is unfavorable to appellant's appeal,
3 citing *Appeal of Don A. Cookston*, 83-SBE-048, decided on January 3, 1983. (*Id.*) Moreover, as to
4 appellant's argument that many of the relevant documents have been destroyed, the FTB states that the
5 contractor was able to provide invoices and it is not clear whether the applicable contract cannot be
6 obtained by either appellant or the contractor. (*Id.*)

7 Next, the FTB cites to *Jones v. Commissioner* (1955) 24 T.C. 563 as an example of where
8 a court found an *overall plan of restoration* of an old building when the building lost its commercial
9 usefulness due to extreme, gradual deterioration. (*Id.* p. 6.)

10 2. The siding was replaced (as opposed to repaired) and thus, its cost is non-
11 deductible.

12 The FTB asserts that repairs in the nature of a replacement (to the extent they stop
13 deterioration and prolong useful life of a property) must either be capitalized (and depreciated) or
14 charged against a replacement reserve, citing to Treasury Regulation section 1.162-4. (*Id.* p. 6.) The
15 FTB argues that the "the siding work . . . created like-new conditions" and "extended the useful life of
16 the property"; thus, the FTB argues that the new siding constitutes a capital expenditure. (*Id.* p. 7.)
17 Similarly, the FTB contends "the siding repairs were not limited efforts to patch up portions that were
18 damaged by mold, infestation, and water damage"; instead, the FTB contends "the majority of the siding
19 was detached and replaced . . ." and the FTB asserts that "when a portion of property has reached the
20 end of its useful life and deteriorated so that it can no longer be repaired, the cost of its replacement
21 must be capitalized", citing to *Oglesby v. Commissioner*, T.C. Memo 2011-93. (*Id.* [emphasis in FTB's
22 brief]. The FTB argues that "appellant did not merely restore the siding to the condition it was in prior
23 to the repair; rather he materially enhanced the strength of the property and thus prolonged its useful
24 life." (*Id.* pp. 7-8.)

25 3. The destruction of the siding and wall "put" the property into working
26 condition.

27 The FTB contends that "if the improvements were made to 'put' the particular capital
28 asset in efficient operating condition, then they are capital in nature" but if "they were made merely to

1 ‘keep’ the asset in efficient operating condition, then they are repairs and are deductible”, citing to *Moss*
2 *v. Commissioner*, supra, at 835. (*Id.* p. 8.) As to the facts at hand, the FTB asserts that “appellant’s own
3 factual account indicates the capital nature of the 2005 improvements.” (*Id.*) Specifically, the FTB
4 asserts that “[t]he siding and interior walls were no longer capable of being restored to efficient
5 operating condition, for if they were capable of such restoration, they would not have been removed but
6 rather would have been partially repaired.” (*Id.*) Thus, the FTB asserts that the costs for 2005 were
7 capital in nature. (*Id.*) Furthermore, as to appellant’s argument that the contractor estimated that over
8 60 percent of the money spent was to repair the premises to its ordinary efficient operating condition, the
9 FTB argues that (i) the contractor’s statement relates only to the 2006 tax year (not to the 2005 tax year
10 on appeal) and (ii) the contractor’s statement is undated and unsigned. (*Id.*)

11 4. Given the extent of work on the property, the work was capital in nature.

12 The FTB asserts that the extent of work performed may be considered in determining
13 whether an expenditure is capital in nature, citing to *Griffin v. Commissioner*, T.C. Memo 1995-404.
14 (*Id.*) In relation to this legal principle, the FTB states that (i) appellant has owned the property since it
15 was built in 1968, and (ii) appellant has not indicated that any maintenance, repair, or remodel work was
16 performed on the walls or siding of the property prior to 2005. (*Id.*) Accordingly, the FTB contends
17 that “over 35 years apparently elapsed between the construction and restoration of the property” and
18 given the significant cost involved, the work is properly classified as capital in nature, as it extended the
19 life of the property, citing to *INDOPCO, Inc. v. Commissioner* (1992) 503 U.S. 79, 88. (*Id.* pp. 8-9.)

