



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
PICKFORD-LASKY PRODUCTIONS, INC.)

Appearances:

For Appellant: Claude I. Parker, Ralph Kohlmeier
Attorneys at Law

For Respondent: W. M.. Walsh, Assistant Franchise Tax
Commissioner; James J. Arditto,
Franchise Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes of 1929, as amended) from the action of the Franchise Tax Commissioner on the protest of Pickford-Lasky Productions, Inc., to a proposed assessment of additional tax in the amount of \$606.89 for the taxable year ended December 31, 1940.

During the year 1936, the Appellant completed the production of two motion pictures entitled "One Rainy Afternoon" and "The Gay Desperado." These were the only pictures produced by the corporation. "One Rainy Afternoon" was released in April, 1936, and "The Gay Desperado" was released the following October. Both pictures were distributed by United Artists, an independent distributor. Within 90 days of the release of each of these pictures it was estimated by officials of United Artists that Appellant would not recover the amounts expended in producing them. Appellant reported no income from these pictures on its franchise tax returns on the theory that it was entitled to recover its costs before it could realize any income. The Commissioner proposed an additional assessment for the income year 1939 upon the theory that the costs of the pictures should be amortized over a limited number of weeks, and that after that period there could be no further deduction for depreciation. He determined the proper period to be 104 weeks, apparently on the assumption that the normal useful life of a motion picture would not exceed two years. The propriety of his action in so doing and in denying Appellant any deduction for depreciation on the pictures for the year 1939 is the only question presented. by this appeal.

The Appellant contends that the action of the Commissioner in requiring the total cost of each picture to be written off during a two-year period, when in fact each had a useful life in excess of two years,, and in taxing all collections from distribution after that period, even though its total receipts will

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never equal its costs of production, is grossly inequitable and not in accord with the taxing statute. Appellant originally argued that inasmuch as it appeared shortly after the release of the pictures that it would be unable to recover its costs, it was entitled to apply all film rental proceeds against those costs and that since at the end of 1939 the total receipts from each of the pictures was less than the cost, no part of the proceeds need be reported as income. Subsequently, while perhaps not entirely abandoning its original position; it contended that there should be apportioned to each year of distribution as an allowance for depreciation a portion of the cost of each picture bearing the same ratio to the total cost that the receipts from distribution in such year bear to the estimated total receipts from each picture.

Under Section 8 (f) of the Bank and Corporation Franchise Tax Act, Appellant is entitled to a deduction from its gross income of a "reasonable allowance for exhaustion, wear and **tear and obsolescence**" of the pictures. It is fundamental that the deductions for depreciation of a picture should be spread over its useful life. Evidence offered by Appellant clearly establishes that it had adequate reason to believe prior to the end of 1936 that four to five years would be required for the distribution of the pictures and subsequent developments justified that conclusion. There appears to be no basis, accordingly, for the determination of the Commissioner as respects the year 1939 that the pictures had a useful life of only two years.

There also appears to be no basis for the original position of the Appellant that it was entitled to apply all the film rentals against the costs of production of the pictures. We are of the opinion, however, that Appellant is entitled to a deduction for depreciation on the pictures for 1939 based on the method above mentioned, i.e., the amortization of cost on the basis of estimated receipts. This method has the effect of spreading the cost of a picture over its useful life and is supported by testimony to the effect that it is in accordance with recognized practices of computing depreciation and that, in fact, it is the only correct method from an accounting standpoint.

A taxpayer is not required to use a straight-line method of computing depreciation when it can be shown that actual depreciation is at varying rates. Cumberland Glass Manufacturing Co. v. United States, 44 Fed. 2d 455. It appeared in 1936 that the depreciation of the pictures here in question would not occur at a constant rate, but rather that the value thereof would decline at a generally decreasing rate. The determination of the amount of the deduction allowable for 1939 under Section 8(f) on the basis of the estimated rentals in accordance with trade practices is, accordingly, entirely reasonable and not precluded by an action taken or deductions made by Appellant as respects prior years.

The estimates made in 1936 of the total rental receipts from each of the pictures were only slightly in excess of the

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actual receipts. Inasmuch as Appellant did not recover the cost of either picture, no purpose would be served by listing the receipts of each picture for any or all of the years 1936 to 1939, inclusive, and the amount deductible on account of depreciation for any year for it is readily apparent that the amount of the deduction for any year, computed by the method of the amortization of cost on the basis of the estimated receipts, would exceed the rental receipts for that year. It follows, then, that Appellant is not liable for any additional tax and that the action of the Commissioner in proposing an additional assessment based on the disallowance of any deduction for depreciation for 1939 was erroneous.

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 Chapter 13, Statutes of 1929, as amended, that the action of Chas. J. McColgan, Franchise Tax Commissioner, on the protest of Pickford-Lasky Productions, Inc., to a proposed assessment of additional tax in the amount of \$606.89 for the taxable year ended December 31, 1940, be and the same is hereby reversed. Said ruling is hereby set aside and the said Commissioner is hereby directed to proceed in conformity with this order,

Done at Sacramento, California, this 1st day of April, 1948, by the State Board of Equalization.

Wm. G. Bonelli, Chairman
George R. Reilly, Member
J. H. Quinn, Member
Jerrold I. Seawell, Member

ATTEST: Dixwell I. Pierce, Secretary