20 5. Any repair allocation for the 2006 tax year is not relevant to the 2005 tax year.

21 As noted above, appellant asserts that (i) on his 2006 federal return, he allocated 60
22 percent of the money spent toward repairs, and (ii) the IRS’s agent, Mr. Gilroy, accepted appellant’s 60
23 percent allocation for the 2006 tax year. As support, appellant provides a letter dated February 23, 2010,
24 from Mr. Gilroy at the IRS. (App. OB, Ex. C.) In response to this argument, the FTB asserts “the letter
25 from the IRS . . . does not specify the reason for which the IRS determined that appellant did not owe
26 additional tax for 2006”; thus, the FTB argues there is no evidence that the IRS accepted appellant’s 60
27 percent allocation. (FTB OB, p. 9.) Furthermore, the FTB asserts that “each taxable year stands on its
28 own . . . thus, the 2006 federal determination does not bear on the year on appeal” (which is for 2005),

1 citing to *Burnet v. Sanford & Brooks Co, supra. (Id.)*

2 Appellant's incidental expenses of \$196 cannot be deducted under the Cohan Rule

3 As noted above, appellant asserts that he spent \$10,403 to repair his Sausalito property in
4 2005, of which appellant asserts that (i) \$10,207 was paid to a contractor, Mr. Robert Greenbury, as
5 evidenced by cancelled checks set forth in Exhibit E of appellant's opening brief, and (ii) \$196 was
6 spent by appellant on "incidental expenses," for which appellant no longer has receipts. As for the \$196
7 that appellant allegedly spent on "incidental expenses," the FTB asserts that (i) appellant has not
8 substantiated those alleged "incidental expenses" and appellant's unsupported assertions are not
9 sufficient to carry his burden of proof, citing to *Appeal of James C. and Monablance A. Walshe,*
10 *75-SBE-073*, decided on October 20, 1975, and (ii) appellant is not entitled to deduct those alleged
11 incidental expenses under the "Cohan Rule" of *Cohan v. Commissioner* (2d Cir 1930) 39 F.2d 540
12 (hereinafter *Cohan*), because (A) the Cohan Rule "should only be applied in cases where the taxpayer
13 has clearly shown that he is entitled to some deduction and that uncertainty exists only as to the exact
14 amount thereof," and (B) as asserted above, all of the expenses in this appeal must be capitalized; thus,
15 appellant is not entitled to deduct any expenses, documented or undocumented, citing to *Cohan, supra,*
16 at 544; *Vanicek v. Commissioner* (1985) 85 T.C. 731, 743. (*Id.* pp. 9-10.)

17 Appellant's Reply Brief

18 Cost of repairs ordinary and necessary

19 Appellant asserts that the cost of repairs was an ordinary and necessary expense because
20 the contractor "kept the premise in proper working state." (App. Reply Br. p. 3.) Specifically, appellant
21 asserts that "[t]he repairs were necessary to stop the water damage, significant mold, and beetle
22 infestation that affected the habitability of the rental property." (*Id.*) As to the sidewall, appellant
23 asserts that (i) he wanted to restore the sidewall to its proper working state and (ii) the repair of the
24 sidewall does not fall into the definition of a capital expenditure, which is a cost that (a) adds to the
25 value of a property, (b) substantially prolongs the property's useful life, or (c) which otherwise provides
26 a long-term benefit. (*Id.*) Here, appellant argues that repair of the sidewall merely placed the sidewall
27 back into its working order and did not add value to the property. (*Id.*)

28 ///

1 No general plan of renovation

2 Appellant argues that each taxable year stands on its own and, therefore, the FTB's
3 argument that there was a *general plan* of renovation must fail, citing to *Burnet v. Sanford & Brooks*
4 *Co., supra.* (*Id.* p. 3.) Specifically, appellant asserts that he paid for repair of the sidewalk in 2005 (as
5 evidenced by the two checks submitted on appeal) and the capital improvements to the bedroom and
6 bathrooms were decided upon after the contractor had been hired to fix the damaged sidewalk.
7 (*Id.* pp. 3-4.) Thus, appellant asserts that there was no general plan of renovation, as the FTB is
8 alleging. (*Id.*) Furthermore, appellant argues that even if the FTB can show there was a general plan of
9 renovation, the ending of the fiscal year cuts off that theory. (*Id.* p. 4.)

10 Repair work not capital in nature

11 Appellant states that “[b]efore the tenant complaint, Appellant’s rental property was in
12 working order” and “the combination of the visible water damage, the significant mold, and beetle
13 infestation caused an immediate threat to habitability of the rental property.” (*Id.* p. 4.) Thus, appellant
14 contends that the 2005 expenses were made merely to “keep” the asset in efficient operation condition.
15 Accordingly, appellant asserts that the repairs are deductible, citing *Moss v. Commissioner, supra.*
16 (*Id.* pp. 4-5.) In addition, appellant concludes with the assertion that “the tenant remained on the
17 premises, with an abatement of rent during the repairs, which shows that the repairs were ordinary.”
18 (*Id.* p. 5.)

19 FTB’s Reply Brief

20 General plan of renovation

21 As to appellant’s argument that a general plan of renovation may not span more than one
22 taxable period, the FTB’s asserts that even if appellant’s argument were valid (which the FTB disputes),
23 the check dated December 30, 2005, states that the payment was for a “remodel”; thus, the FTB argues
24 that “the work performed in 2006 does not need to be considered in order for your Board to find that a
25 general plan of rehabilitation existed in the year on appeal.” (FTB Reply Br. p. 1.) Furthermore, the
26 FTB asserts that “even if a general plan of rehabilitation did not exist in 2005 [as appellant alleges], the
27 expenses may still not be deducted” for the reasons expressed above in the FTB’s opening brief. (*Id.*)
28 In addition, the FTB asserts that appellant’s argument that each taxable year stands alone only “applies

1 to the computation of tax by a competent authority, not to the occurrence of factual circumstances in
2 time and space” citing to *Burnet v. Sanford & Brooks Co. supra*, at 365-366. (*Id.* pp. 1-2.) Thus, the
3 FTB asserts that “[a]lthough appellant’s tax liabilities for 2005 and 2006 must be separately calculated,
4 appellant may not argue that a remodel never took place simply because it began in one year and ended
5 in the next” citing to *Norwest Corp. & Subs. v. Commissioner* (1997) 108 T.C. 265, 279-280. (*Id.* p. 2.)

6 Appellant’s Supplemental Brief

7 *FTB incorrectly applies appellant’s federal transcript*

8 Appellant states that the FTB incorrectly interprets appellant’s federal transcript dated
9 December 28, 2010. (App. Supp. Br. p. 1.) Specifically, appellant notes that the federal transcript
10 specifically lists the \$10,403 federal adjustment as a “repair” and does not list it as a capital
11 improvement. (*Id.*) Based on this fact, and the fact that the IRS decided to take no action as to
12 appellant’s 2006 tax year, appellant argues that these facts support a finding that the IRS cancelled its
13 adjustment for the 2005 tax year. (*Id.*)

14 In addition, appellant argues that the FTB should not rely on appellant’s payment in 2007
15 to prove that appellant had a 2005 tax liability, as the IRS’s inaction in 2005 (as appellant alleges)
16 should stand on its own. (*Id.*)

17 *Various statements and invoices support a finding that the work in 2005 was for*
18 *repairs*

19 Appellant asserts that his neighbor’s statement (Exhibit A of appellant’s opening brief),
20 the contractor’s statement (Exhibit B of appellant’s opening brief), and various invoices and receipts
21 (Exhibit D of appellant’s opening brief) support a finding that the work in 2005 was for repairs (not
22 capital improvements). (*Id.* p. 1.) For example, appellant notes that the contractor’s statement recites
23 that “by far the greater portion of the costs were to repair and preserve the premises . . .” (*Id.* &
24 App. OB, Ex. B.)

25 *Appellant’s notation on the check is NOT an admission that the work in 2005 was for*
26 *repairs*

27 As noted above, the FTB argues that the memo section of appellant’s check dated
28 December 30, 2005, states that the payment was for a “remodel” through December 23, 2005; thus, the

1 FTB argues that the memo section of appellant’s check dated December 30, 2005, is an “admission” that
2 the remodel started in 2005, which contradicts appellant’s contention the remodel began in 2006. As to
3 this argument, appellant asserts that the FTB’s argument is a mischaracterization and ignores the
4 substantial facts appellant provided, which support a finding that the work in 2005 was for repairs.
5 (FTB Supp. Br. pp. 1-2.)

6 *The FTB incorrectly characterizes the construction as a continuous project*

7 Appellant asserts the facts on appeal show that the work performed in 2005 was for
8 repairs and was not part of a general plan of restoration, as the FTB is alleging. (*Id.* p. 2.) In addition,
9 appellant asserts that the FTB’s citation to *Jones v. Commissioner, supra*, is inappropriate to the facts at
10 hand, as the building in that case had lost its commercial usefulness (and, therefore required an overall
11 plan of restoration), whereas the Sausalito property at hand was still being used as a rental while the
12 repairs were being done. (See also *Bank of Houston v. Commissioner*, T.C. Memo 1960-110; *Phillips*
13 *and Easton Supply Co. v. Commissioner* (1953) 20 T.C. 455.) (App. Supp. Br. p. 2.)

14 *The repairs “kept” the property as a rental property*

15 Appellant contends that the repairs did not “put” the property into efficient operating
16 condition; instead, appellant asserts that the repairs “kept” the property as a rental property, citing to
17 *Moss v. Commissioner, supra*, at 835. (*Id.* p. 3.) Specifically, appellant states that at no point did the
18 rental property lose its commercial value and at no point did appellant have to “put” his property back
19 into commercial use. (*Id.*)

20 *Extent of work in 2005 was for repairs only (not capital improvements)*

21 Appellant argues that the work performed in 2005 was only for repairs and was
22 performed in a single month. (*Id.*) Furthermore, appellant contends that “the work was not to
23 completely replace something . . .” (*Id.*) Thus, appellant argues there were no capital improvements in
24 2005. (*Id.*)

25 Applicable Law

26 Federal Adjustments

27 A taxpayer must concede the accuracy of federal changes or prove that those changes,
28 and any California deficiency assessment based thereon, are erroneous. (Rev. & Tax. Code, § 18622,

1 subd. (a); *Appeal of Sheldon I. and Helen R. Brockett*, 86-SBE-109, June 18, 1986; *Appeal of Aaron and*
2 *Eloise Magidow*, 82-SBE-274, Nov. 17, 1982.) It is well-settled that a deficiency assessment based
3 upon federal adjustments to income and deductions is presumed correct and the taxpayer bears the
4 burden of proving the FTB's determination is erroneous. (*Appeal of Sheldon I. and Helen R. Brockett*,
5 *supra.*) Unsupported assertions cannot satisfy a taxpayer's burden of proof. (*Appeal of Aaron and*
6 *Eloise Magidow, supra.*)

7 Deductible Repairs v. Capital Expenditures

8 Income tax deductions are a matter of legislative grace, and a taxpayer who claims a
9 deduction has the burden of proving by competent evidence that he or she is entitled to that deduction.
10 (See *New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435; *Appeal of Michael E. Myers*, 2001-SBE-
11 001, May 31, 2001.) Unsupported assertions cannot satisfy a taxpayer's burden of proof. (*Appeal of*
12 *Aaron and Eloise Magidow, supra.*)

13 Amounts expended for ordinary and necessary incidental repairs and maintenance may be
14 deducted by a cash basis taxpayer when paid, while amounts incurred to permanently improve property
15 or increase its value or useful life must be capitalized and depreciated over the useful life of the
16 improvement. (See *Schroeder v. Commissioner*, T.C. Memo 1996-336; Treas. Regs. § 1.263, subds. (a)-
17 1(b).) The Ninth Circuit has summarized the difference as:

18 The test which normally is to be applied is that if the improvements were made to "put"
19 the particular capital asset inefficient operating condition, then they are capital in nature.
20 If, however, they were made merely to "keep" the asset in efficient operating condition,
then they are repairs and are deductible.

21 Whether an expense is deductible or must be capitalized is a question of fact. (*Schroeder v.*
22 *Commissioner, supra.*) The test is whether an expense materially enhances the value of property or
23 appreciably prolongs the life of the property. (*Plainfield-Union Water Co. v. Commissioner* (1962) 39
24 T.C. 333, 338; see also, *Schroeder v. Commissioner, supra.*) For example, in *Schroeder v.*
25 *Commissioner, supra*, the Tax Court held that replacement of "four or five of the approximately 126 tin
26 roof sections" on the roof of a large barn was a deductible repair expense and not a capital expenditure.
27 The Tax Court held that the cost to replace the tin roof sections (along with the costs of repainting the
28 wood and repounding nails) simply restored the building to its previous condition without adding to the

1 value of the building or prolonging its life in a way that required the costs to be treated as capital. (*Id.*)

2 In *United States v. Wehrli* (10th Cir. 1968) 400 F.2d 686, 689-690, the Tenth Circuit
3 stated that an item which is part of a “general plan of rehabilitation” must be capitalized, even though,
4 standing alone, the item may appropriately be classified as one of repair. The Tenth Circuit stated that
5 whether a general plan of rehabilitation exists must be ascertained from all the surrounding facts and
6 circumstances, including, but not limited to, (i) whether the work was done to suit the needs of an
7 incoming tenant, (ii) whether the work was done to adapt the property to a different use, or (iii) whether
8 the work resulted in an appreciable enhancement of the property’s value. (*Id.*)

9 The Cohan Rule

10 In *Cohan, supra*, the court held that a taxpayer’s entertainment expenses may be
11 estimated, “bearing heavily against the taxpayer whose inexactitude is of his own making,” given that
12 the taxpayer had demonstrated that “he had spent much and that the sums were allowable expenses” and
13 that “there was obviously some basis for computation.” (*Id.* at pp. 543-544; see also (*Fleming v.*
14 *Commissioner*, T.C. Memo 2010-60.)

15 STAFF COMMENTS

16 At the oral hearing, the parties should be prepared to address whether the work performed
17 in 2005:

- 18 • was part of a general plan of capital improvements;
- 19 • was limited to efforts to patch up portions of siding that were damaged by mold, infestation, and
20 water damage, or involved the replacement of the majority of the siding for the property (even
21 the siding that was not damaged by mold, infestation, and water damage); and
- 22 • whether the work in 2005 increased the property’s useful life or value.

23 With regard to the \$196 in undocumented expenses claimed by appellant, he will want to
24 demonstrate that they represent repairs, as opposed to amounts incurred for capital improvements (as
25 noted above), and, further, that he has provided a reasonable basis for computing such expenses.

26 At the hearing, respondent should be prepared to clarify whether its proposed assessment
27 allows any depreciation deduction from the amounts spent in 2005. It appears its proposed assessment
28 follows the IRS assessment, which disallowed both the \$10,207 amount and the \$196 amount in full (for

1 a total of \$10,403 disallowed), without any apparent allowance for depreciation expense. That being
2 said, it appears to staff that any such depreciation allowance would be relatively minor in amount given
3 that the amounts spent were spent toward the end of 2005.

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